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## Pakistan Engineering

### MUGHAL: Positives balance risks; initiate with Neutral

- We initiate coverage on MUGHAL with a Neutral rating and a TP of PkR102/sh (10% total return). Profits are expected to grow 40%YoY in FY17F due to gas supply resumption in 2QFY17. However, growth trajectory should moderate to single-digits over the medium-term, with risks emanating from increased volatility in billet prices.
- The 9.3MW captive power plant will be able to fire-up the furnaces on account of gas supply resumption from SNGPL (2mmcf/d), which should result in annual cost savings of more than PkR1/sh. This incremental power supply has been dedicated to the melting facility since the recently imposed 15% RD has driven-up billet prices.
- MUGHAL trades at a FY17F P/E of 9.7x, at a discount to both the Cement sector and ASTL. This can be attributed to lower pricing power and operational disadvantages compared to both, in our view. Positive surprises can emanate from extraordinary PSDP spending ahead of 2018 elections, and CPEC.

*(Please refer to the detailed report to be released shortly)*

#### Uptick in earnings in FY17; moderate thereafter

We initiate coverage on Mughal Iron and Steel Industries Ltd (MUGHAL), a leading rebar producer in the Northern market, with a Neutral stance supported by a DCF-based TP of PkR102/sh. Our rating is contingent upon a blend of both progressive and adverse triggers. Long awaited power constraints are set to reduce in the wake of SNGPL's resumption of gas supply to industrial consumers, prompting MUGHAL to lift its utilization from very low levels and continue swift earnings growth for FY17F (+40%YoY). However, a 15% regulatory duty (RD) levied on billets amidst fears of anti-dumping duty imposition could moderate earnings uptick for MUGHAL. Nonetheless, the construction uptick in the economy remains intact, providing reasonable basis for demand buoyancy in the rebar industry, particularly in the run-up to 2018 elections.

#### Gas resumption is a bonus; utilization still lagging

SNGPL has resumed gas supply required to ignite the Captive Power Plant (CPP) with three furnaces bearing total capacity of 9.3MW (gross). The provision of 2mmcf/d partially alleviates energy constraints that have for long gridlocked production despite major capacity expansions. The greater energy provision will enable MUGHAL to limit higher input costs due to a 15% RD now on billets, as it can ramp up its melting production. In addition, cost-savings may emanate from (i) lower unit cost of electricity (-36%) as gas tariff tends to be lower than national grid tariff and (ii) reheating cost savings (PkR2,000/ton) brought about by in-house melting. Maximum benefits could have been reaped out of the CPP had the energy been utilized to produce just rebars from procured billets, but this not the case. Furthermore, the recently announced PkR200/mmbtu cut in gas price still fails to compensate for the hike in billet prices needed to substitute the allocation of additional power from melting facility to the rerolling facility.

#### Billet imports halt; prices to shoot up

RD imposition and rising international prices have trimmed MUGHAL's margins as imports of billets have almost ceased. The local installed capacity stands at 1.5mn tons, which feeds the 2.5mn ton rebar industry. Consequently, the demand-supply deficit dictates a rise in billet prices. MUGHAL faces an alarming margin shrinkage compared to producers like ASTL and Agha Steel which tap the low cost potential by producing from an earlier point in the value chain i.e. from scrap. The increase in billet price severely hurts the rebar-billet spread which suffocates MUGHAL as it heavily relies on billet procurement by default.

#### Valuations: Risks prevent rerating to growth multiples

MUGHAL trades at a FY17F P/E of 9.7x where the cement industry trades at a forward P/E of 11.2x (ASTL trades at FY17F/FY18F P/E of 18.9x/10.5x). The stock trades almost at market multiples where we believe high near-term growth trajectory is balanced by risks such as potential anti-dumping duty on billets, discontinuation of gas supply etc.

**ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 3 & 4**

To find our Research on Bloomberg, please type - **IMKP <GO>**

### Initiating Coverage

#### Mughal Iron & Steel Industries Limited

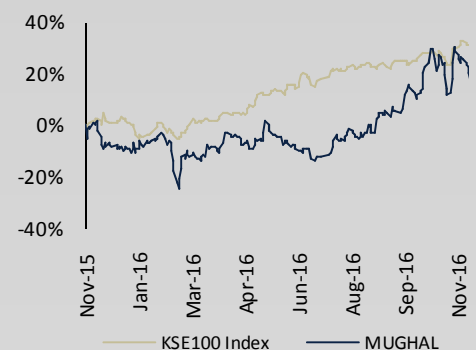
Price (PkR/sh)	96.53
TP (PkR/sh)	102.21
Stance	Neutral
Upside	5.9%
Fwd D/Y	3.6%
Total Return	9.5%
Bloomberg / Reuters	MUGHAL PA / MUGH.KA
Mkt Cap (US\$m)	115.9
52wk Hi-Low (PkR/sh)	99.59-57.88
3m Avg. Daily Vol ('000 shrs)	559
3m Avg. Traded Val (US\$m)	0.479

#### Mughal - Valuation Snapshot

Key Ratios	FY15A	FY16A	FY17F	FY18F	FY19F
EPS (PkR)	4.84	7.10	9.95	10.63	11.00
EPS Growth (%)	56%	47%	40%	7%	4%
PER (X)	19.94	13.59	9.70	9.08	8.77
PBV (X)	3.57	2.87	2.70	2.29	1.96
DPS (PkR)	0.50	3.00	3.50	3.50	3.50
DY (%)	0.5%	3.1%	3.6%	3.6%	3.6%
ROE (%)	24%	23%	29%	27%	24%
EV/EBITDA (x)	12.54	8.80	7.29	6.30	5.85

Source: IMS Research

#### Mughal vs. KSE100 Index

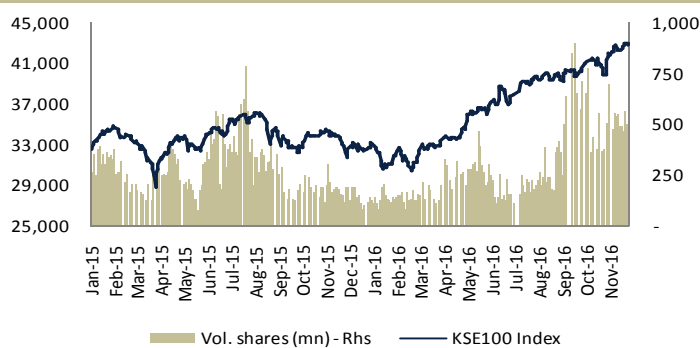


Source: IMS Research

## Morning News

- **PSX set to open bids on Dec 5th:** Pakistan Stock Exchange is scheduled to open bids on Monday, December 5th, submitted by foreign strategic investors and local institutions to acquire up to 40% stake of the bourse. Initially, 17 bids have been submitted by foreign and local strategic investors and financial institutions. Foreign investors consortium includes the Nasdaq, two UK bases funds, Shanghai and the Shenzhen Stock Exchange. Among local institutions, MCB, ABL and Pak-Oman Investment had submitted their bids. Deadline for completion of the bidding process is Dec 27th.
- **OGRA proposes up to 9.4% increase in POL prices for December:** Prices of petroleum products are expected to rise by up to 9.4% for the month of Dec'16 according to the summary sent by OGRA. Specifically, proposal to increase price of petrol by 6.2%, 7.5% of HSD and 9.4% of HOBC has been sent to the government.
- **CDWP approves Pkr36bn worth of projects:** Central Development Working Party has cleared a total of 7 development projects at an estimated cost of Pkr36bn, including a foreign exchange component of Pkr5.56bn.
- **KEL allowed to raise tariff by Pkr0.48/unit:** NEPRA has allowed K-Electric to increase power tariff by Pkr0.48/unit for the month of Oct'16 under the monthly fuel surcharge adjustment mechanism.

## KSE100 Index &amp; Volume



Source: PSX

## World Indices

	Close	DoD Δ	DoD Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Pakistan	42,811.3	-249.4	-0.58%	30.46%	13.31%
China	3,282.9	5.9	0.18%	-7.24%	12.06%
Hong Kong	22,737.1	-93.5	-0.41%	3.75%	9.34%
India	26,394.0	43.8	0.17%	1.06%	-2.24%
Indonesia	5,136.7	22.1	0.43%	-12.10%	2.39%
Malaysia	1,626.9	-1.7	-0.11%	-3.87%	-1.64%
Japan	18,307.0	-49.8	-0.27%	-3.82%	17.53%
Singapore	2,879.1	4.5	0.16%	-0.12%	1.34%
Korea	1,978.4	0.3	0.01%	0.87%	0.41%
Taiwan	9,192.4	-29.9	-0.32%	10.25%	6.07%
Bangladesh	4,793.3	-4.3	-0.09%	3.54%	6.34%
Sri Lanka	6,231.9	-7.0	-0.11%	-9.61%	-0.82%
Philippines	6,781.2	-44.2	-0.65%	-2.46%	-13.02%
Thailand	1,497.2	-3.6	-0.24%	16.24%	3.61%
Vietnam	658.3	-7.0	-1.06%	13.68%	4.11%
USA	2,204.7	2.9	0.13%	7.86%	5.04%
UK	6,772.0	-27.5	-0.4%	8.49%	4.12%
Germany	10,620.5	37.8	0.36%	-1.14%	9.71%

Source: Bloomberg

## Forex &amp; Money Market

	Close	DoD Δ	YoY Δ bps	CYTD Δ bps	FYTD Δ bps
6m Tbill yield (%)	5.93	0.00	-0.46	-0.49	0.04
10Y PIB yield (%)	8.09	0.00	-1.25	-1.24	0.50
6m Kibor (%)	5.99	0.12	-0.29	-0.27	0.18

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Pkr/US\$	104.85	0.005	0.00%	-0.6%	0.1%	0.0%
Pkr/EUR	111.11	-0.461	-0.41%	-0.5%	-2.9%	-4.9%
Pkr/JPY	0.931	-0.003	-0.33%	8.3%	7.0%	-8.7%

Source: Bloomberg

## Commodity Prices

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Gold - US\$/oz	1,184.12	-9.87	-0.8%	12.0%	11.6%	-10.4%
Oil- US\$/bbl	47.08	0.00	0.0%	12.9%	27.1%	-2.6%
Cotton US\$/lb	72.79	-0.48	-0.7%	16.2%	15.0%	15.9%
Coal - US\$/MT	83.40	0.00	0.0%	54.2%	72.1%	42.6%
CRY Index	187.76	0.00	0.0%	2.5%	6.6%	-2.5%

Source: Bloomberg

## Portfolio Flows

(US\$m)	Current	WTD	MTD	12M	CYTD	FYTD
Total FIPI	-11.43	-26.77	-105.89	-225.78	-183.28	-142.34
Individuals	9.91	8.35	58.09	41.28	25.52	-50.16
Companies	0.20	1.50	8.65	-105.18	-116.73	32.11
Banks / DFI	-1.10	-6.05	-44.84	-101.13	-110.23	-83.96
NBFC	3.14	5.25	17.54	209.04	202.82	78.47
Mutual Funds	0.60	24.65	82.24	189.04	186.76	190.89
Other Organization	0.63	0.21	2.88	29.20	33.14	4.79
Broker Trading	-1.95	-7.14	-18.67	-36.47	-37.98	-29.81

Source: NCCPL

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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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