The Pakistan Credit Rating Agency Limited

Rating Report

Etihad Alloys (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Nov-2022	BBB-	A3	Developing	Upgrade	-
16-Nov-2021	BB+	A3	Developing	Initial	-

Rating Rationale and Key Rating Drivers

Etihad Group is setting up a steel industrial unit in Rahim Yar Khan adjacent to its existing Sugar Mill – Etihad Alloys (Pvt.) Limited (EAPL). The unit will have steel melting capacity of 250,000 MT per annum. Primarily, EAPL will be engaged in manufacturing of Steel Billets. The Project is being financed through a mix of debt and equity in the ratio of 80:20. As per the management of EAPL, overall progress of the project is ~62% as of end August-2022.Significant procurement of its Plant and Machinery has been done and the installation work is in progress. Initially, company planned to achieve Commercial Operation Date (COD) by Oct-22. However, due to the lockdown in China owing to resurging of COVID-19, import of EAPL's Plant took approximately six months more time which in turn pushed farther its COD from October 2022 to March 2023. Moreover, due to the delay in COD and continuous devaluation of Pak Rupee against US Dollar, company faced cost overruns to the tune of PKR 1,000 million. However, EAPL has successfully managed to bridge this gap with equal contribution of equity and debt. Technical Associates Pakistan (Pvt.) Ltd is the Civil Contractor of the company. They have vast and proven track record in construction related services. The Company will be maintaining DSRA account providing coverage for three months on its financial obligations till maturity. The company has already executed the PPA with Etihad Power Generation Limited to meet its energy requirements.

The improvement in assigned ratings takes into account the significant work completed towards the construction of complex, though the developing outlook depicts the construction risk. Adding to that, ratings also take comfort from group association and strong sponsors profiles which includes Sugar Mill, Real Estate and Construction Businesses. However, Ratings are dependent on the management's ability to successfully achieve its completion benchmarks and to improve its financial risk profile.

Disclosure

Name of Rated Entity	Etihad Alloys (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Steel(Sep-22)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Profile

Legal Structure Etihad Alloys, a private limited company incorporated in 2021 under the Companies Act 2017, is primarily engaged in manufacturing and sale of high-quality billets

Background Etihad group is establishing a new industrial set up unit in Rahim Yar Khan, Punjab. The setup shall consist of a steel melting unit with billet manufacturing mill with installed capacity of approx. 250,000 tons steel billet per annum). The location of the proposed project is in Rahim Yar Khan adjacent to already installed sugar mill of the group naming Etihad Sugar Mills Limited. The company has acquired 33.5 acres of land area for the installation of steel unit.

Operations EAPL is planning to manufacture steel Billets from scrap. Billet is the basic input material for all value-added steel products. The potential target industry for billet consumers include: i) Wire Rod, ii) Steel Pipes and Tubes, iii) GI Pipes and iv) Rebar Mills which have low melting capacities. EAPL will have strategic edge in producing billet, over its competitors, in shape of availability of cheaper electricity source through its bagasse based captive power plant resulting in lower cost of production and enhanced profitability.

Ownership

Ownership Structure EAPL ownership structure is vested in two parties. Majority stake of 51% is owned by Mr. Muhammad Munir and 49% owned by Etihad Sugar Mills Ltd.

Stability The Company's ownership structure is vested in two parties Etihad sugar mills and Mr. Muhammad Munir. Mr. Muhammad Munir also holds material shareholding in Etihad sugar mills, Etihad Town and Technical Associates. And it bodes well for the stability in the structure.

Business Acumen The sponsors – Chaudhary Muhammad Munir carries experience of successfully managing sugar mill, real estate, hospitality and construction business. The willingness towards the business is evident from the steadfast approach used by the management. Hence, sponsor's business acumen is considered strong.

Financial Strength The sponsors have demonstrated their commitment towards the company by injecting 100% equity in advance. Further the sponsors have contributed about 50% in cost overrun of more than PKR 1,000 million in the project.

Governance

Board Structure The overall control of board only vests in two-member board of directors, both of them are from sponsoring family including the Chairman/CEO, while there are no independent members. Mr. Zahid Jamil holds office of Chief Executive Officer. Mr. Zahid's presence adds significant value to the board on account of his long association, spanning over last four decades, with the industry.

Members' Profile Mr. Zahid Jamil is the CEO of the company. He has on-hand experience in the planning, set-up, erection, deployment & operational exposure at multiple Industrial Projects within the Group; he actively pursues & supervises the procurement activities at all Group Entities and has documented & real time experience of managing plant, equipment & industrial inputs procurement related matters in the Sugar Milling, Medical Equipment, Construction, & Agri Input sectors. Accompanying him on the Board is Mr. Ashfaq Ahmed who has served the banking industry for 23 years and currently associated with the group for over a decade.

Board Effectiveness As the board structure is still developing there are no board committees in place.

Financial Transparency M/s Amir Salman Rizwan, (a member firm of MSI International) is the external auditors of the company. They are listed as a QCR rated CA firm.

Management

Organizational Structure Etihad Alloys, reporting structure is in accordance with the best practices of Code of Corporate Governance. Multi-tier structure includes two senior positions i) COO and ii) Chief Financial Officer. GM operations, Manager Coordination and Planning directly report to COO. Organizational structure will further improve when the company came into commissioning stage.

Management Team Mr. Zahid Jamil is the Chief Executive Officer of the company. Mr. Sakhawat Qureshi is the COO of the company. Previously he has worked as the Chief Engineer at Mughal Steel Industries and General Manager Project at Altuwairqi Group, Saudia Arabia. Mr. Saqib Riaz, FCA is the CFO of the company who has over a decades experience of heading finances and related operations. Previously he has worked as Chief Financial Officer of Nishat (Chunian) Ltd.

Effectiveness Mr. Zahid Jamil-CEO, is supported by team of experienced individuals who are equipped with necessary technical skills.

MIS The company is in process to implement an ERP solution developed by a reputable software house with usual operational modules.

Control Environment The Company is setting up internal control systems and procedures to ensure the quality of goods produced on a continuing basis. These will evolve post achievement of COD.

Business Risk

Industry Dynamics Domestic steel industry has undergone through recent expansion phase. The country's annual steel products' demand hovers around ~13.5mln tons (FY22*). Steel products are broadly classified into long & flat products and tubes & pipes. Almost ~73% of the country's demand is met through local production, while the remaining portion is imported. Moreover, Production of billets was recorded at ~5.3mln MT during 10MFY22 with YoY growth of ~32% (10MFY21: ~4.0mln MT). For the same period H/C.R Sheets (Flat products) production stood at ~2.9mln MT (10MFY21:~2.7mln MT), up ~8% YoY. Regulatory protections in form of increased anti-dumping duties also considered as positive indicator. Whilst, sustained market share, improved business performance and margins are essential for industry players with the flourishing demand in the region.

Relative Position According to the installed capacity of the company and the continuous rise in steel demand, company is set to capture decent share in the market after commissioning based on the projected revenues.

Revenues Based on the industry dynamics and rising demand of the steel company's projected revenues will cross PKR 19bln in first year of commissioning and it will continue to grow at sustainable pace (FY23: 20.486bln, FY24: 21.920bln). Controlled financial cost and operating cost will help the company to book net profit of PKR 278mln in the first year.

Margins Etihad Alloys' projected conservative margins will improve at a slow pace in the upcoming years though will remain in stable position. Projected GP margin will rise to 4.2% in the third year from 3.8% in the first year. The upward trend of scrap prices will impact significantly on the costing structure of the company and give an opportunity to further improvise the profitability.

Sustainability Moving forward, active development on Governmental projects and execution of CPEC projects will contribute to the existing private sector's driven demand. Moreover, Company's geographical diversification to enhance its market share remains vital for the performance.

Financial Risk

Working Capital Etihad Alloys is following a more realistic approach and by following the market trends assuming that in the first year of commissioning net cash cycle will be of 52 days and in the third year it will reduce to 37 days. Furthermore, due to the extended cash cycle days company have to rely on short term borrowings (First year: 2,000mln).

Coverages Like the increase in projected revenues over the years, projected EBITDA will also increase at a stable rate and reach PKR 995mln in the third year from PKR 808 in the first year. Consequently, stagnant in finance costs & enriched FCFO resulted in better coverage (interest: Third year: ~1.4x; Second year: ~1.4x; first year: 1.3).

Capitalization Budgeted Project Cost is being financed through a mix of 80:20 Debt:Equity where the Sponsors have fully injected the Equity in advance. The debt financing is a further mixture of SBP TERF facility and Non-TERF KIBOR based facility from the consortium of UBL and Bank Alfalah Limited. SBP TERF further adds the comfort to the Project being a cheaper finance. Both loans will be repaid in 10 years. Leveraging will be at 71% in third year from 83% in the first year.

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Financial Summary
PKR mln

Etihad Alloys (Pvt.) Ltd	Jun-24	Jun-23	Jun-22	Jun-21
Steel	12M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	2,479	2,578	2,093	574
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	6,810	6,138	385	64
a Inventories	*3,951*	*3,696*	-	-
b Trade Receivables	*2,192*	*2,049*	-	*2*
5 Total Assets	9,289	8,715	2,478	638
6 Current Liabilities	3,860	3,615	209	0
a Trade Payables	*3,860*	*3,615*	*39*	-
7 Borrowings	3,852	3,926	1,732	82
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	1,576	1,173	537	555
11 Shareholders' Equity	1,576	1,173	537	554
B INCOME STATEMENT				
1 Sales	21,920	20,486	-	-
a Cost of Good Sold	*(20,989)*	*(19,661)*	-	-
2 Gross Profit	931	825	-	-
a Operating Expenses	(35)	(32)	(26)	(3)
3 Operating Profit	896	793	(26)	(3)
a Non Operating Income or (Expense)	-	-	*3*	*1*
4 Profit or (Loss) before Interest and Tax	896	793	(23)	(2)
a Total Finance Cost	*(476)*	*(452)*	*(0)*	-
b Taxation	*(17)*	-	*7*	*(574)*
6 Net Income Or (Loss)	403	341	(16)	(576)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*978*	*891*	*(22)*	*(2)*
b Net Cash from Operating Activities before Working Capital Changes	*533*	*465*	*(22)*	*(2)*
c Changes in Working Capital	*(184)*	*(149)*	*(113)*	*(7)*
1 Net Cash provided by Operating Activities	349	316	(134)	(9)
2 Net Cash (Used in) or Available From Investing Activities	-	-	(1,526)	(574)
3 Net Cash (Used in) or Available From Financing Activities	(74)	(92)	1,649	596
4 Net Cash generated or (Used) during the period	275	223	(11)	12
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	7.0%	--	N/A	N/A
b Gross Profit Margin	4.2%	4.0%	N/A	N/A
c Net Profit Margin	1.8%	1.7%	N/A	N/A
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	3.6%	3.6%	N/A	N/A
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	29.3%	39.8%	N/A	N/A
2 Working Capital Management				
a Gross Working Capital (Average Days)	99	102	N/A	N/A
b Net Working Capital (Average Days)	37	70	N/A	N/A
c Current Ratio (Current Assets / Current Liabilities)	1.8	1.7	1.8	145.6
3 Coverages				
a EBITDA / Finance Cost	2.2	2.1	N/A	N/A
b FCFO / Finance Cost+CMLTB+Excess STB	1.4	1.4	N/A	-1.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	2.9	3.9	-80.5	-41.7
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	71.0%	77.0%	76.3%	12.9%
b Interest or Markup Payable (Days)	0.0	0.0	N/A	N/A
c Entity Average Borrowing Rate	11.4%	15.1%	0.0%	0.0%

Credit Rating

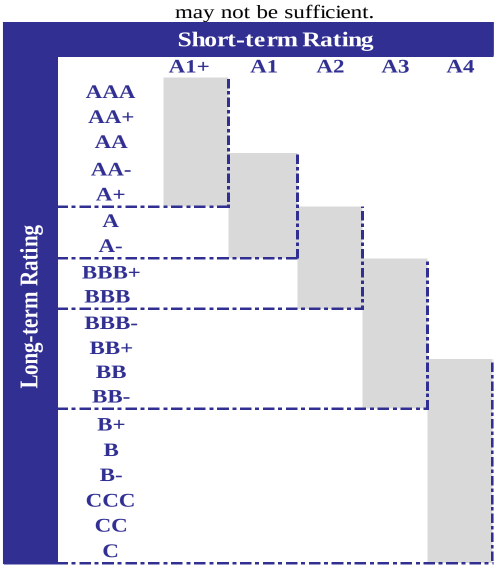
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ 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.
A+ 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.
BBB+ 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.
BB+ BB 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.
B+ 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.
CCC CC C	**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.
D	Obligations are currently in default.

Short-term Rating

Scale	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
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 surveill 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):

Entities
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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(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 | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(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)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(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)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(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)
Proprietary Information