RATING REPORT

Faizan Steel

REPORT DATE:
January 10, 2022

RATING ANALYSTS:

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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Date	*January 10, 2022*	

COMPANY INFORMATION	
Established in 1997	**External auditors:** M/s REANDA Haroon Zakaria & Company Chartered Accountants
Partnership Firm	**Chairman:** Mr. Asif Bhagani
Key Partners:	**Managing Director:** Mr. Aamir Bhagani
Mr. Mansoor Bhagani	
Mr. Asif Bhagani	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Faizan Steel

OVERVIEW OF THE INSTITUTION

Faizan Steel (the Firm) was registered on August 23, 1997 as a partnership firm under Partnership Act 1932. The Firm is principally engaged in manufacturing and supply of steel products. The registered office of the Firm is located at Suit No. 806, 8th Floor, Al-Khaleej Tower, B.M.C.H.S., Main Shaheed-e-Millat Road, Karachi.

RATING RATIONALE

Faizan Steel ('FS' or 'the Firm') is principally engaged in manufacturing and supply of steel products. Being located at S.I.T.E. the Industrial hub of Karachi, manufacturing plant is equipped with a fully automatic steel re-rolling mill, a high end melt shop, and a 230 ft. cooling bed with the capacity of producing over 500 tons a day**.** Bars are manufactured using in-house manufactured steel billet conforming to American, Chinese and British standards. FS's product range includes Premium bars, Seismic bars, Optimum bars, Heavy Duty bar and C-bar.

Steel Sector Outlook

– In tandem with pandemic-induced economic slowdown noted in H2'FY20, demand for steel & allied products was affected, as precipitated by the negative movement in LSM, which fell by 18% in H2'FY20, and revenue contraction experienced by almost all listed steel industry participants.

– However, during FY21, industrial operations picked up pace, as reflected by an uptick of 14.85% in the LSM index. With macroeconomic growth trajectory having a positive outlook, LSM growth is expected to remain elevated during the medium term horizon. Our positive demand outlook for steel is also supported by low per capita steel consumption vis-à-vis regional and global averages.

– During November 2020, steel bar prices were ranging between Rs. 110,000-113,000/MT, which rose to Rs 150,500/MT as at Jun'21. This increase in price was mainly precipitated by rising scrap prices globally and rupee depreciation. Given volatile pattern of scrap prices, the related business risk for steel industry is trended up. In addition, rising power cost and mis-declaration of imported scrap will continue to remain challenges for local industry.

<u>Risk Review – Faizan Steel</u>

Sales & Profitability

P&L (EXTRACT)	FY17	FY18	FY19	FY20	FY21
Net Sales	5,525	5,655	4,348	7,437	12,482
Gross Profit	298	357	303	761	1,067
Profit Before Tax	154	207	173	313	504
Profit After Tax	154	207	173	147	317
Gross Margin (%)	5.4%	6.3%	7.0%	10.2%	8.5%
Net Margin (%)	2.8%	3.7%	4.0%	2.0%	2.5%

– FS's revenue base has grown notably in past 2-year period (FY20-21), as indicated by topline CAGR of 69% during this period. Prior to that, the Firm had posted contraction in topline for FY19, as 2 off 3 units were closed and quantity sold dropped by 29%.

- Subsequently, the management has focused on expanding its main plant operations and as a result quantitative offtake was up by 47% and 50% in FY20 and FY21 respectively. Accordingly most of the uptick in topline is mainly emanating from growth in quantitative sales, while ~20% is emanating from pricing increase.

- The Company's gross margins have posted consistent improvement, with the exception of FY21, wherein a drop was noted being attributed mainly to significant depreciation of local currency, uptick in international scrap steel prices and stiff competition in the market, given that several long steel producers had ended FY20 with high inventory levels.

- In the ongoing year, given significant uptick in pricing of steel scrap and sizable depreciation in local currency, the topline is projected to grow above Rs. 20b, while keeping a prudent approach, margins are likely to be maintained.

- Firm's clientele includes government institutions and a mix of builders and contractors comprising 30% and 70% of the revenues base respectively. Client concentration is considered moderate with only about 20-25% of the revenues emanating from top 10 clients during the past 2-year period (FY20-21).

Capitalization & Funding

Balance Sheet (Extract)	FY17	FY18	FY19	FY20	FY21
Total Assets	1929	2439	2762	6770	8461
Equity	461	1371	1459	1574	1814
Total Liabilities	1468	1068	1303	4102	5553
Total Debt	1200	743	826	3234	4117
- **Short Term Borrowings**	1199	743	798	3234	3802
- **Long-Term Borrowings**	1	0	28	0	314
Capital Structure (Debt: Equity)	72:28	35:65	36:64	67:33	69:31
Gearing (X)	2.60	0.54	0.57	2.05	2.27
Leverage (X)	3.18	0.78	0.89	2.61	3.06

- FS's capital structure has notably shifted towards debt, mainly as working capital requirements have spiked on account of growth in business revenues. This is indicated by the movement in capital structure and increase in gearing, as illustrated in the table above.

- Profit retention has varied over the years, albeit has remained strong. Cumulatively, the Firm has retained 81% of the profit for the past 3-year period (FY19-21). This was following an equity infusion of Rs. 787m in FY18, which was utilized to fund capital expenditures of the Firm.

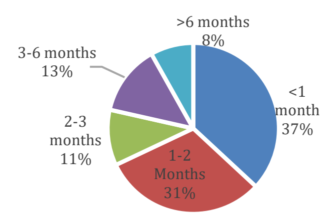
- With the exception of small-sized borrowing under SBP's concessionary scheme, which aggregated to Rs. 122m as of Jun'21, the remaining financing is entirely KIBOR based.

Cash Flow Coverage Indicators

- As shown in the table below, the Company's Cash Conversion Cycle (CCC) stood moderately high as of end-FY20, albeit it has receded in FY21. Historically, the Firm has operated with a well-managed working capital cycle, close to or lower than 100 days. However in recent years, the sizable uptick in business volumes, has increase the Firm's working capital requirements.

	FY17	FY18	FY19	FY20	FY21
Cash Conversion Cycle	**87**	**85**	**103**	**189**	**131**
- **Days Inventory Outstanding**	77	70	34	47	28
- **Days Receivable Outstanding**	26	34	109	186	147
- **Days Payable Outstanding**	16	20	40	44	44

- As illustrated in the table above the CCC is elevated mainly on account of higher trade debts outstanding, while inventory days are comfortably low. The Firm generally operates with a 2-month credit, which can be higher by up to a month for institutional buyers.



- As of Jun'21 percentage of assets tied up in stock of inventory and trade debts stood at 10% (Rs. 882m) and 59% (Rs. 5.0b) respectively. As per management, trade debts were elevated as of end-FY21 albeit these have declined to Rs. 4.8b as of Nov'21, which stands at about of a quarter of the FY22 projected topline. Aging profile of trade debts as of Nov'21 is presented in Figure x. As reflected in the figure, as of Nov'21, 13% (Rs. 642m) of the trade was in the 3-6 month bucket while 8% (Rs. 391m) was in the more than 6 month bucket. Cumulating both buckets, the amount of Rs. 1b (21% of trade debts) reflects trade debts wherein credit risk profile is elevated; it is pertinent to mention that the same has come down from Rs. 2.4b (or 47% of trade debts) as of Jun'21.

	FY18	FY19	FY20	FY21
FFO (In PKR Millions)	111	131	285	649
FFO To Total Debt (%)	20.8	10.1	7.5	12.9
Debt Servicing Coverage Ratio (X)	2.7	3.3	2.4	3.2
Current Ratio	1.96	1.85	1.28	1.22
(Stock In Trade+ Trade Debts)/STD	2.09	2.11	1.44	1.53

– In tandem with uptick in revenue base, FFO has also grown; nevertheless, cash flow coverage indicators remain stressed mainly as the Firm remains in growth phase and borrowings continue to increase in tandem with growing business revenues.

- Long term debt has remained minimal and debt service coverage remained comfortable during the period reviewed. Given addition of long term debt in FY21, DSCR is likely to trend down in FY22 albeit it will remain comfortable.

– The coverage of short-term borrowings by stock of inventory and trade debts is considered comfortably high at 1.5x as at Jun'21.

Key Rating Drivers

The assigned rating incorporates Sponsors long standing association with the Steel Industry

The assigned ratings incorporates FS's operational track record and longstanding association of Firm's sponsors with the domestic steel making industry, including stakes in upstream industries like ship breaking.

Ratings incorporate FS's market positioning & profitability margins

Ratings incorporate the quantum of business revenues and profitability margins of FS. The Firm's revenue base has grown notably in past 2-year period (FY20-21), as indicated by topline CAGR of 69% during this period. FS's gross margins have posted consistent improvement, with the exception of FY21, wherein a drop was noted being attributed mainly to significant depreciation of local currency, uptick in international scrap steel prices and stiff competition in the market, given that several long steel producers had ended FY20 with high inventory levels. Going forward, topline is projected to grow above Rs. 20b in the FY22, while margins are likely to sustain.

Rating is constrained by financial risk profile of FS

The financial risk profile of FS poses a rating constraint, given elevated gearing and increasing debt financing tilt of the capital structure. Furthermore, exposure to credit risk is also notable, albeit having trended down in 5MFY22. Nevertheless, as of Nov'21, an amount of Rs. 1b was outstanding for a period for more than 3 months, which stands at 56% of the Company's equity base.

Ratings incorporate adequate DSCR but stressed Cash flow Coverage Indicators

In line with growth in business revenues, cash flows have improved, albeit as the Firm remains in growth phase, debt is also rising and resultantly cash flow coverages are constrained. Nevertheless, financing is limited to running finance lines while long term debt is minimal, which translates in a comfortable DSCR.

Ratings incorporate FS's operational status as a Partnership Firm.

The Ratings are constrained FS's operational status as a Partnership Firm. Change in operational status to a sole proprietorship or a listed entity could bode well from a ratings purview.

Faizan Steel **Annexure I**

Financial Statement					(Amount in Million)
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**
Property, Plant & Equipment	97	182	170	1507	2017
Long-term deposits	10	-	-	-	-
Stock in Trade	1098	1021	381	854	882
Trade Debts	397	532	1300	3798	5024
Cash & Bank Balances	13	15	11	26	53
Other Assets	314	688	901	585	484
Total Assets	1929	2439	2762	6770	8461
Trade and Other Payables	268	325	477	868	1436
Short Term Borrowings	1199	743	798	3234	3856
Long-Term Borrowings	1.13	-	28	-	261
Total Liabilities	1468	1068	1303	4102	5553
Total Debt	1200	743	826	3234	4117
Partner's Capital	461	1371	1459	1574	1814
INCOME STATEMENT					
Net Sales	5,525	5,655	4,348	7,437	12,482
Gross Profit	298	357	303	761	1,067
Operating Profit	191	273	229	582	803
Profit Before Tax	154	207	173	313	504
Profit After Tax	154	207	173	147	317
RATIO ANALYSIS					
Gross Margin (%)	5.4%	6.3%	7.0%	10.2%	8.5%
Net Margin (%)	2.8%	3.7%	4.0%	2.0%	2.5%
FFO	53	111	131	285	649
FFO to Total Debt	13.3%	20.8%	10.1%	7.5%	12.9%
Debt Servicing Coverage Ratio (x)	NA	2.7	3.3	2.4	3.2
ROAA (%)	8.0%	9.5%	6.7%	3.1%	4.2%
ROAE (%)	33.4%	22.6%	12.3%	9.7%	18.7%
Gearing (x)	2.60	0.54	057	2.05	2.27
Debt Leverage (x)	3.18	0.78	0.89	2.61	3.06
Current Ratio (x)	1.24	1.96	1.85	1.28	1.23
Inventory + Receivables/Short-term Borrowings	1.25	2.09	2.11	1.44	1.55
No. of Days Inventory Outstanding (Days)	77	70	34	47	28
No. of Days Receivable Outstanding (Days)	26	34	109	186	147
No. of Days Payable Outstanding (Days)	16	20	40	44	44
CCC (Days)	87	85	103	189	131

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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 — Annexure III

Name of Rated Entity	Faizan Steel
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
01/10/2022	BBB+	A-2	Stable	Initial

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 Meetings Conducted

Name	Designation	Date
Mr. Faizan Bhagani	Director – Finance	October 26, 2021
Mr. Farooq Qureshi	Manager - Taxation	