RATING REPORT

Faizan Steel

REPORT DATE:
February 15, 2024

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**BBB+/A-2**	**BBB+/A-2**
Rating Date	*February 15, 2024*	*March 31, 2023*
Rating Outlook	Stable	Rating Watch - Developing
Rating Action	Maintained	Maintained

COMPANY INFORMATION	
Incorporated in 1997	**External auditors:** Reanda Haroon Zakaria & Company Chartered Accountants
Partmership Firm	**Chairman of the Board:** Mr. Asif Bhagani
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Faizan Bhagani
Mr. Mansoor Bhagani – 30%	
Mr. Asif Bhagani – 25%	
Mr. Faizan Bhagani – 20%	
Mr. Waseem Bhagani – 15%	
Ms. Fahmeeda Abdul Wahid – 5%	
Mrs. Najma Muhammad Usman – 5%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates: https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: https://docs.vis.com.pk/docs/VISRatingScales.pdf

Faizan Steels

OVERVIEW OF THE INSTITUTION	RATNG RATIONALE

__Faizan Steel__ 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.

Company Profile:

Faizan Steel ('FS' or 'the Firm') is a partnership concern, engaged in the manufacturing and sale of steel bars. The Firm's manufacturing plant is located at S.I.T.E area, Karachi and is equipped with a fully automatic direct steel re-rolling mill, a high-end melt shop, and a 230 ft. cooling bed. FS has an integrated setup in place, where shredded scrap is used to manufacture steel billets, and is then directly converted into bars. FS's product range includes Premium bars, Seismic bars, Optimum bars, Heavy Duty bar and C-bar.

Key Rating Drivers:

High due to exposure to cyclicality and competition in the long steel sector.

VIS considers the business risk within long steel industry to be 'High'. In FY23, the country's economic landscape was constrained with various factors, including supply disruptions linked to the repercussions from the floods in the 1HFY23, surging inflation, the depreciation of the local currency, and dwindling foreign exchange reserves. Seeking to stabilize the economy, the State Bank of Pakistan raised interest rates, while the government introduced measures such as import restrictions, energy price hikes, and increase in corporate taxes. Resultantly, these fiscal and monetary actions inadvertently disrupted supply chains, leading to a significant contraction of GDP to 0.29% in FY23, a sharp decline from the 5.7% growth reported in FY22. The market size was notably reduced due to the contraction in construction activities in the country.

Moreover, the long steel sector in Pakistan is highly fragmented and intensely competitive, hosting more than 300 melting and re-rolling mills. However, only a handful of companies are considered top-tier players, with FS being one of them. The Pakistan Association of Large Steel Producers (PALSP) comprises approximately 52 members, collectively controlling about 70% of primary steel production in the country. Nevertheless, FS, along with other players, faced challenges in maintaining high-capacity utilization evident from the decline in the rebar production capacity from 55.5% in FY22 to 33.5% in FY23, underscoring subdued demand in the sector.

While the high steel prices somewhat mitigated the impact of reduced capacity utilization on revenue, the sector witnessed a significant decline in profitability. The industry's gross margins were squeezed by high input costs, and elevated finance costs further constrained the bottom line. The spike in finance costs was attributed to the heightened interbank rates during the year.

However, due to these factors persisting in the country many of the smaller players have exited the industry, providing larger players with greater pricing power. This has allowed these players, especially FS, to retain their margins despite volumetric decline in sales.

Topline and gross margin increased on the back of higher sales price; however, net margin remained constrained due to higher financial charges.

The Firm, despite the demand constraints in FY23, reported a 14.7% growth in its topline, characterized by 1.2% (FY22: 2.8%) sale of billets and 98.7% (FY22: 97.2%) sale of deformed bars.

This growth in the topline is primarily attributable to the increase in selling price per metric ton, successfully passing on the impact of rising input costs to the customers. Moreover, this rising trend in the sales is also witnessed in FS's 1HFY24.

Supported by inventory gains resulting from the prior year's buildup of raw materials and increasing prices of finished goods in FY23, the Firm improved its gross margins to 9.7% (FY22: 7.1%) in the period under review. This trend persisted in 1HFY24, with reported gross margins reaching 11.6% during the period. However, this did not lead to higher net margins as they were constrained by escalating financial costs, attributed to an 825-bps increase in local policy rates during the year. Net margins were reported at 2.0% in FY23 (FY22: 2.2%), remaining relatively steady at 1.9% in 1HFY24.

Capitalization profile has continued to remain elevated.

Over the years, the Firm's capitalization metrics have consistently remained elevated, with a 5-year average gearing and leverage of 2.0x and 2.8x, respectively. In more recent years, there has been further deterioration in the gearing ratio reported at 3.3x (FY23: 3.0x, FY22: 3.2x) and leverage ratios improved to 3.8x (FY23: 4.0x, FY22: 4.3x), respectively, in 1HFY24. This deterioration in the gearing is attributed to a significant increase in short-term borrowings in FY23, driven by expanded operations and higher working capital requirements. Short-term debt utilization has remained high to navigate the challenging economic landscape in FY23, continuing into 1HFY24.

Adequate liquidity and coverage profiles.

The Firm has historically maintained an adequate liquidity profile with a 5-Year average current ratio of 1.3x. However, in recent years the current ratio has shown deteriorating trend from 1.8x in FY19 to 1.1x (FY23: 1.1x, FY22: 1.1x) in 1HFY24.

Similarly, the Firm has sustained a healthy coverage profile, however, with the increasing finance burden, the debt service coverage ratio (DSCR) eroded to 1.3x (FY23: 1.4x, FY22: 1.9x, FY21: 2.7x, FY20: 2.1x) in 1HFY24. Nevertheless, both metrics continue to be commensurate with assigned ratings.

Considerations for future reviews.

Going forward, ratings will remain sensitive to the Firm's ability to improve its capitalization profile and maintain its other key financial metrics in line with assigned ratings.

Faizan Steel **Appendix I**

REGULATORY DISCLOSURES

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

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
01/31/2024	BBB+	A-2	Stable	Mainatined
03/31/2023	BBB+	A-2	Rating Watch - Developing	Maintained
01/31/2023	BBB+	A-2	Stable	Reaffirmed
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.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1.	Mr. Faizan Bhagani	Partner/Director	16th January,2024
2.	Mr. Muhammad Mustafa	Manager – Finance & Audit	
3.	Mr. Yasir Iqbal	Manager – Finance & Audit	