



The Pakistan Credit Rating Agency Limited

Rating Report

Usman Steels (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
21-Jan-2022	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Incorporated in April 1978, Usman Steels Private Limited is engaged in the business of ship breaking. The Company's site spread over four ship breaking yards, all around costal line of Gaddani Beach, District Lasbella, Balochistan. Usman Steels purchases ships directly from ship owners or through Ship brokers for recycling, to retrieve multipurpose ship steel plates and steel scrap to fulfill rapidly increasing steel raw material demand in domestic market. The South-Asian ship-breaking industry, including India, Bangladesh, Pakistan and Turkey, are countries where majority of the ship-breaking activity has been happening. Among all Pakistan ship-breaking yards hold advantages of having favorable geography and weather, cheap manpower making it preferred destination for ship-breaking activities. The ratings are largely supported by the long-standing experience of the group in diversified sectors and company's sponsor's, who have nearly three decades of experience in the ship breaking business. The Company's operations and profitability are highly exposed to the fluctuations in ship prices along with exchange rates and are dependent on prevailing scrap prices, which could result in poor realisations, irrespective of the availability of improved quality of vessels in the market. The ratings take into account, high financing requirement for procurement of ship along with availability of unserviceable ships in international market and its continued presence in the Company. The ratings reflect Company's medium-scale operations, as highlighted by revenue of PKR 4.7bln in 9MCY21 (CY20: PKR 3.5bln). The increase in revenue is mainly driven by rising demand of steel in the local market along with increased prices. A growth in steel demand can be interlinked with construction activities in Pakistan. The company's net working capital cycle increased to negative 319 days in 9MCY21 (CY20: 298 days) owing to reduced payable days, which is evident from increased short-term borrowings (9MCY21: ~PKR 4.6bln, CY20: PKR 3.5bln). Company has taken a short-term borrowing line of ~PKR 6.5bln including, funded and non-funded credit facilities against charge on current assets of the company.

Any decline in the scale of operations, negatively affecting the liquidity profile and financial matrices, would remain critical for the ratings. A substantial improvement in the revenue, profitability, along with improved compliance with regulatory framework will bode well.

Disclosure

Name of Rated Entity	Usman Steels (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Shipping(Jun-21)
Rating Analysts	Bazah Tul Qamar bazahtul.qamar@pacra.com +92-42-35869504

Profile

Legal Structure Usman Steels (Pvt.) Limited ('Usman Steels' or 'the Company') was incorporated in April, 1978 as a Private Limited Company. The Company's site spread over four ship breaking yards, all around costal line of Gaddani Beach, District Lasbella, Balochistan.

Background Ship Breaking in Pakistan started in 1947 at Gadani. Gadani is a village of Lasbela district located in the southern part of Baluchistan along the Arabian Sea. Pakistan. Gadani Ship breaking yard contain 128 ship breaking lots and the annual capacity of ship breaking is more than 150 ships of all sizes. This Industry was active in the era of 1970-1980 and became the world more efficient industry. But its performance become very low when high tax imposed in 1997 and that's why the competitors grow more and more and Pakistan become the least efficient. And revival of this industry started again in 2012.

Operations The Company was established with the objective of importing unserviceable Vessels exclusively for the purpose of breaking and to retrieve multipurpose steel scrape in general and ship steel plates in particular to fulfill rapidly increasing steel raw material demand in domestic market.

Ownership

Ownership Structure The Company's major ownership resides with the family of Mr. Ikhlq Memon. The major stake with Mr. Ikhlq Memon (61%). The remaining stake resides with Mr. Usman (33%), Ms. Salma Ikhlq (3%) and Mr. Ishaq (3%).

Stability The Company is completely owned by the sponsoring family. The Company's succession plan is not formally documented indicating low stability of the ownership structure.

Business Acumen The sponsors have been involved in multiple businesses in edible oil, textile, ship breaking, and automobiles. Mr. Ikhlq Memon, the CEO of the Company and Maple Development (Pvt.) Limited, over 30 years of experience in the Ship breaking and Real Estate Sectors. He also holds the position of Chairman of Pakistan Ship Breaking Association (P.S.B.A).

Financial Strength The sponsors hold sufficient net worth to support the Company in times of distress. Furthermore, sponsors also benefit from multiple ventures and companies that provide substantial strength.

Governance

Board Structure The Company's BoD comprises three Executive Directors. All three directors are from the sponsoring family. Lack of independent oversight and diversity indicates a room for improvement

Members' Profile Mr. Muhammed Ikhlq Memon is the Chief Executive Officer of M/s. Usman Steels (Pvt.) Ltd. He is a successful entrepreneur having an excellent understanding of ship breaking, land development, construction of high-rise tower, import, export and different manufacturing sectors. Mr. Usman, the Director of Pakistan Oil Mills (Pvt.) Limited, and has been associated with the Company for over 3 decades.

Board Effectiveness The Board lacks formal sub-committees. During CY20, there were 4 meetings and attendance remained full. The minutes of Board meetings are adequately documented.

Financial Transparency The external auditors of the Company, Shah and Co. Chartered Accountants, have expressed an unqualified opinion on the financial statements of the Company for the year ended Dec-20. The firm is neither QCR rated nor in SBP's panel of auditors.

Management

Organizational Structure The organizational structure has been optimized as per the operational needs. The Company operates through four functions: Production, Finance, Sales & Marketing, and Procurement.

Management Team Mr. Muhammed Usman is the Director of M/s Pakistan Oil Mills (Pvt.) Limited and M/s. Usman Steels (Pvt.) Ltd. He is a distinguished entrepreneur and good experience in the businesses of import, exports, real estate, land development and different Manufacturing sectors. In addition, he has also good understanding about investment banking and derivative market. He is delivering with the company since

Effectiveness There are no management committees in place. Management meets on need basis to ensure efficiency of the Company's operations.

MIS The Company has no formally installed software. Reports are prepared on need-basis for the management and Directors. The most common report prepared is stock report showing the ships in hand, with respect to their weight, rate and amount.

Control Environment To ensure operational efficiency, the Company has setup an internal audit function, which implements and monitors the policies and procedures of the Company.

Business Risk

Industry Dynamics This industry is much wider as 1000 ships are breaking down per year around the globe. And the dismantling includes all kinds of ships i.e., passenger ships, bulkers, container ships etc. to recover steel which is used in many other things. The countries which work in this industry are US, Canada, Denmark, Turkey, Pakistan, Belgium, Denmark, India, Mexico, Bangladesh, China, and UK. Gadani Ship breaking yard contain 128 ship breaking lots and the annual capacity of ship breaking is more than 150 ships of all sizes. This Industry was active in the era of 1970-1980 and became the world more efficient industry. But its performance become very low when high tax imposed in 1997 and that's why the competitors grow more and more and Pakistan become the least efficient. And revival of this industry started again in 2012

Relative Position M/s Usman Steel (Pvt) Ltd is a leading company in ship breaking industry, and contributing much need economic value in overall macro economy of the country, and also source of bread earning for thousands of workers, both skilled and unskilled.

Revenues Usman Steel witnessed the growth of 73% while generating a turnover of PKR ~4,772mln during 9MCY21, against 3,587mln in CY20. This increase is due to rising demand of steel in the local market along with increased prices. A growth in steel demand can be interlinked with construction activities in Pakistan.

Margins Gross profit margins of the company, likewise increased in 9MCY21, standing at ~19.3% (CY20: ~18.5%). This is mainly due to relatively higher off take of steel plates in local market. As in previous year due to the impacts of COVID-19, construction activities were slowed down, while the fixed cost was still there. However, as the things settled more margins showed a further upward movement.

Sustainability Since Steel prices are going up in the market, on the other hand ship prices are also soaring up. Company is on the outlook of buying more ships. This year seven ships already purchased and beached. Recently company beached a big ship weighing 40,914 LDT in the month of July. A lot emphasis of present Government is on housing and construction industry resulting in increase in demand of steel.

Financial Risk

Working Capital Company's Working capital requirement is majorly fulfilled by a mix of internal cashflows and short-term borrowing lines. Sales are on cash and credit. For cash sale discount is given whereas for credit sales 10 to 20 days are allowed for payment depending on the volume. Company has taken a short-term borrowing line from a single bank.

Coverages During 9MCY21, coverages of the company remained strong owing to an increase in FCFO's. this increase is mainly attributable to the rise in profits because of volumetric and price increase in Sales. During 9MCY21 interest coverage ratio stood at 10.2x as compared to 4x in CY20.

Capitalization Usman Steel has the moderately-leveraged capital structure, with debt equity ratio of ~69.5% in 9MCY21. The Company has no long-term borrowings on its book.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Usman Steels Private Limited Ship Breaking	Sep-21	Dec-20	Dec-19	Dec-18
	9M	12M	12M	12M

A BALANCE SHEET

1 Non-Current Assets	77	73	79	40
2 Investments	-	-	-	-
3 Related Party Exposure	175	63	88	36
4 Current Assets	7,284	5,033	3,213	4,677
<i>a Inventories</i>	5,364	4,615	1,547	4,230
<i>b Trade Receivables</i>	944	198	487	220
5 Total Assets	7,535	5,170	3,380	4,753
6 Current Liabilities	223	227	680	192
<i>a Trade Payables</i>	0	-	497	5
7 Borrowings	4,639	3,551	1,635	3,814
8 Related Party Exposure	447	15	32	35
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	2,227	1,377	1,032	712
11 Shareholders' Equity	2,227	1,377	1,032	712

B INCOME STATEMENT

1 Sales	4,772	3,587	4,086	4,705
<i>a Cost of Good Sold</i>	(3,849)	(2,924)	(3,220)	(4,081)
2 Gross Profit	922	663	865	625
<i>a Operating Expenses</i>	(73)	(63)	(40)	(53)
3 Operating Profit	849	600	826	571
<i>a Non Operating Income or (Expense)</i>	35	(35)	-	-
4 Profit or (Loss) before Interest and Tax	883	565	826	571
<i>a Total Finance Cost</i>	(89)	(100)	(472)	(201)
<i>b Taxation</i>	(206)	(121)	(117)	(147)
6 Net Income Or (Loss)	589	345	237	224

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	909	393	817	305
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	909	393	345	284
<i>c Changes in Working Capital</i>	(1,026)	(2,649)	2,174	(2,046)
1 Net Cash provided by Operating Activities	(117)	(2,256)	2,519	(1,762)
2 Net Cash (Used in) or Available From Investing Activities	(119)	25	(14)	(21)
3 Net Cash (Used in) or Available From Financing Activities	1,228	1,893	(2,181)	150
4 Net Cash generated or (Used) during the period	992	(337)	324	(1,633)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	77.3%	-12.2%	-13.2%	--
<i>b Gross Profit Margin</i>	19.3%	18.5%	21.2%	13.3%
<i>c Net Profit Margin</i>	12.3%	9.6%	5.8%	4.8%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	-2.5%	-62.9%	73.2%	-37.0%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]</i>	43.5%	28.6%	27.1%	31.5%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	319	348	548	17
<i>b Net Working Capital (Average Days)</i>	319	298	525	17
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	32.7	22.2	4.7	24.4
3 Coverages				
<i>a EBITDA / Finance Cost</i>	10.2	4.7	1.8	2.0
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	10.2	3.9	1.7	1.5
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.4	0.0	0.1	0.3
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	69.5%	72.1%	61.8%	84.4%
<i>b Interest or Markup Payable (Days)</i>	0.0	0.0	0.0	0.0
<i>c Entity Average Borrowing Rate</i>	3.2%	3.8%	17.1%	5.2%

Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
AA-	
A+	
A	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
A-	
BBB+	
BBB	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BBB-	
BB+	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
BB	
BB-	
B+	
B	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
B-	
CCC	
CC	Very high credit risk. Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
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- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
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- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

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