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Inter Market Pulse

Pakistan Steel

MUGHAL: Power woes to settle by FY19; upgrade to Buy

- We revise up our TP for MUGHAL to PkR150/sh and upgrade our rating to Buy led by our expectation that its power constraints will be considerably resolved beyond FY18. Intermittent power supply was the single biggest impediment hampering MUGHAL's sales/earnings growth despite construction boom in the country.
- MUGHAL has planned to add a 19MW LNG-fired CPP by FY19, which will take total power supply at its disposal to 48MW. We believe this will enable the company to almost completely alleviate dependence on external billets and thereby protecting itself from impact of higher duty on billets.
- Further positive triggers remain intact on the back of the BMR on the re-rolling facility, which we understand will lead to cost efficiencies. While we await clarity from management on nature and extent of these efficiencies, we highlight this as an upside trigger to our estimates.

Upgrade to Buy with revised TP of PkR150/sh

We lift our target price for Mughal Iron & Steel Ltd (MUGHAL) by 40% to PkR150/sh (total return 18%). MUGHAL's planned investment in a 19MW LNG-fired captive power plant, which is expected to come online by FY19, will significantly alleviate its power supply issues and thus enable it to better capture the growth in the construction industry. This will culminate in two significant benefits: (i) increase in-house billet production and protection on margins, and (ii) also increase utilization of its re-rolling facility to produce more rebars and other long steel products. Moreover, the Capex is expected to improve efficiency of the rebar re-rolling facility due to a BMR. However, we revise down our FY17/18F EPS estimates to PkR8.74/9.26 in light of the recent results, which missed our expectations on account of softer margins (dragged by untimely procurement of scrap amid rising prices).

PkR1bn Capex puts the company in a sweet spot to overcome its shortcomings

MUGHAL's plan to spend about PkR1bn in new captive power capacity is a fairly prudent move. It will allow MUGHAL to acquire 6 additional furnaces bearing gross capacity of 3.1MW each, adding up to 18.6MW in total. The company currently has 29.3MW of electricity at its disposal (20MW from the national grid and 9.3MW from CPP). The incremental power supply is expected to considerably boost production at its own melting facility. We expect the CPP to be operational by FY19, although the company will shed light on the exact completion date of the project in due course. As a result of this project, we expect an additional production of 130,000 tons of billets and 62,000 tons of Rebar. The billet procurement from the local market will be reduced to as low as possible. We have assumed that MUGHAL will finance the project fully with debt. On availability of further granular details, we will revise our estimates accordingly.

Revising down FY17/FY18 estimates due to poor 2Q results

MUGHAL's 2Q earnings were eroded by 15% QoQ due in large part to untimely purchase of scrap during a rising price backdrop – which was triggered by increased gas provision and higher duty on billets. We feel the problem will linger on for another year or so until the expansion in the CPP comes online by FY19. MUGHAL's Net Sales fell 15% YoY which can be attributed to lower prices than last year. MUGHAL also recorded the lowest gross margins of 8% since 2QFY15. Further, the leased facility is not yet operational (expected online in 4QFY17).

Positive triggers to emanate from BMR procedure

Alongside the above investment, MUGHAL will also undertake a BMR of its re-rolling facility which is expected to improve the efficiency of its rebar production (which is presently much less efficient compared to Amreli Steel). We await management guidance on the extent of cost-efficiencies.

Mughal Iron & Steel Industries Limited

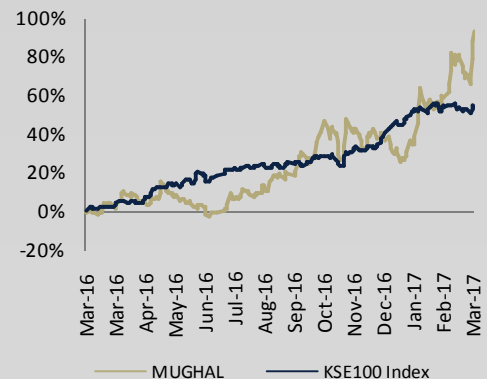
Price (PkR/sh)	130.41
TP (PkR/sh)	150.00
Stance	Buy
Upside	15.0%
Fwd D/Y	2.7%
Total Return	18%
Bloomberg / Reuters	MUGHAL PA / MUGH.KA
Mkt Cap (US\$m)	156.5
12m Hi-Low (PkR/sh)	130.41/65.8
3m Avg. Daily Vol ('000 shrs)	532
3m Avg. Traded Val (US\$m)	0.52

MUGHAL - Valuation Snapshot

(PkR mn)	FY16A	FY17F	FY18F	FY19F
Sales	18,983	17,146	18,594	24,500
Sales growth	55.1%	-9.7%	8.4%	31.8%
NPAT	893	1,099	1,166	1,635
Growth	46.7%	23.0%	6.0%	40.3%
EPS (PkR)	7.10	8.74	9.26	13.00
PER (x)	18.36	14.92	14.08	10.04
DPS (PkR)	3.00	3.50	3.50	3.50
DY (%)	2.3%	2.7%	2.7%	2.7%
PBV (x)	3.87	3.65	3.19	2.79
ROE (%)	21.1%	24.5%	22.6%	27.8%
EV/EBITDA (x)	11.14	9.56	8.77	7.02

Source: IMS Research

MUGHAL vs. KSE100 Index



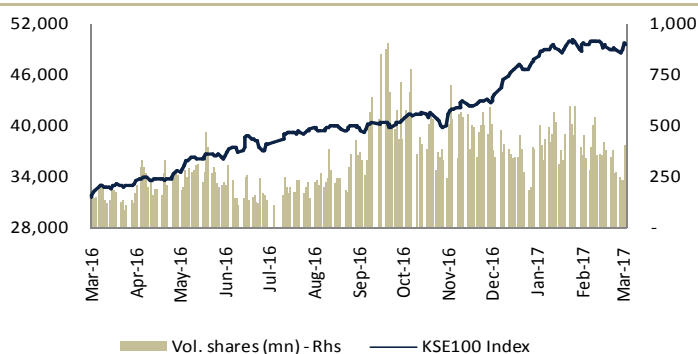
Source: IMS Research

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 3 & 4

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

Morning News

- **Advances to private sector reach PkR410bn:** According to SBP's 4QCY16 Banking Sector Report, advance to the private sector clocked in at PkR410bn, up 11%YoY. Advances posted its highest quarterly growth in the last 10years, with growth trend likely to extend going forward. NPL ratio of the sector dropped to 10.1%, which is an 8yr low. On the flipside, profitability of the sector may remain under pressure in the ongoing low interest rate environment.
- **PSX receives payment against 40% stake from Chinese:** Pakistan Stock Exchange (PSX) has received payment amounting to US\$85.5mn from sale of 40% stake at PkR28/sh from the Chinese Consortium.
- **Dynea Pakistan approves production facility's expansion:** Board of Directors of Dynea Pakistan has approved capacity expansion in their production facility of formaldehyde from existing 59k tons to 109k tons. Total estimated cost of expansion would be about PkR510mn.
- **Power sector's outstanding dues jump to PkR414bn:** Total outstanding dues to the Power Sector stood at PkR414bn, which includes PkR160bn overdue payments from CPPA-G owed to GENCOs.
- **Cotton production target missed by 25%:** Pakistan has recorded cotton production of 10.5mn bales against target of 14.1mn bales in FY17. Cotton production, however, registered an 8%YoY growth.
- **FBR falling short on revenue collection target:** According to provisional numbers, tax collected by FBR FYTD stands at PkR1.92tn against target of PkR2.08tn.

KSE100 Index & Volume

Source: PSX

Forex & Money Market

	Close	DoD Δ	YoY Δ bps	CYTD Δ bps	FYTD Δ bps
6m Tbill yield (%)	5.97	0.00	-0.24	-0.04	0.09
10Y PIB yield (%)	8.05	0.00	-0.54	-0.47	0.46
6m Kibor (%)	6.01	-0.06	-0.34	-0.11	-0.04

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
PkR/US\$	104.85	0.01	0.01%	0.0%	0.2%	0.0%
PkR/EUR	110.34	-0.08	-0.07%	-3.1%	-0.2%	-5.5%
PkR/JPY	0.918	0.00	0.01%	-0.2%	2.5%	-10.0%

Source: Bloomberg

World Indices

	Close	DoD Δ	DoD Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Pakistan	49,623.8	-72.3	-0.15%	3.80%	31.34%
China	3,218.3	-11.7	-0.36%	3.69%	9.85%
Hong Kong	23,552.7	-175.3	-0.74%	7.06%	13.26%
India	28,832.5	-7.3	-0.03%	8.28%	6.79%
Indonesia	5,391.2	-17.0	-0.32%	-12.10%	7.47%
Malaysia	1,708.4	-7.3	-0.42%	4.06%	3.28%
Japan	19,469.2	-95.6	-0.49%	1.86%	25.00%
Singapore	3,122.3	-14.1	-0.45%	8.39%	9.91%
Korea	2,078.8	-23.9	-1.14%	2.58%	5.50%
Taiwan	9,648.2	-43.6	-0.45%	4.27%	11.33%
Bangladesh	5,586.8	0.0	0.00%	10.94%	23.94%
Sri Lanka	6,101.5	-25.6	-0.42%	-2.04%	-2.89%
Philippines	7,247.1	12.2	0.17%	5.94%	-7.04%
Thailand	1,566.2	-3.7	-0.24%	2.61%	8.39%
Vietnam	712.6	5.1	0.72%	7.18%	12.71%
USA	2,383.1	1.2	0.05%	6.44%	13.54%
UK	7,374.3	-8.1	-0.1%	3.24%	13.37%
Germany	12,027.4	-32.2	-0.27%	4.76%	24.25%

Source: Bloomberg

Commodity Prices

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Gold - US\$/oz	1,229.24	-5.07	-0.4%	-2.8%	6.7%	-7.0%
Oil- US\$/bbl	52.61	0.00	0.0%	52.2%	-2.1%	8.9%
Cotton US\$/lb	75.99	0.30	0.4%	30.1%	7.6%	21.0%
Coal - US\$/MT	82.75	-0.65	-0.8%	63.9%	-1.2%	41.5%
CRY Index	189.31	0.50	0.3%	12.3%	-1.7%	-2.5%

Source: Bloomberg

Portfolio Flows

(US\$m)	Current	WTD*	MTD	12M	CYTD	FYTD
Total FIPI	(3.85)	(32.7)	(11.6)	(398.5)	(152.1)	(450.0)
Individuals	(5.1)	(9.6)	(4.6)	25.2	(8.1)	(27.2)
Companies	(0.9)	21.0	2.0	(90.1)	41.5	103.2
Banks / DFI	3.1	13.0	3.6	(184.2)	(47.2)	(140.3)
NBFC	(0.2)	(1.3)	(1.2)	207.8	19.4	120.9
Mutual Funds	3.3	(7.7)	1.0	422.8	93.0	399.8
Other Organization	0.2	0.1	(0.5)	4.7	17.8	(7.7)
Broker Trading	(0.1)	9.2	7.9	(7.0)	16.4	(17.8)
Insurance Companies	3.6	7.9	3.3	19.4	19.4	19.4

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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