RATING REPORT

Faizan Steel

REPORT DATE:
January 31, 2023

RATING ANALYSTS:
Asfia Aziz
asfia.aziz@vis.com.pk

Muhammad Taha
m.taha@vis.com.pk

RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**BBB+/A-2**	**BBB+/A-2**
Rating Outlook	Stable	Stable
Rating Date	January 31, 2023	January 10, 2022
Rating Action	Reaffirmed	Initial

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 – 30%	
Mr. Asif Bhagani – 25%	
Mr. Faizan Bhagani – 20%	
Mr. Waseem Bhagani – 15%	

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 a partnership concern, which is engaged in the manufacturing and sale of steel bars. Being located at S.I.T.E. the Industrial hub of Karachi, manufacturing plant is equipped with a fully automatic direct steel re-rolling mill, a high-end melt shop, and a 230 ft. cooling bed. There is an integrated setup in place, where shredded scrap is used to manufacture steel billets, which are then directly converted into bars. Given direct re-rolling ability, energy efficiency is relatively better as compared to non-integrated players. FS's product range includes Premium bars, Seismic bars, Optimum bars, Heavy Duty bar and C-bar.

Power requirement of the entity stands at 20 MW and is met via electricity supplied by K-Electric. In this regard, the management is currently pursuing the project of installing a separate grid station with a total cost of around Rs. 1b (to be financed by long-term debt). This is expected to be completed by the end of calendar year 2023. Furthermore, solar panels with a capacity of 2 MW are also being installed (via a concessionary rate scheme of the State Bank of Pakistan for financing green energy projects), which are expected to become operational by 1QFY24. Additional debt of around Rs. 50m for this purpose is expected to be drawn, as part of the above-mentioned arrangement, in the ongoing year from Oct'22.

Over the past two years, the company incurred capex (purchase of plot, induction furnace, solar panels) to the tune of Rs. 1.1b financed through a debt: equity ratio of around 50:50. Hence, at end-June'22, production capacity of the entity was reported higher at 166,200 MT per annum. Historically, capacity utilization has remained at high levels; however, some reduction was observed in the ongoing year due to the challenging macroeconomic dynamics.

	FY20	FY21	FY22
Practical Capacity (in MT)			
Billets	55,125	73,125	162,500
Bars	86,800	134,070	166,200
Production (in MT)			
Billets	47,944	66,745	147,802
Bars	81,018	122,098	153,043
Capacity Utilization			
Billets	87%	91%	91%
Bars	93%	91%	92%

Business risk profile for the steel sector is considered to be on the higher side due to the reliance on imported raw material and current macroeconomic condition.

Business risk for the steel sector is considered to be on the higher side, considering its sensitivity to exchange rate movement and volatile nature of raw material prices. Primary raw material for the entity is steel scrap, which is imported mainly from Europe. Shredded scrap prices peaked at around $600/MT in March'22, but then followed a downward trend until Dec'22. Given the economic slowdown in developed nations and supply chain disruptions caused by the Russia-Ukraine conflict, global outlook for the sector is currently bleak.

Duty structure for the imported raw material consists of 2% Additional Custom Duty, 5% Regulatory Duty, 17% Sales Tax, 2% Income Tax, and 1.25% ETO Cess. As far as the Pakistani market is concerned, a high inflation rate has adversely affected the consumer purchasing power. Moreover, due to the recent floods in parts of Punjab and Sindh as well the economic/political uncertainty, there has been a noticeable reduction in infrastructure development projects. Consequently, steel manufacturing businesses have experienced a fall in demand during the ongoing year, with many operating at reduced capacity. Procurement of raw material is also a challenge, considering the restriction imposed on the opening of LCs by the State Bank of Pakistan (SBP).

Substantial growth in topline during FY22 attributable to a mix of volume and price increase. With macroeconomic slowdown in the ongoing year, VIS expects revenue base to decline in the ongoing year.

Sales revenue of FS almost doubled in FY22 and was reported at Rs. 24.1b (FY21: Rs. 12.5b) attributable to a 50% increase in volumes and a 29% price uptick. Given production facility is situated in Karachi, its business is mainly conducted in Southern part of the country majorly targeted to institutional buyers comprising builders/developers. Customer concentration has improved on a timeline basis with top ten customers constituting 28% (FY21: 38%, FY20: 31%) of sales in FY22. Amongst the top 10 customers, a clear focus towards institutional customers is seen which account for 90% of total revenue. The client base mainly consists of builders and certain government authorities, with comfort garnered from long-standing relationships with these.

Despite the suppressed demand for steel products in the economy during the ongoing year, the entity was largely able to maintain sales revenue in 1QFY23. However, the unavailability of raw materials due to LC restrictions continue to pose a major challenge which is expected to cause the revenue base for full year FY23 to decline.

Gross margins decreased during FY22 due to higher raw material costs; however, the same showcased improvement in 1QFY23 due to higher average selling prices and inventory gains. However, with elevated finance costs on borrowings, net margins of the company have depicted weakening in the review period.

Given a limited passing on ability of increasing shredded scrap prices (+56% YoY in FY22), gross margins of the firm reduced to 7.1% (FY21: 8.5%) in FY22. With elevation in finance costs due to higher quantum of short-term borrowings to finance working capital needs along with rising interest rates; net margins of the company declined to 2.2% (FY21: 2.5%) in FY22.

In line with a rise in rebar prices and inventory gains on scrap procured, improvement was observed in gross margins during 1QFY23 to 9.5%. Sustainability of the same is yet to be seen amidst supply constraints due to bleak macroeconomic environment. Net margins continued to be dragged by higher finance costs in 1QFY23. Improvement in profitability indicators will be important to sustain the ratings.

With subdued profitability and elevated debt levels, liquidity coverages of the firm also trended downwards. Sustaining the ratings warrants improvement in the same over the rating horizon.

Although Funds from Operations (FFO) exhibited double-digit growth in absolute terms during FY22, coverage of the same against outstanding obligations reduced due to elevated borrowings to finance expansion plans and working capital needs. FFO to Long-Term Debt, FFO to Total Debt and Debt Servicing Coverage Ratio were reported lower at 123% (FY22: 142%, FY21: 248%), 8.0% (FY22: 10.6%, FY21: 15.8%) and 1.38x (FY22: 2.3x, FY21: 3.2x), respectively in 1QFY23. Coverage of stock in trade and trade debts against Short-term borrowings stood at border level of 1.30x (FY22: 1.4x, FY21: 1.5x) at end-September'22. Going forward, keeping cash flow coverages in alignment with benchmarks is considered important from rating perspective.

A highly leveraged capital structure.

Over the period July'22-Sep'23, entity's quantum of debt almost doubled to Rs. 8.2b (FY21: Rs. 4.1b). A significant proportion (93%) of the same consists of short-term borrowings, which have increased over time to finance higher working capital requirements. Additional long-term debt has also been take on a gradual basis to raise funds for solar energy and grid station projects. Consequently, at end-1QFY23, leverage ratio and gearing ratio were reported at elevated levels of 4.0x (FY22: 4.3x, FY21: 3.1x) and 3.4x (FY22: 3.24x, FY21: 2.27), respectively. Going forward, long term debt to the tune of Rs. 650m (from Oct'22 onwards) is expected to be drawn over the next 10-12 months to finance capital expenditure related to the grid station. Hence, sustainable growth in the equity base through profit retention is considered vital to improve leverage indicators.

Corporate Governance Framework depicts room for improvement.

FS is family-owned business that currently has the status of a partnership concern (AoP). In line with that, the Board of Directors also consists of four partners. There is no separate internal audit department in place either. The entity uses an ERP system of Oracle with integrated modules related to production, purchasing, sales, finance, and HR. Over the medium to long-term, conversion of the entity into a private limited company might bode well for the ratings.

Financial Summary	(Rs. *in Millions*)					(Annexure I)
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Property, Plant & Equipment	97	182	170	1,507	2,017	2,482	2,536
Long-term deposits	10	-	-	-	-	78	-
Stock in Trade	1,098	1,021	381	854	882	2,234	2,650
Trade Debts	397	532	1,300	3,798	5,024	7,539	7,275
Cash & Bank Balances	13	15	11	26	53	208	62
Other Assets	314	688	901	585	383	349	613
Total Assets	1,929	2,439	2,762	6,770	8,360	12,889	13,135
Trade and Other Payables	268	325	477	868	1,436	2,290	1,472
Short Term Borrowings	1,199	743	798	3,234	3,856	6,915	7,645
Long-Term Borrowings *(Inc. current matur)*	1	-	28	-	261	429	527
Total Liabilities	1,468	1,068	1,303	4,102	5,553	9,634	9,645
Total Debt	1,200	743	826	3,234	4,117	7,344	8,172
Equity	461	1,371	1,459	1,574	1,814	2,263	2,415
INCOME STATEMENT							
Net Sales	5,525	5,655	4,348	7,437	12,482	24,126	5,715
Gross Profit	298	357	303	761	1,067	1,710	545
Operating Profit	191	273	229	582	803	1,441	478
Profit Before Tax	154	207	173	313	504	835	158
Profit After Tax	154	207	173	147	317	533	101
RATIO ANALYSIS							
Gross Margin (%)	5.4%	6.3%	7.0%	10.2%	8.5%	7.1%	9.5%
Net Margin (%)	2.8%	3.7%	4.0%	2.0%	2.5%	2.2%	1.8%
FFO	53	111	131	285	649	780	163
FFO to Long-Term Debt	4681%	NA	466%	NA	248%	182%	123%
FFO to Total Debt	4.4%	14.9%	15.8%	8.8%	15.8%	10.6%	8.0%
Debt Servicing Coverage Ratio (x)		2.66	3.35	2.39	3.17	2.33	1.38
ROAA (%)	8.0%	9.5%	6.7%	3.1%	4.2%	5.0%	3.1%
ROAE (%)	33.4%	22.6%	12.3%	9.7%	18.7%	26.1%	17.2%
Gearing (x)	2.60	0.54	0.57	2.05	2.27	3.24	3.38
Debt Leverage (x)	3.18	0.78	0.89	2.61	3.06	4.26	3.99
Current Ratio (x)	1.24	1.96	1.85	1.28	1.19	1.12	1.16
Inventory + Receivables/Short-term Borrowings	1.25	2.09	2.11	1.44	1.53	1.41	1.30
No. of days inventory outstanding	77	70	34	47	28	36	47
No. of days receivable outstanding	26	34	109	186	147	114	116
No. of days payable outstanding	16	20	40	44	44	34	22
CCC	87	85	103	189	131	116	140

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	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.
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. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.
Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
01/31/2023	BBB+	A-2	Stable	Reaffirmed
01/10/2022	BBB+	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Faizan Bhagani	Director	January 09, 2023
Mr. Muhammad Mustafa	Senior Manager Audit & Finance	
Mr. Yasir Iqbal	Senior Manager ERP & Finance	
Mr. Shahreyar Mushtaq	Manager Finance	