



The Pakistan Credit Rating Agency Limited

Rating Report

Mughal Iron & Steel Industries Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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 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 two independent directors 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. Demand from retail segment is also earmarked by the management as future growth driver. The ongoing expansion projects of 'Additional power capacity' and 'replacement of BMR mill' etc. will enable Mughal to increase its market presence.

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. Going forward, owing to debt driven expansion, the leveraging is bound to increase; however expected to be comfortably managed through healthy cash flows.

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 is vital.

Disclosure

Name of Rated Entity	Mughal Iron & Steel Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Steel(Jan-18)
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, and the business was incorporated in 2010. The company operates through its registered head office located in Lahore and 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; infrastructural projects comprising power and energy, roads and bridges, and dams/generation and distribution networks; and economic housing solutions. 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 such as I-beams, L-sections, C-section, H-beam, T-bar etc. in the downstream industry.

Ownership

Ownership Structure Presently, the company is majority (~75%) owned by Mughal family, followed by Financial Institutions (~11%) and general public (~14%).

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 The sponsors have demonstrated their commitment towards the company by injecting funds on as and when required basis. Given that Mughal is the flagship entity of sponsors, willingness to support the company in case the 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 the year, Mr. Muhammad Waleed Bin Tariq resigned from the board which resulted in an appointment of a new board member - Mr. Abdul Rehman Qureshi.

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. The audit committee comprises of four members, all of whom are non-executive directors. Attendance of Board members at Board meetings and committee meetings was 100%, with zero absence against a target of 95%. Furthermore, presence of Mr. Salman Ali Shah 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 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. He is currently the CEO of many other companies; some prominent ones are, Mughal Energy Limited, Mughal Steel Re-Rolling Industries Limited, Mughal International IMPEX Limited and Indus Engineering (Private) Limited. The CEO 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 for senior management are generated frequently. The 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, transit sheet, supply ledger, receivable report, inventory report, cash management dashboard, 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 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. However, improved business performance and margins is essential for industry players in era of growing interest rate, exchange rate and expected inflationary environment in foreseeable future.

Relative Position Mughal is a known name in the steel industry. 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 strengthen its market positioning.

Revenues Topline witnessed a growth of 18% YoY (FY18: PKR 22.2mln, FY17: PKR 18.8mln) primarily due to increase in selling price and production of self-manufactured billets. Overall sales remained positively skewed towards local market (FY18: 99.9%; FY17: 95.8%). The company's capacity utilization level for 'Melting' and 'Re-Rolling' improved to 62% and 56% respectively (FY17: 37%; 54%). However, in FY18 there was a significant increase in Mughal's operating expense; mainly marketing (to expand its post expansion segmental footprints, increase in selling expenses and freight outward costs) and administrative expenses which rose to 50% and 30% respectively. Furthermore, Finance cost rose to PKR 550mln (FY17: PKR 256mln) on account of greater STB. Even Though there was a significant surge in costs but Mughal's PAT increased by 30% YOY on account of attractive sales. (FY18: PKR 1,290mln; FY17: PKR 991mln). During 1QFY19, the company secured topline of PKR 6.0bln.

Margins During FY18, Mughal's gross and operating margins improved on account of ameliorated prices due to the imposition of anti dumping duty by the NTC in the corresponding year (Gross: 1QFY19: 12.2%, FY18: 12.6%, FY17: 10.3%, Operating: 1QFY19: 10.1%, FY18: 10.1%, FY17: 8.2%).

Sustainability Going forward, Mughal envisages tremendous growth emanating from retail segment. On the back of improving macro-economic indicators driven by strong growth in infrastructure; market for steel is expected to remain strong.

Financial Risk

Working Capital During FY18, Mughal's working capital requirements, represented by net cash cycle (net working capital days) – a function of inventory, receivables and payables – increased to 103days (end-Jun17: 78days). This is due to higher receivables, bulk purchase of inventory (Inventory days: FY18: 84days; FY17: 70days) and early payment to creditors (Creditor days: FY18: 3days; FY17: 16days). The company manages its working capital requirements through mix of internal generation and short term borrowings (FY18: PKR 7840mln, FY17: PKR 8014mln). Current ratio remained the same at 1.3x.

Coverages During FY18, on account of higher YoY profitability, FCFO increased to PKR 1,918mln (FY17: PKR 1,398mln). Despite surge in debt levels and related finance/operating costs in FY18, Mughal was able to maintain adequate coverage ratios.(interest: end-Jun18: 3.5x; end-Jun17: 5.6x, debt service: end-Jun18: 3.5x ; end-Jun17: 5.0x). With the predicted gradual addition in debt, coverages are expected to be affected but remain inbounds of adequacy.

Capitalization During 1QFY18, Debt to Capital ratio marginally stood at 57% (end-Jun18: 54%, end-Jun17: 55%). Debt composition (90% short-term) remained tilted towards short-term borrowings. Going forward, owing to debt driven expansion, the leveraging is bound to increase; however expected to be comfortably managed through healthy cash flows.

Mughal Iron & Steel Industries Limited (Mughal)

	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	3M	Annual	Annual	Annual
BALANCE SHEET				
Non-Current Assets	7,118	6,344	4,275	3,928
Investments	-	-	-	-
Current Assets	12,496	11,130	11,749	7,852
Inventory	6,405	5,320	5,382	4,221
Trade Receivables	1,244	1,263	1,355	943
Others	4,848	4,547	5,012	2,688
Total Assets	19,614	17,475	16,024	11,780
Debt	10,461	8,669	8,046	4,209
Short-term	9,420	7,840	8,014	4,100
Long-term (Inlc. Current Maturity of long-term debt)	1,041	829	32	109
Other short-term liabilities	572	568	698	1,689
Other long-term Liabilities	762	771	643	1,646
Shareholder's Equity	7,818	7,466	6,637	4,235
Total Liabilities & Equity	19,614	17,475	16,024	11,780
INCOME STATEMENT				
Turnover	6,016	22,226	18,803	18,983
Gross Profit	733	2,794	1,942	2,059
Operating profit	607	2,235	1,536	1,757
Financial Charges	(163)	(550)	(249)	(318)
Net Income	352	1,290	991	893
Cashflow Statement				
Free Cashflow from Operations (FCFO)	579	1,918	1,398	1,438
Net Cash changes in Working Capital	(1,076)	(468)	(2,451)	(1,791)
Net Cash from Operating Activities	(595)	932	(1,273)	(577)
Net Cash from Investing Activities	(811)	(2,180)	(650)	(238)
Net Cash from Financing Activities	1,792	160	1,501	391
Ratio Analysis				
Performance				
Turnover Growth (same period last year)	11.5%	18.2%	-1.0%	55.1%
Gross Margin	12.2%	12.6%	10.3%	10.8%
Net Margin	5.9%	5.8%	5.3%	4.7%
ROE	19.1%	18.0%	17.2%	21.4%
Coverages				
Interest Coverage (x) (FCFO/Gross Interest)	3.6	3.5	5.6	4.5
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	3.2	3.5	5.0	3.7
Debt Payback (Years) (Total LT Debt Including UnCovered Total STBs)/(FCFO- Gross Interest)	0.6	0.6	0.0	1.8
Liquidity				
Net WC Days (Inventory Days + Receivable Days - Payable Days)	107	107	100	45
Short-term Total Leverage (Net Current Assets - STB) / Current Assets	20.0%	24.5%	25.8%	26.3%
Capital Structure (Total Debt/Total Debt+Equity)	57.2%	53.7%	54.8%	59.0%

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

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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

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- (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.
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- (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)
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- (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)
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- (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)

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- (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)

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