

## RATING REPORT

### Ferrous Engineering Industry

**REPORT DATE:**

May 28, 2019

**RATING ANALYSTS:**

Syed Fahim Haider Shah  
[fahim.haider@vis.com.pk](mailto:fahim.haider@vis.com.pk)

Maimoon Rasheed  
[maimoon@vis.com.pk](mailto:maimoon@vis.com.pk)

**RATING DETAILS**

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	BBB-	A-2
<i>Rating Outlook</i>	<i>Stable</i>	
Rating Action	Initial	
<i>Rating Date</i>	<i>May 23, '19</i>	

**INFORMATION**

Incorporated in 2007	External auditors: Inaam ul Haq & Co. Chartered Accountants.
Sole Proprietorship	Sole Proprietor: Mr. Muhammad Irshad
<b>Key Shareholders (with stake 5% or more):</b>	
Mr. Muhammad Irshad – 100%	

**APPLICABLE METHODOLOGY**

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

## Ferrous Engineering Industry

### OVERVIEW OF THE INSTITUTION

Ferrous Engineering Industry (FEI) was established in 2007 as a sole proprietorship. The principal business activity of FEI is commercial trading various types of steel sheets and manufacturing and allied steel products.

### RATING RATIONALE

Ferrous Engineering Industry (FEI) was established by Mr. Muhammad Irshad in 2007 as a sole proprietorship. The principal business activity of FEI is import, processing and sale of hot rolled, cold rolled, galvanized and painted coils. FEI imports aforementioned steel products directly from the manufacturers located in China, Europe, Latin America, CIS and South Africa. The company is also involved in the manufacturing and sale of corrugated sheets, steel pipes, sheet piles, scaffoldings guard rails and steel channels. Other business interests of sponsor include AI Commodities (Pvt.) Limited which is a steel & allied products trading company incorporated in the U.K. and a steel services & fabrication company located in the Kingdom of Saudi Arabia. Moreover, no property of the sponsor is pledged against finance with any financial institutions in Pakistan.

The assigned ratings take into account experience of sponsor in commercial steel trading and established relations with some major customers. The ratings draw comfort from the sustained growth in sales and stability in profit margins with the expanding scale of trading and manufacturing operations. The ratings also factor in adequate liquidity position and manageable leverage indicators in the absence of long-term borrowings. FEI intends to establish a steel melting and billet casting unit during FY20 and FY21. The project will be fully funded by owner's capital and hence fresh equity injection will positively impact the leverage indicators. The ratings are constrained by FEI's status as a sole proprietorship and its vulnerability to pricing and currency risks, increasing power costs and changing supply-demand dynamics of steel industry amid slowing economic growth. The sole proprietor is planning to convert FEI into private limited company. The succession risk is considered low as two sons of Mr. Irshad are actively involved in day to day business operations.

#### Sales and profitability:

Net sales of FEI have increased on a timeline basis mainly on account of higher volumetric sales and improved selling prices. Though the sponsor has longstanding relations with the customers, the concentration is considered on the higher side. Moreover, customer retention is highly dependent on pricing, credit terms and supply dynamics of the industry. Due to higher sales and favorable prices, gross profits have increased on a timeline basis with largely stable margins. The steady increase in finance cost was due to higher utilization of debt financing on a timeline basis. Accounting for taxation, net profits of FEI were recorded higher with slightly improved net margins.

#### Liquidity and Cash Flows

FEI generated higher funds from operations (FFO) during FY18 on the back of improved profits. The current ratio has remained well above the minimum benchmark of 1.0x over the review period. The inventory plus receivables to short-term borrowings ratio of 1.8x at end-FY18 indicates that FEI is not solely relying on short-term borrowings to fund its working capital requirements. In the absence of any long-term debt, FEI's capacity to meet its financial obligations is considered adequate despite higher short-term borrowings.

#### Capitalization and Funding

The augmentation of capital base is attributable to retention of profits. There is no defined policy and the amount of drawings depends on the owner's discretion. The debt profile of FEI comprises short-term borrowings only. Due to higher utilization of short-term borrowings and modest increase in net capital, gearing and debt leverage indicators, albeit remained low, increased to 0.61x and 0.64x by end-1HFY19 (FY18: 0.40x and 0.46x; FY17: 0.72x and 0.73x), respectively. The sponsor has no plan to mobilize long-term borrowings over the foreseeable future. Given the planned equity injection for expansion purposes, leverage indicators are expected to improve during FY20 and FY21.

**ISSUE/ISSUER RATING SCALE & DEFINITIONS**

**Annexure I**

**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](http://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](http://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](http://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.

<b>REGULATORY DISCLOSURES</b>		<b>Annexure II</b>			
<b>Name of Rated Entity</b>	Ferrous Engineering Industry				
<b>Sector</b>	Steel				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>RATING TYPE: ENTITY</b>				
	23/05/2019	BBB-	A-2	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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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