The Pakistan Credit Rating Agency Limited

# Rating Report

## Usman Steels (Pvt.) Limited

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 20-Jan-2023 | BBB | A2 | Stable | Maintain | - |
| 21-Jan-2022 | BBB | A2 | Stable | Initial | - |

**Rating Rationale and Key Rating Drivers**

Incorporated in April 1978, Usman Steels (Pvt.) 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 realizations, irrespective of the availability of improved quality of vessels in the market. Audit for the current year end CY22 is under process. And as per Dec 2021 financial statements company's exposure to banking lines are solely working capital related and pledged against the inventory - ships. There are no long term specific bank borrowings to date therefore credit risk has already been minimized and secured against the available stock. The ratings reflect Company's medium-scale operations, as highlighted by revenue of PKR 10,816mln in CY21 (CY20: PKR 3.5bln). The increase in revenue is mainly driven by rising steel prices along with the increased demand of steel in the local market. 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.

The uncertain economic condition and availability of ships considering limited foreign exchange reserves resulting in decline in the scale of operations, is a concern, which is cushioned by the fact that financing requirement also become low in such times.

| 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-22),Methodology \| Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology \| Rating Modifiers(Jun-22) |
| **Related Research** | Sector Study \| Shipping(Jun-22) |
| **Rating Analysts** | Anam Waqas Ghayour \| anam.waqas@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. Ikhlaq Memon. The major stake with Mr. Ikhlaq Memon (61%). The remaining stake resides with Mr. Usman (33%), Ms. Salma Ikhlaq (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. Ikhlaq 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 Ikhlaq 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 200% while generating a turnover of PKR 10,816mln during CY21, 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, deteriorated in CY21, standing at 13% (CY20: ~18.5%). This is mainly due to relatively higher prices of ships in international market along with the continuous depreciation of Rupee.

**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.

## 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 amounting to PKR 4,22mln.

**Coverages** During CY21, 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 CY21 interest coverage ratio stood at 5.6x as compared to 4x in CY20.

**Capitalization** Usman Steel has the moderately-leveraged capital structure, with debt equity ratio of ~65.9% in CY21. The Company has no long-term borrowings on its book. Additionally, company also loaned ~PKR 979mln to the BoD.

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*Financial Summary*
*PKR mln*

| Usman Steels Private Limited<br>Ship Breaking | Dec-21<br>12M | Dec-20<br>12M | Dec-19<br>12M | Dec-18<br>12M |
|---|---|---|---|---|
| **A BALANCE SHEET** | | | | |
| 1 Non-Current Assets | 89 | 73 | 79 | 40 |
| 2 Investments | - | - | - | - |
| 3 Related Party Exposure | 1,372 | 63 | 88 | 36 |
| 4 Current Assets | 6,417 | 5,033 | 3,213 | 4,677 |
| *a Inventories* | *4,285* | *4,615* | *1,547* | *4,230* |
| *b Trade Receivables* | *1,230* | *198* | *487* | *220* |
| **5 Total Assets** | 7,879 | 5,170 | 3,380 | 4,753 |
| 6 Current Liabilities | 475 | 227 | 680 | 192 |
| *a Trade Payables* | *3* | - | *497* | *5* |
| 7 Borrowings | 4,522 | 3,551 | 1,635 | 3,814 |
| 8 Related Party Exposure | 357 | 15 | 32 | 35 |
| 9 Non-Current Liabilities | - | - | - | - |
| **10 Net Assets** | 2,524 | 1,377 | 1,032 | 712 |
| **11 Shareholders' Equity** | 2,524 | 1,377 | 1,032 | 712 |
| **B INCOME STATEMENT** | | | | |
| **1 Sales** | 10,816 | 3,587 | 4,086 | 4,705 |
| *a Cost of Good Sold* | *(9,414)* | *(2,924)* | *(3,220)* | *(4,081)* |
| **2 Gross Profit** | 1,402 | 663 | 865 | 625 |
| *a Operating Expenses* | (58) | (63) | (40) | (53) |
| **3 Operating Profit** | 1,344 | 600 | 826 | 571 |
| *a Non Operating Income or (Expense)* | *312* | *(35)* | - | - |
| **4 Profit or (Loss) before Interest and Tax** | 1,656 | 565 | 826 | 571 |
| *a Total Finance Cost* | *(252)* | *(100)* | *(472)* | *(201)* |
| *b Taxation* | *(408)* | *(121)* | *(117)* | *(147)* |
| **6 Net Income Or (Loss)** | 996 | 345 | 237 | 224 |
| **C CASH FLOW STATEMENT** | | | | |
| *a Free Cash Flows from Operations (FCFO)* | *1,404* | *393* | *817* | *305* |
| *b Net Cash from Operating Activities before Working Capital Changes* | *1,404* | *393* | *345* | *284* |
| *c Changes in Working Capital* | - | *(2,649)* | *2,174* | *(2,046)* |
| **1 Net Cash provided by Operating Activities** | 1,404 | (2,256) | 2,519 | (1,762) |
| **2 Net Cash (Used in) or Available From Investing Activities** | - | 25 | (14) | (21) |
| **3 Net Cash (Used in) or Available From Financing Activities** | - | 1,893 | (2,181) | 150 |
| **4 Net Cash generated or (Used) during the period** | 1,404 | (337) | 324 | (1,633) |
| **D RATIO ANALYSIS** | | | | |
| **1 Performance** | | | | |
| *a Sales Growth (for the period)* | 201.5% | -12.2% | -13.2% | -- |
| *b Gross Profit Margin* | 13.0% | 18.5% | 21.2% | 13.3% |
| *c Net Profit Margin* | 9.2% | 9.6% | 5.8% | 4.8% |
| *d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)* | 13.0% | -62.9% | 73.2% | -37.0% |
| *e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sh* | 51.1% | 28.6% | 27.1% | 31.5% |
| **2 Working Capital Management** | | | | |
| *a Gross Working Capital (Average Days)* | 174 | 348 | 548 | 17 |
| *b Net Working Capital (Average Days)* | 174 | 298 | 525 | 17 |
| *c Current Ratio (Current Assets / Current Liabilities)* | 13.5 | 22.2 | 4.7 | 24.4 |
| **3 Coverages** | | | | |
| *a EBITDA / Finance Cost* | 5.6 | 4.7 | 1.8 | 2.0 |
| *b FCFO / Finance Cost+CMLTB+Excess STB* | 5.6 | 3.9 | 1.7 | 1.5 |
| *c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)* | 0.3 | 0.0 | 0.1 | 0.3 |
| **4 Capital Structure** | | | | |
| *a Total Borrowings / (Total Borrowings+Shareholders' Equity)* | 65.9% | 72.1% | 61.8% | 84.4% |
| *b Interest or Markup Payable (Days)* | 126.4 | 0.0 | 0.0 | 0.0 |
| *c Entity Average Borrowing Rate* | 6.3% | 3.8% | 17.1% | 5.2% |

## Credit Rating

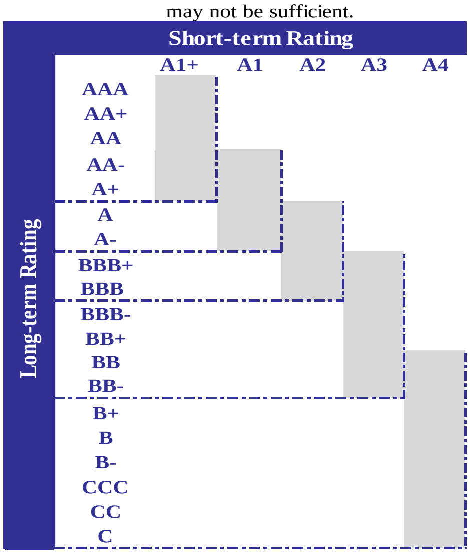
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

**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+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies 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**