RATING REPORT

Izhar Construction (Pvt.) Limited (ICPL)

REPORT DATE:
March 2, 2020

RATING ANALYSTS:

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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	A-	A-1
Rating Date	*31st December, 2019*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 1960	**External auditors:** Ishtiaq Ahmad & Co. Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Ayub Sabir Izhar
	Chief Executive Officer: Mr. Amir Farooq Izhar
Key Shareholders: (Above 10%)	
Mr. Yaqoob Tahir Izhar -22%	
Mr. Amir Farooq Izhar - 18%	
Mr. Mahboob Nasir Izhar - 18%	
Mr. Marghoob Shakir Izhar - 15%	

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

Izhar Construction (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Izhar Construction (Pvt.) Limited was incorporated in 1960 under Companies Act 1913 (Repealed with enactment of the companies Act, 2017 on May 30, 2017) as a private limited company The principal activities of the company are rendering engineering services and to carry out construction work.

Profile of Chief Executive Officer

Mr. Amir Farooq Izhar has been associated with the company for three decades as CEO. He has done civil engineering from USA and has vast experience in Pre-Engineered Buildings System, Dwelling Construction Technology, sales and marketing strategy.

Profile of Chairman

Mr. Ayub Sabir Izhar is the group chairman of Izhar Group of Companies. He has done engineering from London, UK. He has been associated with the group for the last 36 years. He has vast experience in the fields of Construction engineering services, real estate development, business planning and strategy.

Financial Snapshot

Core Equity: end-FY19: Rs. 9.4b; end-FY18: Rs. 8.2b; FY17: Rs. 6.3

Assets: end-FY19: Rs. 9.8b; end-FY18: Rs. 10.8b; FY17: Rs. 11.8b

Profit After Tax: FY19: Rs. 1.1b; FY18: 2.0b; FY17: 1.1b

RATING RATIONALE

The ratings assigned to Izhar Contruction (Pvt.) Limited (ICPL) take into account company's association with Izhar Group of Companies having an established footprint in the construction business developed over the years. Financial risk profile is strong as evident from virtually debt-free capital structure, strong liquidity, sizeable coverages and adequate cash balances. Despite, slack economic growth the company's ability to sustain topline has provided strength to the ratings. The ratings also incorporate inherent synergies and diversification in the group structure, providing implicit strength to the business model. The ratings also assume an uptick in the economic cycle, thereby bringing prospective growth in the company's revenue. However, the ratings remained constrained on account of presence of the company in high business risk sector involving capsizing of revenues owing to political unrest & instability, regulatory changes and missed completion deadlines. The ratings will remain dependent on timely completion of key commercial projects without any significant cost and time overruns while maintaining healthy sales velocity and collection efficiency, as projected, will remain critical to avoid cash flow mismatches.

Key Rating Drivers:

Company's profile: ICPL is the flagship company of Izhar group of companies involved in construction engineering services and has its credit numerous large scale industrial, commercial, educational, infrastructure, power and other projects; the group is also involved in manufacturing of pre-cast and pre-stressed concrete components, pre-engineered steel building (PEB), digital energy meters & smart metering solutions, switch gears, transformers and cable management system and also provide wide-range services for mechanical, electrical and plumbing work along with sales and distribution services for electromechanical products, equipment and system.

Izhar Concrete (Pvt.) limited is the parent member of Izhar Group of Companies which is the pioneer and the largest single entity engaged in manufacturing of pre-cast and pre-stressed concrete components. Another sister concern of ICPL, MEP Solutions (Pvt.) Limited (MEPS), is a contracting firm providing end to end solutions for mechanical, electrical and plumbing work. Izhar Steel (Pvt.) Limited is the largest production facility furnishing pre-engineered buildings (PEB) and steel structures in Pakistan. Further, Izhar Housing (Pvt.) Limited is involved in building residential complexes, while Accurate (Pvt.) Limited is a manufacturing concern focusing on digital energy meters and smart metering solutions. The group also includes a manufacturing concern for specialized switch gears, transformers and cable management systems, under the banner of Green T&D (Pvt.) Limited. Another venture of Izhar group is the Electrocraft Engineering, involved in sales and distribution of electromechanical products, equipment and systems. Due to integration and diversification in the group companies, it has competitive advantage in efficiently rendering construction services at various scales.

ICPL has completed numerous large infrastructures, industrial, commercial, educational and high-rise building projects till date. The company has a history of recurring businesses from the same clients on account of established relationships as a result of efficient and timely completion of projects. A few recent major projects include:

- Grey structure and facade works for construction of Qarshi Indus Hospital
- Construction of Coca Cola head office building
- Construction of Packages Mall

- Construction of CCL and CGL plant at Aisha Steel Mills Limited
- Infrastructure project management services for the USAID projects at the National University of Sciences and Technology (NUST) and Jinnah Post Graduate Medical College (JPMC)
- Construction of 30MW coal power plant of DG Khan Cement Co. Ltd.
- Extension of 9 MW coal & biomass power plant of Nishat Dyeing and finishing Refuse Derive Fuel (RDF) plants of DG Khan Cement Co. Ltd.
- Civil, (Mechanical, Electrical & Plumbing) MEP, Heating Ventilation and Air-conditioning (HVAC) and Pre-engineered Building (PEB) works for construction of 10,000 TPD Cement Plant for D.G. Khan Cement at Hub Baluchistan.
- Construction structural, architectural, plumbing, HVAC and external works of Atlas Honda Ltd.
- Civil works, PEB and MEP works for Nippon Paint Pakistan's warehouse
- Civil works for construction of warehouse building of Pak Electron Ltd.
- Construction of Allied Bank Limited (ABL) warehouse building
- Civil works for construction of warehouse building of Digital World Pakistan
- Construction of manufacturing plant buildings and civil works of Dalda Foods (Pvt.) Ltd.

During FY19, additions of Rs. 161.1m were made in property, plant and equipment, which majorly included construction machinery, scaffolding, shuttering. Majority of the construction machinery and equipment installed is of UK, Japanese, Chinese and Italian made. Timely replacement and addition of latest machinery has ensured operational efficiency for the company.

Investment property and investment in associate: Investment property held by company, stood higher at Rs. 1.1b (FY18: Rs. 780.7m; FY17: 176.4m) at end-FY19. Land worth Rs. 333.7m and building of Rs. 13.7m was acquired during FY19. The land held by the company mainly comprised commercial, residential and agricultural land in Islamabad, Lahore and Peshawar, while the buildings acquired are located in commercial area, Garden Town, Lahore. During FY19, the company has recorded gain on sale of land amounted to Rs. 36.3m (FY18: 16.8m; FY17: 1.8). Investment in associates stood at Rs. 52.3m (FY18: Rs. 52.3m; FY17: Rs. 52.3m) at end-FY19, related to 40% shares of MEP Solutions (Pvt.) Ltd., 9.93% shares of Green Industrial Solutions (Pvt.) Ltd. and 49.99% shares of Green Revolution (Pvt.) Ltd.

Lower revenue from execution of construction contracts due to subdued economic growth: ICPL topline has grown at a CAGR of 12.1% during the last three years. However, due to general economic slowdown and reduced infrastructure & construction activities in the country, the company's net revenue stood lower at Rs. 6.6b (FY18: Rs. 7.4b: FY17: Rs. 4.1b) during FY19. Gross revenue emanating from execution of construction contracts largely constituted the total sales mix; however, revenue from sale of goods amounted to Rs. 487.7m (FY18: Rs. 66.2m; FY17: Rs. 200.9m) during FY19. The sale of goods pertained to ready-mix concrete *(concrete manufactured in batch plant)* constituting only 7.3% (FY18: 0.92%; FY17: 4.9%) of the net revenue. Gross margins declined to 24.5% (FY18: 34.5%; FY17: 34.5%) during the review period. The decline in margins was a function of increase in salaries, wages and benefits owing to revision in salaries and the construction supervisory services provided for a major project entailing relatively higher salaries. The contribution of the same in cost of goods manufactured has increased along with higher proportion of overheads during FY19, an outcome of local currency depreciation and inflated prices. Further, material consumed for concrete-mix sale, increased to Rs. 121.8m (FY18: Rs. 41.3m; FY18: Rs. 120.5m). However, cost of inventories consumed decreased to Rs 2.7b

(FY18: 3.2b; FY17: Rs. 1.5b) in line with lower scale of operations and higher closing stock. Depreciation charge decreased due to lower value of construction and scaffolding machinery. Administrative expenses stood higher at Rs. 483.7m (FY18: Rs. 433.2m; FY17: 345.5m) primarily due to higher salaries and benefits during the outgoing year.

Other operating expenses constituting workers Profit Participation Fund and Workers Welfare Fund stood lower at Rs. 60.9m (FY18: Rs. 104.0m; FY17: Rs. 37.9m) and other income comprising rental income, gain on disposal of fixed assets and income from profits from banks stood lower at Rs. 57.7m (FY18: Rs. 71.3b; FY17: Rs. 146.7m) during FY19. Finance cost decreased during FY19 to Rs. 15.1m (FY18: Rs. 19.7m; FY17: Rs. 14.0m), on account of lower guarantee commission, as the majority contracts executed during the review period pertained to brought forward contracts. Despite the tax credit and lower finance cost, company's net profit reduced to Rs. 1.1b (FY18: Rs. 2.0b; FY17: Rs. 1.1b) on account of compression in margins and higher administrative expenses. In addition, lower income generation from other sources during FY19 vis-à-vis preceding year also contributed to reduction in bottom line.

The management projects turnover from contracts to increase by 10% in the ongoing year and the margins are likely to remain at current levels, meanwhile with the revival of overall economic indicators, the management expects the revenue to increase at a modest rate, going forward. A list of ongoing projects, with total value and timeline is presented below:

Name & Project Description	Value in Rs. (Million)	Completion Date
Construction of structural works of Dolmen Mall, DHA Phase VI, Lahore	2,459	Dec'19-Apr'21
Civil, MEP, HVAC work for construction of double storey car parking area at Allama Iqbal International Airport, Lahore	5,903	Aug'17-Dec'19
Civil works for the construction of category-III structures at K2/K3, Karachi	3,664	May'18-Apr'20
Construction of sub & super structure Orient Square Hotel, Lahore	1,138	Oct'19-Apr'22
Civil works of main mill building and ancillary structures of Hyudai Nishat Motors (Pvt.) Ltd. Faisalabad	990	Apr'18-Mar'20
Construction of Hemodialysis plant & office building at Renacon, Faisalabad	647	Dec'18-Feb'20
Civil work for construction of 10 MW Waste Heat Recovery and 30 MW Coal Fired Power Plant at DG Khan Cement	595	Dec'19-Aug'20
Building and finishing works for construction of Indus Hospital QF NST Campus, Lahore	520	Oct'19-Aug'20
Construction of Ecolean Packaging Plant at Sundar Industrial Estate, Lahore	466	Apr'18-Dec'19
Block masonry and façade work for construction of 650 bedded Indus Hospital, Lahore	218	Mar'19-Dec'19
Construction of cash and carry store and mall complex, Multan	380	Sep'19-Mar'20
Construction of structural work for Elan Tower, Islamabad	327	Dec'17-Dec'19
Earth work and piling work for Orient Square Hotel, Lahore	181	May'19-Dec'19
Civil, MEP & PEB structure work for construction of warehouse and allied works on design and build basis	225	Mar'19-Dec'19
Civil works for construction of Waste Heat Recovery Project at DG Khan Cement Plan Khairpur, Chakwal	140	Mar'19-Dec'19
Finishing works for Waste Heat Recovery Project at DG Khan Cement Plan Khairpur, Chakwal	17	Oct'19-Feb'20

Strong liquidity and sizeable debt coverage ratio: Liquidity profile of the company is considered strong. As a result of lower profitability, lower non-cash adjustments and higher gain on disposal of assets, Funds from Operations (FFO) decreased to Rs. 699.7m (FY18: Rs. 1.6b; FY17: Rs. 960.6m) during the review period. On back of virtually debt-free balance sheet, debt service coverage ratio, although decreased, remained sizeable at 47.5x (FY18: Rs. 82.4x; FY17: 69.5x) during FY19.

Inventories stood higher at Rs. 1.2b (FY18: Rs. 475.4m; FY17: Rs. 230.3m), mainly due to bulk of materials purchased at favorable rates during the outgoing year. Trade debts amounted to Rs. 1.8b (FY18: Rs. 2.0b; FY17: Rs.1.9b); the decrease is in line with lower revenue, given trade debts in respect to total sales remained almost at prior year's level of 26.7% (FY18: 28.8%). These receivables include retention money with clients amounting to Rs. 934.0m (FY18: Rs. 893.5m; FY17: Rs. 678.7m) at end-FY19, entailing 5% of the contract amount withheld by the client as a mean of security and payable at the completion of the project, as specified in contractual terms. Ageing of receivables (excluding retention money) is considered satisfactory as 95% (FY18: 95%; FY17: 93%) of the receivables fall within 6 months' credit bracket. Short-term loans amounted to Rs. 2.1b (FY18: Rs. 2.0b; FY17: Rs. 1.6b) at end-FY19. Four-fifth of these short-term loans pertained to unsecured interest-free loan given to associated companies; as it has been norm in the group companies to not to avail funded credit lines from banks to keep the financial cost at significantly lower level. Further, short-term deposits, advances and pre-payments stood higher at Rs. 2.4b (FY18: Rs. 2.1b; FY17: Rs. 2.2b) mainly owing to higher advance tax and sales tax refundable, however, advances made to suppliers decreased, at end-FY19. The company has cash and bank balances available of Rs. 1.6b (FY18: 2.0b; FY17: Rs. 2.0b) at end-FY19. While the liabilities comprised only trade and other payable, the same stood lower at Rs. 1.8b (FY18: Rs. 2.0b; FY17: Rs. 2.3b), accordingly, current ratio increased to 5.09x (FY18: 4.37x; FY17: 3.14x) at end-FY19. The company has non-funded facilities amounting to Rs. 1.7b (FY18: Rs. 2.3b) in the form of bank guarantees from different commercial banks in connection with contracts awarded.

Augmentation in equity on back of profit retention; conservative capital structure characterized by virtually debt-free balance sheet: Core-equity of the company has augmented solely on account on profit retention to Rs. 9.4b (FY18: Rs. 8.2b; FY17: Rs. 6.3b) by the end-FY19. Revaluation surplus on property, plant and equipment stood at Rs. 607.5m (FY18: Rs. 620.9m; FY17: Rs. 1.2b) by end-FY19. Further, no dividend was paid during the outgoing year (FY18: Rs. 30.0m; FY17: Rs. 296.0m). ICPL meets its entire working capital need through internal sources; the company's balance sheet has continued to remain debt free. Due to aforementioned reasons, debt leverage improved to 0.19x (FY18: 0.24; FY17: 0.37x). Equity base is projected to enhance on back of profit retention, meanwhile given absence of any debt, capitalization indicators will remain strong, according to management, going forward.

BALANCE SHEET *(PKR millions)*	FY17	FY18	FY19
Property, plant & Equipment	2,351	1,353	1,412
Investment Property	176	781	1,100
Investment in associates	52	52	52
Inventories	230	475	1,175
Trade Debts (including retention money)	1,194	2,050	1,832
Short-term loans	1,590	2,013	2,121
Short-term deposits, Advances and Prepayments	2,199	2,136	2,433
Cash & Bank Balances	2,017	1,960	1,644
Other Assets	8	12	22
Total Assets	9,817	10,832	11,791
Trade and Other Payables	2,308	1,978	1,814
Long Term Debt *(including current maturity)*	-	-	-
Short Term Debt	-	-	-
Tier-1 Equity	6,271	8,233	9,369
Surplus on Revaluation of PP&E	1,240	621	607
Total Equity	7,511	8,854	9,977
Paid-up Capital	100	100	100
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	4,062	7,123	6,641
Gross Profit	1,399	2,454	1,625
Operating Profit	1,054	2,021	1,141
Profit Before Tax	1,149	1,969	1,123
Profit After Tax	1,120	1,962	1,123
Funds from Operations	961	1,600	700
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	34.5	34.5	24.5
Net Margins	27.6	27.5	16.9
Current Ratio (x)	3.14	4.37	5.09
Net Working Capital	4,932	6,668	7,411
FFO to Total Debt (x)	-	-	-
FFO to Long Term Debt (x)	-	-	-
Debt Leverage (x)	0.37	0.24	0.19
Gearing (x)	-	-	-
DSCR (x)	69.5	82.4	47.5
ROAA (%)	11.4	19.0	9.9
ROAE (%)	17.9	27.1	12.8

ISSUE/ISSUER RATING SCALE & DEFINITIONS 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	Izhar Construction (Pvt.) Limited
Sector	Cement & Construction
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table 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.
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Due Diligence Meeting/s Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
31-12-2019	A-	A-1	Stable	Initial

Due Diligence Meeting/s Conducted

	Name	Designation	Date
1	Mr. Waseem Iftikhar	G.M. Finance and MIS	26-Dec-2019

REGULATORY DISCLOSURES Appendix III

Name of Rated Entity	Izhar Construction (Pvt.) Limited
Sector	Cement & Construction
Type of Relationship	Solicited
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Rating History	see table 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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
31-12-2019	A-	A-1	Stable	Initial