The Pakistan Credit Rating Agency Limited

Rating Report

Mughal Iron & Steel Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Sep-2019	A-	A2	Positive	Maintain	-
25-Mar-2019	A-	A2	Positive	Maintain	-
18-Dec-2018	A-	A2	Positive	Maintain	-
27-Jan-2018	A-	A2	Positive	Initial	-

Rating Rationale and Key Rating Drivers

Mughal is a known name in the steel industry. The Company's business profile has significantly improved post listing on PSX, few years back. Governance framework strengthened by induction of independent oversight on board. The Company has diversity in its product slate; Rebars, T-Iron and Girders etc. Furthermore, establishment of strong brands like 'Mughal Supreme' gives competitive edge to the Company. The company has attained formidable market share by penetrating retail segment. The strategic realignment executed over the last few years by channeling 60% volumes (previous: 10% of sales mix) to retail market has been fruitful. The capacity expansion project (planned COD: Jun-19) will further enable Mughal to increase its efficiency and market presence. The reported profitability in recent period shows that Mughal is holding its position. The established distribution network and knowledge of management on supply chain dynamics is a positive contribution to Mughal. Going forward, management is eying backward integration. The company is fast moving towards technologically advanced manufacturing facilities, which provides efficiency and scale as well. The business profile witnessed continuous improvement in recent periods. However, margins witnessed slight reduction – an industry wide phenomenon – primarily attributable to global increase in prices of raw material (scrap, iron) and depreciation of Pak Rupee. The general industry dynamics reflect weakening. The ratings incorporate Mughal's good financial risk profile which has sustained over the years. The short term borrowings (net of cash) are largely aligned with the working capital requirements. Going forward, with increased working capital requirements post expansion prudent management of cash flows remain essential for the ratings

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

Disclosure

Name of Rated Entity	Mughal Iron & Steel Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19)
Related Research	Sector Study | Steel(Mar-19)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Mughal Iron & Steel Industries Ltd. is a listed Company since March 2015. Its shares are traded on Pakistan Stock Exchange Limited (PSX). The Company's shares are quoted under the Engineering Sector.

Background Incepted in early 1950's in the form of a proprietorship firm, the business was incorporated in 2010. The company operates through its registered head office located in Lahore while the factory is located 17 KM's Sheikhupura road with sales centers located at Badami Bagh, Lahore. Its products are used in hi-tech industrial complexes; residential and infrastructural projects comprising power and energy etc. The company also exports its products to Afghanistan.

Operations Mughal's primary operations include manufacturing and sales of billets, spring steel, deformed bars, rebars, cold twisted rebars and a wide range of sections etc. in the downstream industry.

Ownership

Ownership Structure Mughal's ownership structure has changed post listing. Presently, the company is majority (~75%) owned by Mughal family, followed by Financial Institutions, and general public.

Stability Ownership structure of the Company is seen as stable as no ownership changes are expected in near future. Majority stake will rest with the Mughal family.

Business Acumen The sponsors – Mughal family – carry over five decades of experience in steel and allied business.

Financial Strength Given that Mughal is the flagship entity of sponsors, willingness to support the company in case need arises is considered high; also supplemented by access to capital markets.

Governance

Board Structure The overall control of board vests in nine-member board of directors, wherein seven are from sponsoring family including the Chairman and the CEO, while two are independent members. During 1QFY19, Mr. Salman Shah (independent director) resigned from the board which resulted in an appointment of his replacement - Mr. Shoieb Ahmed Khan.

Members' Profile Mughal's Board Members carry, requisite skills, competence, diversification in terms of knowledge background and experiences, which is considered positive.

Board Effectiveness There are two board committees in place, these include: (i) Audit, and (ii) Human Resource & Remuneration. Furthermore, presence of Mr. Shoieb Ahmed Khan and the newly elected Mr. Abdul Rehman Qureshi on the board as independent directors are all good factors for the governance framework of the company.

Financial Transparency M/s Fazal Mahmood & Company, Chartered Accountants, classified in category 'C' by SBP and having a QCR rating, are the external auditors of the company. They have expressed an unqualified opinion for the Financial statements of end-Jun18.

Management

Organizational Structure Mughal has a streamlined organizational structure with clearly demarcated roles and high degree of delegation. The reporting lines are segregated between two executive directors and CEO which in turn report to the BoD. The current structure results in strong decision making and brings operational efficiencies.

Management Team Mr. Khurram Javed (CEO) has been instrumental in improving the overall HR quality of the company. He is supported by a team of experienced individuals equipped with necessary technical skills and relevant industry experience.

Effectiveness Mughal has no formal management committees in place. All respective departments have their own meetings and their heads review key performance areas of the department and report to respective executive directors.

MIS MIS reports are customized as per the requirements of the management on daily, weekly and monthly basis. Some of the reports generated include re-ordering sheet, financial facilities status etc

Control Environment 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 deployed in 2007; is currently being used for reporting purposes.

Business Risk

Industry Dynamics Domestic steel industry is undergoing expansions (flat and long product's manufacturers) announced in previous government's regime. With the commencement of capacity expansions, industry player's performance in current scenario of slowdown in infrastructure projects remains vital. Regulatory protections in form of increased anti-dumping duties is a positive indicator. However, improved business performance and margins are essential for industry players in era of growing key policy rate, depreciating rupee against other currencies and contemporary inflationary pressures.

Relative Position The company has diversity in its product slate and its profiling has significantly improved post listing on PSX. The in-process expansion of 'Additional power capacity' and 'replacement of BMR mill' etc. will enable Mughal to further strengthen its market positioning

Revenues During 9MFY19, topline witnessed a growth of ~26% YoY (9MFY19: PKR 20.9mln; 9MFY18: PKR 16.6mln) primarily due to increase in selling price and sales volume. During 9MFY19, Mughal's sales composition remained tilted towards 'Steel Reinforcement bars' which contributed a total of 58% (FY18: 63%) to the topline, with 'Girders' seeing an increasing trend at 36% (FY18: 33%). Overall sales remained positively skewed towards local market (9MFY19; 99.9%; FY18: 99.9%; FY17: 95.8%). In FY18, the company's capacity utilization level for 'Melting' and 'Re-Rolling' improved to 62% and 56% respectively (FY17: 37%; 54%). An YOY increase was witnessed in the company's operating expenses - up by ~6% (mainly marketing; to expand its post expansion footprints). During 9MFY19, finance costs also shot up to PKR 585mln (FY18: PKR 550mln; 9MFY18: PKR 408mln). Even though there was a significant surge is expenses but the company managed to generate PAT of PKR 1.0bln (FY18: PKR 1.2bln; 9MFY19: PKR 947mln) up by ~14% YOY.

Margins During 9MFY19, Mughal's gross and operating margins witnessed marginal decline (Gross9MFY19: ~12%, FY18: ~13%, 9MFY18: ~13%, Operating: 9MFY19: ~10%, FY18: ~10%, 9MFY18: ~10%). The downward trend is attributable to increase in average raw material consumption rates and increase in other costs of production due to inflationary impact of massive devaluation of local currency.

Sustainability Going forward, Mughal envisages healthy growth emanating from retail segment. During the year, 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 of 28 MW Grid Load has further been energized and added in the total available load capacity of the Company. Consequently, the Company now has total of 59.99 MW load available from its 132-KV dedicated Grid Station. Furthermore, the management is eyeing backward integration which will bode well once materialized.

Financial Risk

Working Capital During 9MFY19, Mughal's working capital requirements, represented by net cash cycle – decreased to 100days (end-Jun18: 107days). This is due to lower receivable days, higher inventory turnover (Inventory days: 9MFY19: 80days; FY18: 88days) and early payment to creditors (Creditor days: 9MFY19: 1day; FY18: 3days). The company manages its working capital requirements through mix of internal generation and short term borrowings (STB; 9MFY19: PKR 8.8bln, FY18: PKR 7.8bln). The company's liquidity profile has improved over the years (Current ratio: (9MFY19: 17.4x; FY18; 19.6x).

Coverages During 9MFY19, on account of higher YoY profitability, FCFO increased to PKR 1.9bln (9MFY18: PKR 1.5bln). Despite surge in debt levels and related finance costs, the company was able to maintain adequate coverage ratios. (Interest: end-Mar19: 3.5x, end-Jun18: 3.6x; end-Mar18: 4.1x, debt service: end-Mar19: 2.3x, end-Jun18: 3.6x; end-Mar18: 4.1x). Going forward, with planned commencement of expansion by Jun-19, cashflows are likely to strengthen further.

Capitalization During 9MFY19, D/E ratio stood at ~59% (end-Jun18: ~54%, end-Mar18: ~48%). The overall debt of the company has been witnessing an increasing trend on account of ongoing expansions and supplementary cushion for the shortcomings of working capital, due to which short-term borrowing have been a significant portion of the total debt book (9MFY19: STB ~79%; FY18: STB: ~81%). Going forward, owing to debt driven expansion, the leveraging is bound to increase; however expected to be managed through planned cash flows.

PACRA

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Mughal Steels Infrastructure | Steel	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
A BALANCE SHEET				
1 Non-Current Assets	7,983	6,344	4,275	3,928
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	12,898	11,130	11,749	7,852
a Inventories	*6,983*	*5,320*	*5,382*	*4,221*
b Trade Receivables	*1,822*	*1,263*	*1,355*	*943*
5 Total Assets	20,881	17,475	16,024	11,780
6 Current Liabilities	740	568	698	1,689
a Trade Payables	*55*	*42*	*272*	*1,277*
7 Borrowings	11,266	8,669	8,046	4,209
8 Related Party Exposure	-	-	-	937
9 Non-Current Liabilities	888	771	643	709
10 Net Assets	7,988	7,466	6,637	4,235
11 Shareholders' Equity	7,988	7,466	6,637	4,235
B INCOME STATEMENT				
1 Sales	20,938	22,226	18,803	18,983
a Cost of Good Sold	*(18,502)*	*(19,431)*	*(16,861)*	*(16,925)*
2 Gross Profit	2,436	2,794	1,942	2,059
a Operating Expenses	(433)	(559)	(406)	(302)
3 Operating Profit	2,003	2,235	1,536	1,757
a Non Operating Income or (Expense)	*(80)*	*(81)*	*(65)*	*(150)*
4 Profit or (Loss) before Interest and Tax	1,923	2,154	1,471	1,607
a Total Finance Cost	*(585)*	*(550)*	*(249)*	*(318)*
b Taxation	*(264)*	*(314)*	*(232)*	*(399)*
6 Net Income Or (Loss)	1,075	1,290	990	890
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,964*	*1,918*	*1,398*	*1,438*
b Net Cash from Operating Activities before Working Capital Changes	*1,517*	*1,401*	*1,178*	*1,214*
c Changes in Working Capital	*(1,873)*	*(468)*	*(2,451)*	*(1,791)*
1 Net Cash provided by Operating Activities	(356)	932	(1,273)	(577)
2 Net Cash (Used in) or Available From Investing Activities	(1,740)	(2,180)	(452)	(238)
3 Net Cash (Used in) or Available From Financing Activities	1,950	160	3,667	391
4 Net Cash generated or (Used) during the period	(146)	(1,088)	1,942	(424)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	25.6%	18.2%	-1.0%	55.1%
b Gross Profit Margin	11.6%	12.6%	10.3%	10.8%
c Net Profit Margin	5.1%	5.8%	5.3%	4.7%
d Cash Conversion Efficiency (EBITDA/Sales)	10.3%	10.9%	9.0%	9.4%
e Return on Equity (ROE)	18.5%	18.3%	18.2%	22.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	101	109	116	105
b Net Working Capital (Average Days)	100	107	100	59
c Current Ratio (Total Current Assets/Total Current Liabilities)	17.4	19.6	16.8	4.6
3 Coverages				
a EBITDA / Finance Cost	3.8	4.5	7.3	6.6
b FCFO / Finance Cost+CMLTB+Excess STB	2.3	3.6	5.3	4.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.3	0.6	0.0	0.9
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	58.5%	53.7%	54.8%	54.9%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Average Borrowing Rate	7.6%	6.4%	3.5%	6.3%

Credit Rating Scale & Definitions

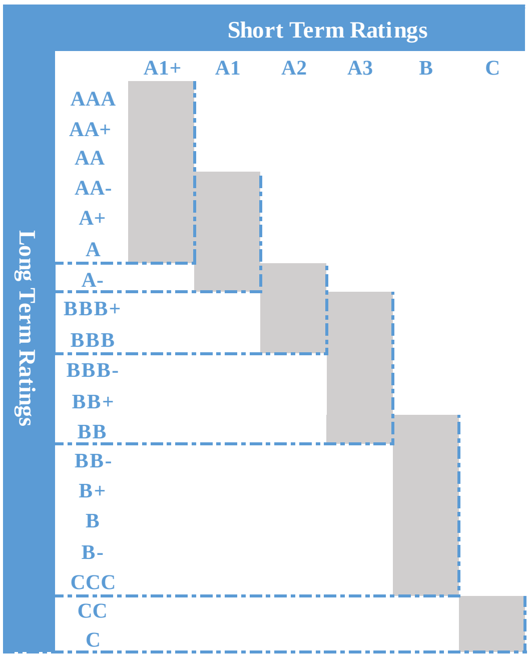
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) 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 | Chapter III | 14-(f-VII)
Proprietary Information