RATING REPORT

Naveena Steel Mills (Pvt.) Limited

REPORT DATE:
July 25, 2023

RATING ANALYSTS:
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Rating Details	
Long-Term Rating	**A-**
Short-term Rating	**A-2**
Rating Action	Initial
Rating Outlook	*Stable*
Rating Date (Entity)	July 25, 2023

COMPANY INFORMATION	
Incorporated in 2017	**External auditors:**
Private Limited Company	**Chairman of the Board:** Mr. Asif Riaz
Key Shareholders:	**Chief Executive Officer:** Mr. Saqib Riaz
Naveena Group (Pvt.) Limited – 99.99%	**External Auditors:** Ibrahim Shaikh & Co. (Chartered Accountants)

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (May 2023): ***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***

Naveena Steel Mills (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Naveena Steel Mills (Pvt.) Limited was incorporated in 2017 as a private limited company. It is a wholly owned subsidiary of Naveena Group (Pvt.) Limited. Principal activity of the company is manufacturing and sale of steel bars and billets. Registered office and production plant are Based in Karachi.

Profile of the CEO:

Mr. Saqib Riaz has a graduate degree in Commerce and has completed various business courses at an international level. In addition to this role, he is the Managing Director of Naveena Group and holds memberships of different corporate bodies, such as Pakistan Business Council and Pakistan Textile Council. Moreover, he also serves as the Chairman of Pakistan Association of Large Steel Producers (PALSP).

RATING RATIONALE

Incorporated in 2017, Naveena Steel Mills (Pvt.) Limited (NSML) commenced operations as a greenfield project employing technologically advanced steel melting and rerolling mill. It is a wholly owned subsidiary of Naveena Group (Pvt.) Limited, with the group having exposure in the textile, energy and construction sectors. Registered office and plant of the company are located at Shahrah-e-Faisal and Port Qasim, Karachi respectively. Sponsors of the group have the diverse experience, spanning over three decades, of managing the businesses mentioned in the table below:

Group Companies
Naveena Group (Pvt.) Limited
Naveena Exports Limited
Naveen Steel Mills (Pvt.) Limited
Naveena Developers (Pvt.) Limited
Naveena Capital (Pvt.) Limited
Lakeside Energy (Pvt.) Limited

<u>Characteristics of the Production Plant</u>

NSML uses Direct Rolling Technology whereby billet manufactured from the Continuous Casting Machine (CCM) comes directly to rolling mill via Direct Charging ROT. With the aid of induction heater, the billet temperature is increased without emission of toxic gases. The rolling mill is based on the latest European technology. The mill operation is automated so that heat energy is conserved, manual labor is reduced and the capital cost is optimized. The technology of direct rolling and induction heater provides the following benefits to the company:

- Enormous savings in energy consumption and thus Green House Gas (GHG) emissions.
- Savings in scale losses which would have been burnt in the billet reheating furnace.
- Improve product yield by reduction in wastage.
- Low capital investment and maintenance costs associated with the induction heater as they are compact in size and comparatively more energy efficient against reheating furnace.

The installed mill also complies to environmental standards as depicted from the following:

- The fumes from the furnace are collected, cooled and cleaned through a Primary and Secondary Fume Extraction and Dedusting Plant.

- The liquids discharged from the plant are treated in a waste water treatment plant within the plant premises. The water from the treatment plant is recycled and used for cooling and horticulture purposes.
- The Company is compliant with the requirement of and has a valid NOC from the Sindh Environmental Protection Agency (SEPA).

Particulars	FY 21	FY 22
Production Capacity (in MT)		
Re-rolling	270,000	270,000
Melting (Equivalent Rebar)	180,000	180,000
Actual Production (in MT)		
Rebars	114,833	169,215
Capacity Utilization (in %)		
In terms of Re-rolling Capacity	43%	63%
In terms of Melting Capacity	64%	94%

At end-June'22, production plant of the company has rerolling capacity (rebars) of 270,000 MT per annum, for which 67% (180,000 MT) of the required melting capacity is available in-house. Current expansion in the melting capacity (with the installation of a third furnace with capacity of 90,000 MT), which is expected to be completed in the ongoing year FY24, will result in completely in-house billet making capability. Total cost of this expansion was estimated at Rs. 1.8b which was financed by a mix of debt (mainly TERF) and internal cash generation.

With post-COVID growth in demand during FY22, capacity utilization levels of the company have improved with the same reported at 63% (FY21: 43%) of Re-rolling capacity i.e., at 94% of the Melting Capacity (FY21: 63%). However, due to a slowdown in the economy being a function of inflationary pressures and resultant fall in demand, production plant operated at around two-third of the available Melting capacity in the 9MFY23.

Power requirement of the plant is met via a 40 MW connection from K-Electric, which is sufficient to meet the power requirements of the Company (including expansion via third furnace project).

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

Business risk for the 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 the UK. Shredded scrap prices peaked at around $600/MT in March'22, but then followed a downward trend until Dec'22. Research indicates that in 2023, demand in Europe is expected to continue to shrink due to the recession, high energy costs, and reduced consumer confidence, while demand in China is expected to remain flat. In view of the economic slowdown in developed nations and potential supply chain disruptions caused by the Russia-Ukraine conflict, global outlook for the sector subdued.

Duty structure for the imported raw material in Pakistan consists of 2% Additional Custom Duty, 5% Regulatory Duty, 18% Sales Tax, 2% Income Tax, and 1.25% ETO Cess. With inflationary pressures affecting the consumer purchasing power, recent floods in Sindh and lower Punjab along with the economic/political uncertainty, a noticeable reduction in infrastructure development projects has been observed during FY23 impacting demand from steel manufacturing businesses during the year, with all players operating at reduced capacity. Furthermore, pressure on foreign reserves of the country has caused raw material constraints owing to the restrictions imposed on the opening of LCs by the State Bank of Pakistan (SBP).

Topline growth in FY22 a determinant of both higher sales volumes and average selling prices. However, dip in topline seen in 3QFY23 owing to lower demand.

Revenue of the company almost doubled in FY22 and was reported at Rs. 26.4b (FY21: Rs. 13b) due to the rise in construction activities provided by favorable government policies and economic recovery post COVID-19. Sales volumes in FY22 went up by 40% and average selling price increased by 44% in the same period. However, during 9MFY23, the company reported lower revenue as compared to the same period last year due to overall demand contraction, exhibiting a decline of about 15.2% YoY. Going forward, management envisages expanding its market share in the Punjab region for which a sales office in Multan has been established, while one will be opened in Lahore soon. Meeting projected revenue targets will be important from a ratings perspective.

With economies of scale post commencement of plant along with higher sales prices, gross and margins of the company increased slightly in FY22. Further comfort is drawn from tax credit availed. However, net margins came under pressure in 9MFY23 due to currency devaluation and higher finance cost.

Gross margins of NSML were reported at 11.6% (FY21: 11.1%) in FY22 due to economies of scale and higher average selling prices. Even though the average price of scrap rose by 51% in FY22 vis-à-vis FY21, the company was able to successfully pass on major impact of higher input costs to its customers. Operating expenses rose in line with sales revenue; while finance cost increased significantly because of a higher quantum of debt and rising interest rates. Despite escalated finance costs, net margins improved to 5.2% (FY21: 4.8%) in FY22. Bottom-line was also supported by lower tax charge due to tax credit availed. The Company is formed through investment of 76.72% owned equity by issuance of equity shares against cash consideration. Therefore, the Company is eligible to claim Tax Credit provided in prevalent section 65D of the Income Tax Ordinance 2001.

During 9MFY23, gross margins increased to 13.9% as higher costs were passed on to customers, however, net margins were squeezed to 2.4% due to elevated finance charges as policy rates rose notably. Going forward, improvement in profitability profile will be important.

Pressure on liquidity indicators in 3QFY23

Funds From Operations (FFO) of the company improved in FY22 in line with higher profit generation. Consequently, FFO coverage to total and long-term debt were reported at satisfactory levels of 18% (FY21: 15%) and 51% (FY21: 42%), respectively at end-June'22. Owing to increase in finance charges paid, Debt Serving Coverage Ratio (DSCR) was reported lower at 2.8x (FY21: 4.2x) at end-June'22. Given further rise in finance cost and subdued cash flows during 3QFY23, DSCR further weakened to 1.1x. Although declining, stock in trade and trade debts provided sufficient coverage against short-term borrowings. Working capital cycle of the company is seen to extend on a timeline basis largely on account of higher finished goods inventory levels due to suppressed demand. To finance the same, short-term debt levels have risen on a timeline basis. Going forward, improvement in company's overall profitability is considered vital to reduce pressure on liquidity profile.

Increase in leverage indicators in 3QFY23 on the account of lower equity base and timeline increase in debt levels.

Equity base of the company increased to Rs. 10.3b (FY22: Rs. 9.9b, FY21: Rs. 8.6b) at end-March'23 owing to greater profit retention. Quantum of debt has also risen on a timeline basis to finance expansion plans and working capital needs. Leverage and gearing both remained relatively stable at 1.19x (FY22: 1.17x, FY21: 0.91x) and 0.91x (FY22: 0.92x, FY21: 0.70x) at end-March'23, respectively, as increase in equity approximately offset uptick in debt levels. Although no further major drawdown of long-term debt is planned over the rating horizon, escalated working capital needs may further pressure the capitalization profile of the company.

REGULATORY DISCLOSURES	Appendix I
Name of Rated Entity	Naveena Steel Mills (Pvt.) Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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.
Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
25-July-23	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. M. Anwar Kamal	Director Sales & Marketing	December 09, 2022
Mr. Mirza Taimur Ali Baig	CFO	December 09, 2022
Mr. Waqar Haider	Manager Finance	December 09, 2022