

RATING REPORT

Data Steel Pipes Industries (Pvt.) Limited

REPORT DATE:

October 24, 2017

RATING ANALYSTS:

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RATING DETAILS

	Initial Rating	
	Long-term	Short-term
Rating Category		
Entity	BBB	A-3
Rating Outlook	Stable	
Rating Date	October 24, 2017	

COMPANY INFORMATION

Incorporated in 1993	External auditors: Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants
	Chairman and Chief Executive Officer: Mr. Sarfaraz Khan
Key Shareholders (with stake 5% or more):	
Mr. Sarfaraz Khan (43%)	
Mr. Shehzad Khan (34%)	
Mr. Shahnawaz Khan (11%)	
Aventus Pvt. Ltd (12%)	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) <http://www.jcrvis.com.pk/kc-meth.aspx>

Data Steel Pipes Industries (Pvt.) Limited

OVERVIEW OF
THE
INSTITUTION

Data Steel Pipe Industries (Pvt.) Limited was incorporated in Karachi as a private limited company on November 24, 1993 under the Companies Ordinance 1984. The principal business of the company is to manufacture and sell spiral seam welded steel pipes.

Profile of Chairman & CEO

Mr. Sarfaraz Khan spearheads the company as the Chairman/Chief Executive of the firm. Mr. Khan has completed his educational qualifications from London School of Economics and North Western University in the field of Industrial engineering and management sciences. He has been associated with the company since its inception.

RATING RATIONALE

In terms of installed capacity, Data Steel Pipe Industries (Pvt.) Limited (DSPIL) is amongst the leading manufacturers of large diameter high pressure carbon steel line pipes and applicator of multi-layer polyolefin/single layer fusion bonded epoxy coatings in the country. The company has two main plants comprising the pipe mill and coating plant which includes equipment meeting international standard requirements. The plant at Sadiqabad, District Rahim Yar Khan has a maximum annual production capacity of 200,000 MT of steel pipes (triple shift capacity) in the ranges of diameter from 6" to 140" coupled with a coating plant capacity of 2million square meters per annum.

Sector Dynamics and Business Risk

Cyclicality: Cyclicality in sales is a significant risk particularly for large diameter pipe manufacturers, given the reliance of large diameter pipe manufacturers on public sector and pipeline augmentation projects of gas utility companies. However, in the backdrop of planned pipeline infrastructure projects, pipeline sales orders are expected to remain healthy over the medium term. Major project announced and for which tendering is expected over the next one year include 1100km North-South gas pipeline.

Competition from Imports: While threat of dumping particularly from China remains a significant risk, duties on pipe imports and high transportation cost has facilitated in partly mitigating competition from imports. Local large diameter pipe manufacturers also enjoy the advantage of SRO 827 through which a price preference is provided to them against imports.

Volatility in HRC prices: A key risk is increase in HRC prices post bid submission. This is due to bids being made based on current or expected HRC prices at the time of the contract while contract award and procurement of HRC is done with a time lag.

Financial Profile

Profitability: Sales and gross margins have shown significant volatility over the last few years. While sales (FY17: Rs. 2.67b; FY16: Rs. 1.7b) increased during FY17, margins witnessed a noticeable decline to 8% (FY16: 17%) on account of higher HRC prices. Excluding a non-recurring loss on investment property, profit before tax stood at prior year level of Rs. 40m due to lower finance cost. Accounting for loss incurred on sale of investment property and taxation, the company incurred loss after tax of Rs. 94.8m in FY17. Going forward, profitability has been projected to witness significant increase on account of volumetric growth in sales.

Liquidity: Liquidity profile of the company is constrained on account of significant volatility in cash flows and sizeable overdue trade debts. However, working capital cycle of the company is positive while exchange rate risk is covered as per contract terms with two major gas utility companies. The company reported Funds Flow from Operations of Rs. 121.3m in FY17 (FY16: Rs. 69.8). While the company currently has no orders in hand, stock in trade carried on the balance sheet is significant due to incomplete execution of orders obtained. Moreover, provision against trade creditors is sizeable at around Rs. 1.32b (prudently recognized in payables and not contingencies) and includes liquidated damages claims by two gas utility companies. Reduction in stock in trade and settlement of claims by creditors is considered important.

Capitalization: Net equity stood at Rs. 809.6m (FY16: Rs. 904.2m) at end-FY17. The company did not have any borrowings on its balance sheet at end-FY17 and utilization of long-term borrowing has historically remained limited. Short-term borrowings have been mobilized for funding raw material procurement. Capital expenditure to the tune of Rs. 500m is planned. Timing of the same may vary with cash flows of the company.

Corporate Governance

Given the company's status as a private limited company, overall board composition and oversight has room for improvement through inclusion of additional independent directors on board and extending board oversight beyond regulatory approvals.

ISSUE/ISSUER RATING SCALE & DEFINITION**Appendix II****Medium to Long-Term****AAA**

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term**A-1+**

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities

and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

JCR-VIS Credit Rating Company Limited

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

REGULATORY DISCLOSURES

Appendix III

Name of Rated Entity	Data Steel Pipes Industries Limited				
Sector	Steel Industry				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	October 24, 2017	BBB	A-3	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	JCR-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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