

Inter Market Pulse

Pakistan Steel

MUGHAL: Benefits of planned capex largely priced in; Neutral

- We lower our rating on MUGHAL from Buy to Neutral with a TP of PkR156/sh following 12% rally since our last report. Our new estimates reflect management guidance on cost efficiencies and capacity enhancement of the bar rerolling mill; the BMR is going to enhance the former's capacity by 90,000tons per annum.
- The company has resorted to a rights issue of 100% at par to partly fund the Capex of PkR1.75bn, contrary to our assumption of 100% debt financing. This will raise PkR1.25bn, while the remaining PkR500mn will be financed through debt. As a result, we have adjusted up our earnings estimates with lower finance costs.
- We reiterate our optimism for the game-changing development of additional captive power generation (18.6MW). MUGHAL is undergoing an installation of six engines to add gross capacity of 18.6 MW to its existing CPP of 9.3MW. Besides this, the company is also planning to undergo a BMR procedure to improve cost efficiencies.

Greater clarity on announced capex...

We revise our rating on Mughal Iron & Steel (MUGHAL) from Buy to Neutral with a new TP of PkR156/share (PkR 78/sh ex-right), up by 4%, following a 12% rally since our last report. Nonetheless, we have tweaked our estimates on greater clarity on financing, timeline and expected benefits of the announced investments. The management shed greater light on the cost efficiencies that can converge MUGHAL's margins close to Amreli's – also leading to valuation convergence, in our view. Among other benefits, the BMR is expected to enhance the bar re-rolling capacity by 90,000tons and alloy production constraints.

...which will accrue multiple benefits

The melting procedure will produce better quality billets as compared to previously imported lower quality billets. The economies of scale are expected to play a major role in improving the efficiency of melting process. Moreover, a BMR-procedure on the bar re-rolling mill is expected to improve the power consumption rate up to 80kwhr/ton as compared to the current 130kwhr/ton previously. These changes significantly improve our earnings estimates for FY19. Mughal's core rebar capacity was initially restricted to 150,000 tpa (pre FY16). The company then modified one of the mills to increase the capacity to 300,000tons. Post BMR, further 90,000tons will be added to capacity.

Equity financing lowers our assumption of financing costs

The rights issue lifts our earnings from FY18 and beyond due to lower finance costs than expected earlier. Our estimates for FY18/19F are thus up 6%/29% to PkR9.80/16.78 (based on pre-right shares). The total project costs around PkR1.75bn compared to our earlier expectation of PkR1bn. We had further assumed the project to be financed completely by debt, but the management announced 100% rights issue at par, raising around PkR1.25bn for the total project, while the remaining PkR500mn will be funded through debt. With a 100% rights issue, the liquidity of company's shares in the market may also improve.

In-house production to boost gross margins

Historically, MUGHAL has lagged behind Amreli Steels (ASTL) due to lower utilization levels and cost inefficiencies. ASTL has operated close at full-scale with in-house production of billets and is due to expand capacity. MUGHAL's GP margins have hovered between 9%-11% while ASTL's margin were on average 16%, in the last 5years. We think MUGHAL can now achieve similar levels of gross margins with successful implementation of aforementioned capex. Better utilization levels and margins can lead to valuation convergence as well, in our view.

Mughal Iron & Steel Industries Limited

Price (PkR/sh)	142.83
TP (PkR/sh)	156.00
Stance	Neutral
Upside	9.2%
Fwd D/Y	2.5%
Total Return	11.7%
Bloomberg / Reuters	MUGHAL PA / MUGH.KA
Mkt Cap (US\$m)	171.4
52wk Hi-Low (PkR/sh)	148.04-65.8
3m Avg. Daily Vol ('000 shrs)	631
3m Avg. Traded Val (US\$m)	0.727

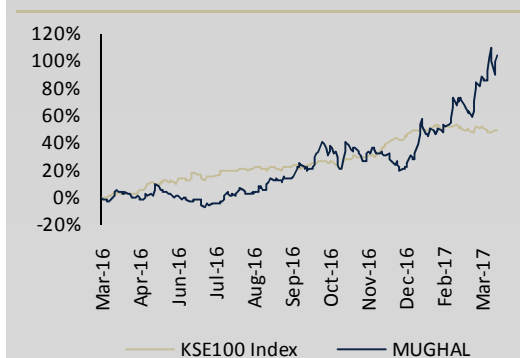
MUGHAL - Valuation Snapshot

(PkR mn)	FY16A	FY17F	FY18F	FY19F
Sales	18,983	17,146	18,594	24,500
NPAT	893	1,099	1,233	2,111
Growth	46.7%	23.0%	12.2%	71.2%
EPS (PkR)	7.10	8.74	9.80	16.78
EPS (PkR)*	3.55	4.37	4.90	8.39
PER (x)	20.11	16.35	14.57	8.51
DPS (PkR)	3.00	3.50	3.50	3.50
DPS (PkR)*	1.50	1.75	1.75	1.75
DY (%)	2.1%	2.5%	2.5%	2.5%
PBV (x)	4.24	3.13	3.01	2.84
ROE (%)	21.1%	19.1%	20.7%	33.4%
EV/EBITDA (x)	12.00	9.71	9.47	6.26

Source: IMS Research

*EX-Right

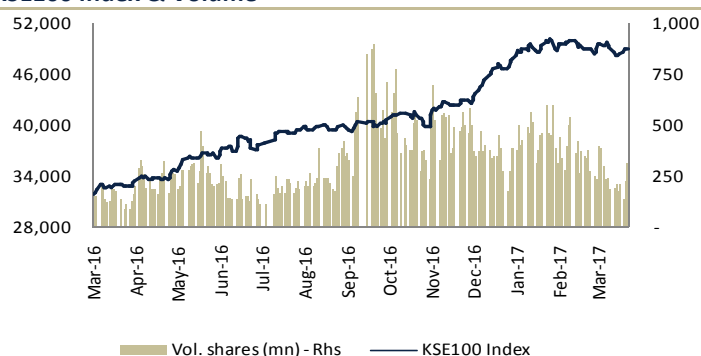
MUGHAL vs. KSE100 Index



Source: IMS Research

Morning News

- **Policy rate remains unchanged at 5.75%:** Monetary Policy Committee of SBP has decided to maintain Policy rate at 5.75% for next two months.
- **Ministry seeks up to 20% tariff cut for Thar coal projects:** The Ministry of Water and Power has requested, in a letter to the National Electric Power Regulatory Authority (Nepra), up to 20% reduction in upfront tariff for new Thar coal-based power projects due to (i) 10-15% decline in machinery cost, (ii) decline in interest rates from 9.75% to 5.75%, and (iii) increasing the repayment structure from 10 year to 13-15 years respectively.
- **K-Electric: Govt, not consumers, to benefit from tariff cut:** News reports suggest the federal government will be the ultimate beneficiary of the recent cut in power tariff of K-Electric, and not end-consumers, while the power utility takes a financial hit. According to a senior official from NEPRA, the reduction in the tariff of K-Electric consumers will bring down subsidy cost for the government, and there will be no relief for end consumers.
- **Fearing higher deficit, govt reluctant to clear circular debt:** The pressure to keep fiscal deficit within reasonable bounds before the announcement of next budget has prevented the government from releasing adequate funds to clear the runaway circular debt. However, after four years, the picture is not very much different as the debt has again soared to Pkr393bn. According to officials aware of the development, the Ministry of Finance is going to release Pkr6bn, of which PSO is expected to get just Pkr3bn against its receivables of Pkr274bn.
- **LHC fixes 5th April for Anti-Dumping duty hearing:** The Lahore High Court (LHC) has fixed April 5, 2017 as next date for hearing of cases filed by commercial importers of tiles, steel, paper, chemical and yarn in the four new petitions against the anti-dumping duty investigations by the National Tariff Commission (NTC).
- **British firm to set up cement plant in KPK:** A British firm has agreed to construct cement plant in KPK. The plant is expected to come online by end of 2020 and would cost of US\$400mn.

KSE100 Index & Volume**Forex & Money Market**

	Close	DoD Δ	YoY Δ bps	CYTD Δ bps	FYTD Δ bps
6m Tbill yield (%)	5.97	0.00	-0.21	-0.04	0.09
10Y PIB yield (%)	8.05	0.00	-0.49	-0.47	0.46
6m Kibor (%)	6.09	0.01	-0.26	-0.03	0.04

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Pkr/US\$	104.84	-0.01	-0.01%	0.1%	0.2%	0.0%
Pkr/EUR	113.31	0.22	0.19%	-3.2%	2.5%	-3.0%
Pkr/JPY	0.944	0.00	0.24%	1.5%	5.4%	-7.5%

Source: Bloomberg

World Indices

	Close	DoD Δ	DoD Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Pakistan	48,971.1	-45.7	-0.09%	2.43%	29.61%
China	3,269.4	23.2	0.72%	5.34%	11.60%
Hong Kong	24,358.3	63.4	0.26%	10.72%	17.14%
India	29,421.4	56.5	0.19%	10.50%	8.97%
Indonesia	5,567.1	-1.6	-0.03%	-12.10%	10.97%
Malaysia	1,745.8	-2.1	-0.12%	6.34%	5.54%
Japan	19,262.5	53.5	0.28%	0.78%	23.67%
Singapore	3,142.9	11.2	0.36%	9.10%	10.63%
Korea	2,169.0	1.0	0.04%	7.03%	10.08%
Taiwan	9,903.0	-7.0	-0.07%	7.02%	14.27%
Bangladesh	5,726.2	0.0	0.00%	13.70%	27.04%
Sri Lanka	5,996.3	16.4	0.27%	-3.72%	-4.57%
Philippines	7,269.6	-23.4	-0.32%	6.27%	-6.75%
Thailand	1,573.5	2.8	0.18%	3.09%	8.89%
Vietnam	722.1	0.2	0.03%	8.61%	14.22%
USA	2,344.0	-2.0	-0.08%	4.70%	11.68%
UK	7,336.8	-3.9	-0.1%	2.72%	12.80%
Germany	12,064.27	24.6	0.20%	5.08%	24.63%

Source: Bloomberg

Commodity Prices

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Gold - US\$/oz	1,243.57	-1.73	-0.1%	2.2%	7.9%	-5.9%
Oil - US\$/bbl	47.97	0.97	2.1%	26.4%	-10.7%	-0.7%
Cotton US\$/lb	77.47	0.20	0.3%	34.2%	9.7%	23.3%
Coal - US\$/MT	77.40	0.00	0.0%	48.6%	-7.6%	32.3%
CRY Index	183.47	-0.18	-0.1%	6.6%	-4.7%	-5.6%

Source: Bloomberg

Portfolio Flows

(US\$m)	Current	WTD*	MTD	12M	CYTD	FYTD
Total FIPI	0.71	(1.5)	(3.8)	(389.2)	(144.3)	(442.2)
Individuals	(0.1)	(11.2)	(40.4)	(4.2)	(44.0)	(63.0)
Companies	0.1	8.3	24.3	(62.2)	63.8	125.4
Banks / DFI	(4.9)	(7.2)	(11.5)	(193.4)	(62.2)	(155.4)
NBFC	(0.0)	(0.1)	(1.8)	200.9	18.7	120.3
Mutual Funds	2.1	4.8	11.3	426.5	103.2	410.0
Other Organization	(1.6)	(2.5)	(0.7)	(2.2)	17.7	(7.9)
Broker Trading	4.0	8.0	10.9	(3.8)	19.4	(14.9)
Insurance Companies	(0.3)	1.5	11.7	27.8	27.8	27.8

Source: NCCPL

*Last 5 working days

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Ratings Guide*	Total Return
Buy	More than 15%
Neutral	Between 0% - 15%
Sell	Below 0%

*Based on 12 month horizon unless stated otherwise in the report. Total Return is sum of any Upside/Downside (percentage difference between the Target Price and Market Price) and Dividend Yield.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: (i) Gas supply abandonment, (ii) Additional duty withdrawal on rebars, and (iii) Increasing Scrap Prices.

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