The Pakistan Credit Rating Agency Limited

ENTITY RATINGS REPORT

MUGHAL IRON & STEEL INDUSTRIES LIMITED

ENTITY	RATINGS	OUTLOOK	ACTION
Mughal Iron & Steel Industries Limited (Mughal)	Long Term: A- Short Term: A2	Positive	Initial

RATING RATIONALE

Mughal is a known name in the steel industry. The company has diversity in its product slate; Rebars, T-Iron and Girders etc. The company profiling has significantly improved post listing on PSX. Mughal has a large board with one independent director (Mr. Salman Ali Shah) and has plans to increase the same in line with corporate governance requirements. Mughal has a sizeable capacity to an extent unutilized. The ratings take strength from strong brand value of Mughal Steel in the local industry. The company has attained formidable market share; amidst rising demand emanating from large infrastructure projects. Demand from retail segment is also on the rise – earmarked by the management as future growth driver. The ongoing expansion projects – 100% financed through equity – have positioned Mughal to take advantage of rising demand. During FY17, Mughal witnessed dilution in margins as it competed with dumped steel products originating from China, however, the situation is likely to improve post anti-dumping duty. Mughal unlike south players have to incur freight cost – that explains its differential in margins. The ratings incorporate Mughal's adequate financial risk profile which has sustained over the years. The short term borrowings (net of cash) are largely aligned with the working capital. Moreover, leveraging has improved on account of successful capital market transaction (100% right issue at par) during the year, which has augmented equity. Going forward, with no major addition in debt, coverages are expected to remain robust.

KEY RATING DRIVER

The ratings are dependent upon the company's ability to sustain its business profile amidst strong competition, herein, effective and prudent management of financial risk indicators remain important. Moreover, strengthening of governance framework with addition of independent directors is vital.

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JANUARY 2018

MUGHAL IRON & STEEL INDUSTRIES LIMITED (MUGHAL) PROFILE	
Incorporated	1998 (partnership), 2010 (unlisted public limited company), 2015 (listed public limited company)
Major Business	▪ Manufacturing and sale of billets, spring steel, deformed bars, rebars, cold twisted rebars and a huge range of sections such as I-beams, L-sections, C-section, H-beam, T-bar etc. in the downstream industry.
Legal Status	Listed
Head Office	Lahore

INDUSTRY SNAPSHOT

Domestic steel industry is experiencing rapid growth on account of positive demand fundamentals emanating from large infrastructure projects. Improving macro-economic indicators are driving growth in retail segment as well. The industry is in expansion phase reflecting expected changes in the domestic landscape of the industry. Regulatory protection in the shape of anti-dumping duties coupled with increase in regulatory duties bodes well for domestic industry.

OWNERSHIP — GOOD

- Post IPO in 2015, the ownership structure of the company has changed. Presently, the company is majority (~75%) owned by Mughal family, followed by Financial Institutions, and general public.
- The sponsors – Mughal family – carry over five decades of experience in steel and allied business. The sponsors have demonstrated their commitment towards the company by injecting funds on as and when required basis.

GOVERNANCE — ADEQUATE

- The overall control of board vests in nine-member board of directors, wherein eight are from sponsoring family including the Chairman and CEO, while one is an independent member.
- Presence of Mr. Salman Ali Shah on the board as an independent director strengthens governance framework of the company.
- There are two board committees in place, these include: (i) Audit, and (ii) Human Resource & Remuneration.
- The audit committee comprises four members, all of whom are non-executive directors; a good governance practice.
- The auditors of the company M/s Fazal Mahmood & Company, Chartered Accountants, have expressed an unqualified opinion and review report for the year ended 30th June, 2017.
- The internal audit function of the company is in-house and reports directly to the board's Audit Committee.

MANAGEMENT — GOOD

- Mughal has a lean organizational structure with an experienced management team.
- Mr. Khurram Javed is the CEO of the company. He carries nine years of professional experience and holds an MBA from Coventry University. He has been instrumental in improving the overall HR quality of the company with induction of professionals from different fields.
- The CEO is supported by a team of experienced individuals equipped with necessary technical skills and relevant industry experience.

SYSTEMS & CONTROLS — ADEQUATE

- The company is in the process of implementing sophisticated and advanced technology such as Microsoft dynamics for real time reporting. However, an SQL based ERP system is currently being used for reporting purposes. The system was deployed in 2007.
- MIS reports for senior management are generated frequently. The reports are customized as per the requirements of the management.

PERFORMANCE — GOOD

- During FY17, Mughal sustained its performance amidst competition from dumped steel originating from China. Revenue stood at PKR 18.8bln (FY16: 18.9bln), registering a nominal dip of ~1% on YoY basis.
- Mughal uses imported scrap as its raw material. Hence, the upward trend in international scrap prices (~7%) during FY17 contributed towards slimming business margins (gross: FY17: 10.3%, FY16: 10.8%; operating: FY17: 8.2%, FY16: 9.3%).
- Higher operating expenses led by marketing expense incurred to launch new brand (Mughal Supreme) was offset by rationalization in finance costs resulting in higher profitability.
- PAT improved to PKR 991mln (FY16: PKR 893mln) depicting a ~11% growth on YoY basis.
- During 1QFY18, revenue witnessed handsome growth of 45% YoY. Margins improved slightly on the back of recoup in steel prices.
- During Jun-17, National Tariff Commission (NTC) imposed anti-dumping duty of 24.04% on continuous casting steel billets. Moreover, during Oct-17, NTC has also imposed anti-dumping duty of 19.15% on rebars originating from China in addition to 30% regulatory duty already in place. This would positively impact Mughal and the sector, going forward.
- Mughal has earmarked retail segment as a future growth driver. To cater rising demand, expansion plan was approved which would result in increase in installed capacity of rebar re-rolling from 150,000 MT to 430,000 MT. Subsequently, expansion in installed generation capacity from 9.3MW to 27.9MW is also planned.

FINANCIAL RISK — ADEQUATE

- Mughals' working capital needs increased during FY17 – due to higher receivables, bulk purchase of inventory on account of lower raw material prices and payment to creditors. Owing to this, net cash cycle was increased to 78days at end-Jun17 (end-Jun16: 45days).
- Working capital needs were funded via short-term borrowings (STBs). As a result, during FY17, STBs almost doubled. However, the company has PKR 7,372mln in unutilized facilities at end-Jun17 (end-Jun16: PKR 4,385mln).
- On account of lower YoY profitability, FCFO declined to PKR 1,398mln (FY16: PKR 1,438mln). However, maturity of long-term debt strengthened coverages (interest: end-Jun17: 5.6x, end-Jun16: 4.5x; debt service: end-Jun17: 5.0x, end-Jun16: 3.7x).
- Mughal enhanced its equity by way of right issue. The addition in equity coupled with higher profitability was sufficient to absorb PKR 3.9bln addition in STBs hence, the debt to debt plus equity ratio improved to 55% (end-Jun16: 59%). Entire debt outstanding pertains to short-term.

PKR mln

Mughal Iron & Steel Industries Limited (Mughal)

BALANCE SHEET	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
	3M	Annual	Annual	Annual
Non-Current Assets	**4,574**	**4,275**	**3,928**	**3,306**
Investments	-	-	-	-
Current Assets	**11,738**	**11,749**	**7,852**	**8,164**
Inventory	5,199	5,382	4,221	4,812
Trade Receivables	1,232	1,355	943	478
Others	5,307	5,012	2,688	2,874
Total Assets	**16,312**	**16,024**	**11,780**	**11,470**
Debt	**8,014**	**8,046**	**4,209**	**2,559**
Short-term	8,001	8,014	4,100	2,305
Long-term (Inlc. Current Maturity of long-term debt)	13	32	109	254
Other short-term liabilities	693	698	1,689	4,367
Other long-term Liabilities	662	643	1,646	902
Shareholder's Equity	**6,943**	**6,637**	**4,235**	**3,642**
Total Liabilities & Equity	**16,312**	**16,024**	**11,780**	**11,470**

INCOME STATEMENT	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
Turnover	**5,397**	**18,803**	**18,983**	**12,241**
Gross Profit	668	1,942	2,059	1,284
Operating profit	559	1,536	1,757	1,105
Financial Charges	(143)	(249)	(318)	(350)
Net Income	**306**	**991**	**893**	**721**

Cashflow Statement	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
Free Cashflow from Operations (FCFO)	474	1,398	1,438	1,129
Net Cash changes in Working Capital	201	(2,451)	(1,791)	934
Net Cash from Operating Activities	578	(1,273)	(577)	1,716
Net Cash from InvestingActivities	(959)	(650)	(238)	(1,033)
Net Cash from Financing Activities	962	1,501	391	(633)

Ratio Analysis	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
Performance				
Turnover Growth (same period last year)	45.3%	-1.0%	55.1%	109.0%
Gross Margin	12.4%	10.3%	10.8%	10.5%
Net Margin	5.7%	5.3%	4.7%	5.9%
ROE	17.8%	17.2%	21.4%	24.5%
Coverages				
Interest Coverage (x) (FCFO/Gross Interest)	3.3	5.6	4.5	3.2
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	3.2	5.0	3.7	2.3
Debt Payback (Years) (Total LT Debt Including UnCovered Total STBs)/(FCFO- Gross Interest)	0.0	0.0	1.8	2.5
Liquidity				
Net WC Days (Inventory Days + Receivable Days - Payable Days)	75	78	45	28
Short-term Total Leverage (Net Current Assets - STB) / Current Assets	25.9%	25.8%	26.3%	18.3%
Capital Structure (Total Debt/Total Debt+Equity)	53.6%	54.8%	59.0%	53.8%

CREDIT RATING
SCALE & DEFINITIONS

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 RATINGS

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA 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+ A 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+ BBB 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+ BB 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+ B 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 CC 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 RATINGS

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 conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information

Regulatory and Supplementary Disclosure

Rated Entity

Entity	Mughal Iron & Steel Industries Limited (Mughal)
Sector	Steel
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Notification Date	LT Rating	ST Rating	Action	Outlook
27-Jan-18	A-	A2	Initial	Positive

Related Criteria and Research

Methodology	Corporate Rating Methodology
Sector Research	Steel Sector - Viewpoint | Jan-18

Rating Analysts

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Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

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PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer.
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PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating.

Reporting of Misconduct
PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

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Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter;

Prohibition

Probability of Default (PD)

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.