RATING REPORT

Razaque Steels (Private) Limited

REPORT DATE:
May 24, 2021

RATING ANALYST:
Muhammad Tabish
muhammad.tabish@vis.com.pk

RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**BBB-/A-3**	**BBB-/A-3**
Rating Date (Entity)	*May 24, 2021*	*March 09, 2020*
Rating Outlook	Stable	Stable

COMPANY INFORMATION	
Incorporated in 1963	**External auditors:** BDO Ebrahim & Co. Chartered Accountants
Private Limited Company	**Managing Director (MD):** Mr. Irshad Mowjee
Key Shareholders (with stake 5% or more):	
Mr. Irshad Mowjee – 50%	
Ms. Farhana Mowjee – 50%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2019) ***https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf***

Razaque Steels (Private) Limited

OVERVIEW OF THE INSTITUTION

Razaque Steels (Private) Limited (RSPL) was incorporated on 18th July 1963 as a Private Limited Company under the Companies Ordinance 1984. The company is primarily engaged in the manufacturing and sale of steel bars and billets with its registered head office based in Karachi, Pakistan.

Directors' Profile

Mr. Irshad Mowjee has been associated with the family business as the Managing Director since 2006. He is a B.A (Hons) in Economics from City of London Polytechnic and also holds MBA degree from Imperial College, University of London.

Ms. Farhana Mowjee is the Director and has been associated with the company since 1991. Prior to joining RSPL; she has served as a Manager in Ernst and Young (UK). She holds a Bachelors of Arts (Hons) in Philosophy from University College London. She also completed her Chartered Accountancy Training and Qualification in 1988 in UK.

RATING RATIONALE

Razaque Steels (Private) Limited (RSPL) stands amongst the small-sized players in the long steel industry with the installed capacity of billets and reinforcement bars (rebars) at 50,000MTs and 48,000MTs, respectively. It is a family owned business and has a strong track record of operations since its founding more than five decades ago. The company over the years has primarily remained focused towards catering to corporate clients.

RSPL has two production facilities; Unit-A (Re-rolling Mill) and Unit-B (Billets facility acquired from Faizan Steel Group on a long-term operating lease) located at S.I.T.E-Karachi and Hub-Balochistan, respectively. Energy requirement of both facilities is met through dedicated feeders which ensure uninterrupted full load power supply.

Capacity utilization of bars stood lower at 79% in the outgoing fiscal year on account of plant being shut down for 51 days due to pandemic-induced slowdown in demand. This resulted in operational challenges for all industry players. However, given subsequent economy recovery and favorable outlook for construction industry, RSPL's plants are currently operating at nearly full capacities. Moreover, Unit-A underwent upgradation during the plant closure period for efficiency enhancement which resulted in stated re-rolling capacity to increase from 40,000MTs to 48,000MTs. Going forward, management has planned to further improve capacity through eliminating production bottlenecks and gradual automation of the machinery.

<u>**Key Rating Drivers**</u>

Positive demand outlook and low interest rate environment has lowered industry's business risk profile. Significant duty protection provided the added support.
LSM sector grew by 7.45% (as per PBS) in 8MFY'21 amid third wave of Covid-19 pandemic. Specifically, billets manufacturing during the same period witnessed a notable increase of 34.5% which exclusively indicates sharp pick-up in demand. With GoP entering into its last two years term, infrastructure spending is expected to pick up which would drive industry demand going forward; particularly from GoP's PSDP allocation, CPEC related projects, Naya Pakistan Housing Scheme, Construction Sector Package. This along with lower interest regime would serve as an added stimulant. Nevertheless, downside risk, in the short-tern, remains elevated on account of third wave.

Business risk of the long steel sector is considered as high given its fragmented and competitive nature accompanied by sensitivity to exchange rate & interest rate changes and price volatility of raw material. For RSPL, the core raw material is scrap metal which comprises around two-third of the manufacturing cost. However, the sector continues to be supported by strong sovereign protection through import tariffs like ~ 39% (RD of 15%; ADD of 24%) and ~ 49.5% (RD of 30%, ADD of 19.15%) duty on Chinese imported billets and rebars, respectively.

Despite pandemic-induced slowdown, topline continues to witness a growth trend on account of volumetric growth and higher rebar prices.
RSPL's topline can be categorized into two products i.e. Deformed Bars' (DBs) and 'Billets', with the latter being a semi-finished raw material product sold (when produced in excess) to other long steel producers for conversion to bars. DBs constitute more than four-fifth of topline while the remaining is contributed by billet sales.

Topline of the company posted a 5-Year CAGR of 11% while crossing the Rs. 4b mark in FY20. The year-on-year uptick of ~9% in sales was mainly attributable to volumetric growth in DBs while average selling prices dropped by ~6%. The local rebar prices have recouped in the ongoing year on account of hike in international raw material prices. In 9M'FY21, RSPL recorded sales of Rs. 3.8b. Going forward, sales growth would be a function of gradual increase in production capacity and improved rebar prices.

Gross margins have improved yet remain on the lower side. Higher reliance on borrowings adversely impacts the net margins

Gross margins have trended upwards (HFY21: 7.1%; FY20: 6.6%; FY19: 4.5%) as a result of backward integration of operations and efficient scrap procurement. The margins yet remain on the lower side and compare unfavorably to industry peers. This is mainly due to the long distance between melting and re-rolling units which translates in to higher transport and re-heating expenses. Fuel & power costs stood higher by ~35% in FY20. Going forward, management expects margins to improve on the back of increasing reliance on local scrap procurement.

Administrative overheads stood around prior year's level whereas selling and distribution expense grew considerably. The heavy rains in the outgoing year caused the boundary wall to collapse and such disruptions along with the higher reliance on borrowings adversely impacted bottom-line as the company registers two consecutive years of pre-tax losses.

Low equity base and increased debt utilization resulted in elevated leverage indicators.

Equity base has largely remained stagnant due to depressed profitability. Debt profile is short term in nature with total debt amounting to Rs. 1.2b at end-HFY21. In recent years, higher working capital requirements has necessitated increase in utilization of short-term debt. Consequently, leverage and gearing ratios have increased on a timeline basis.

Besides increased debt utilization, loan from sponsor was increased from Rs. 38m in FY18 to Rs. 204m in HFY21. At present, RSPL's adjusted gearing & leverage (loan from sponsor treated as equity) remain within the threshold for the assigned rating. However, growing working capital requirements may continue to increase leverage indicators going forward.

Increased working capital cycle has stressed company's operating cash flows.

During the period under review, delayed payments from customers has affected the company's working capital cycle. Thus, increasing the borrowing requirement to fund the same. Given the two-fold increase in interest cost paid, FFO (in absolute terms) has turned negative in the outgoing year.

The company's trade debts amounted to Rs. 986.3m, which represents around one-third of total asset base. Of total trade debts, around two-fifth is outstanding for a period of more than 90 days constituting about 42% of the company's adjusted equity. Current ratio was reported at 1.13x (FY20: 1.14x; FY19: 1.18x) at end-HFY21.

Corporate governance framework has significant room for improvement

Overall board structure and oversight has room for improvement through induction of independent directors, greater discussion on future strategy along with improvisation in internal control framework. Development and documentation of a formal succession plan is also considered important. Moreover, there are considerable concerns and improvement areas highlighted in the management letter which need to be addressed, going forward.

Razaque Steels (Private) Limited **Appendix I**

FINANCIAL SUMMARY						*(amounts in PKR millions)*
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Fixed Assets	257.1	282.8	349.2	517.4	629.5	655.6
Stock-in-Trade	251.2	458.2	254.8	838.8	850.2	615.1
Trade Debts	318.9	295.2	264.5	421.0	690.4	814.4
Cash & Bank Balances	54.1	1.1	1.2	5.2	3.5	2.3
Total Assets	955.5	1,200.4	1,088.1	2,215.3	2,552.9	2,551.6
Trade and Other Payables	285.2	342.4	285.6	315.4	189.6	211.7
Long Term Debt	-	-	-	-	-	16.3
Short Term Debt	132.9	252.5	126.2	1,037.0	1,150.3	1,096.2
Total Debt	132.9	252.5	126.2	1,037.0	1,150.3	1,112.5
Total Equity	363.2	435.7	458.0	561.3	617.7	618.1
INCOME STATEMENT						
Net Sales	2,557.8	2,443.4	1,995.4	3,224.0	3,944.7	4,313.2
Gross Profit	137.6	120.1	125.9	209.2	176.1	286.1
Profit Before Tax	65.4	128.5	70.1	146.9	(3.5)	(4.8)
Profit After Tax	35.7	72.5	42.3	103.3	(6.1)	0.4
RATIO ANALYSIS						
Gross Margin (%)	5.4%	4.9%	6.3%	6.5%	4.5%	6.6%
Net Margin	1.4%	3.0%	2.1%	3.2%	-0.2%	0.01%
Net Working Capital	270.2	310.2	277.6	295.7	985.5	985.9
Trade debts/Sales	12.5%	12.1%	13.3%	13.1%	17.5%	18.9%
FFO	1.0	41.5	46.2	131.8	14.4	(99.8)
FFO to Total Debt (%)	0.7%	16.4%	36.6%	12.7%	1.2%	-8.9%
FFO to Long Term Debt (%)	NA	NA	NA	NA	NA	NA
Current Ratio (x)	1.64	1.52	1.67	1.22	1.18	1.14
Debt Servicing Coverage Ratio (x)	1.03	2.87	4.34	3.67	1.13	0.47
Gearing (x)	0.37	0.58	0.28	1.85	1.86	1.80
ROAA (%)	3.7%	6.7%	3.7%	6.3%	-0.2%	0.02%
ROAE (%)	9.8%	18.2%	9.5%	20.3%	-0.99%	0.07%

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	**Appendix III**
Name of Rated Entity	Razaque Steels (Private) Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see below
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Copyright 2021 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meeting Conducted	see below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
24/05/2021	BBB-	A-3	Stable	Re-affirmed
03/09/2020	BBB-	A-3	Stable	Re-affirmed
11/19/2018	BBB-	A-3	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Farhana Mowjee	Director	April 19, 2020
Mr. Irshad Mowjee	Director	