RATING REPORT

Mughal Iron & Steel Industries Limited

REPORT DATE:
December 8, 2023

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-Term	Short-term	Long-Term	Short-term
Entity	A+	A-1	A+	A-1
Rating Date	*December 8, 2023*		*March 31, 2023*	
Rating Outlook	*Stable*		*Rating Watch-Negative*	
Rating Action	Maintained		Maintained	
Sukuk	A+		A+	
Rating Date	*December 8, 2023*		*March 31, 2023*	
Rating Outlook	*Stable*		*Rating Watch-Negative*	
Rating Action	Maintained		Maintained	

COMPANY INFORMATION

Incorporated in 2010	**External auditors:** M/s Fazal Mahmood & Company Chartered Accountants M/s Muniff Ziauddin & Co. Chartered Accountants
Public Listed Company	**Chairman of the Board:** Mr. Mirza Javed Iqbal **Chief Executive Officer:** Mr. Khurram Javaid
Key Stakeholders (with stake 10% or more):	
Director, CEO, Their Spouse & Minor Children – 43.19%	
Associated Companies, Undertaking, & Related Parties – 32.15%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf
VIS Rating the Issue (August 2023)
https://docs.vis.com.pk/docs/Rating-the-Issue-Aug-2023.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Mughal Iron & Steel Industries Limited

OVERVIEW OF THE INSTITUTION

Mughal Iron & Steel Industries Limited (MISIL) was incorporated as a public limited company on February 16, 2010, under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017). The principal business activity of the company is manufacturing and sale of long steel products. The manufacturing facility is located at 17-KM Sheikhupura Road, while head office is located at 31-A Shadman I, Lahore.

Chairman's Profile: Mr. Mirza Javed Iqbal has been a prominent figure of the steel industry of Pakistan in 1976. He has promoted energy efficiency and has advocated tech advancement in the industry.

CEO's Profile: Mr. Khurram Javaid with an MBA from Coventry University, UK, leads Mughal Steel as CEO. Under his leadership, the Company has gone through modernization, product diversification, and an expanded market presence.

RATING RATIONALE

Corporate Profile

Mughal Iron & Steel Industries Limited ("MISIL" or "the Company") was established on February 16, 2010, as a public limited company. MISIL is a public listed company with its shares traded on the Pakistan Stock Exchange Limited (PSX). Operating from its headquarters in Lahore, the company is engaged in both ferrous and non-ferrous business segments. However, the primary focus remains on the manufacturing and sale of mild steel products within the ferrous segment. The Company has manufacturing plants and warehouses on Sheikhupura Road, Lahore, and sales centers in Badami Bagh, Lahore.

Sukuk Structure:

Mughal has issued PKR 5.0 bln Listed, Secured & Privately Placed Long-Term Islamic Certificates (Sukuk) with a Green Shoe option of PKR 2 bln. The Sukuk has a 5-year tenor, priced at 3MK+1.3% p.a., with quarterly profit payments. A Debt Service Reserve Account (DSRA) is maintained, equal to one full upcoming installment, under lien of the Invest Agent throughout the facility's tenor. During the grace period, DSRA accumulates for one profit payment. Besides DSRA, a debt payment account (DPA) is maintained, with one-third of the upcoming installment deposited monthly by the 25th day. The security structure involves a first pari passu charge over all present and future movable assets, with a 25% margin.

Key Rating Drivers

Business risk is considered high due to exposure to cyclicality, exposure to foreign exchange rate fluctuation, volatility in international steel prices and challenging competitive environment.

VIS considers the business risk within long steel industry to be 'High'. In FY23, the country's economic landscape was constrained with various factors, including supply disruptions linked to the repercussions from the floods in 1HFY23, surging inflation, the depreciation of the local currency, and dwindling foreign exchange reserves. Seeking to stabilize the economy, the State Bank of Pakistan raised interest rates and letter of credit (LC) restrictions, while the government introduced measures such as energy price hikes and increase in corporate taxes. Resultantly, these fiscal and monetary actions inadvertently disrupted supply chains, leading to a significant contraction of GDP to 0.29% in FY23, a sharp decline from the 5.7% growth reported in FY22. The market size was reduced due to the contraction in construction activities in the country.

Moreover. the long steel sector in Pakistan is highly fragmented and intensely competitive, hosting more than 300 melting and re-rolling mills. However, only a handful of companies are considered top-tier players, with MISIL being one of them. The Pakistan Association of Large Steel Producers (PALSP) comprises approximately 52 members, collectively controlling about 70% of primary steel production in the country. Nevertheless, MISIL, along with other large players, faced challenges in maintaining high-capacity utilization. In FY23, MISIL, along with Agha Steels Industries and Amreli Steels, managed to utilize only 35.7% of their combined billet production capacity, a significant decline from the 56.3% achieved in FY22. Simultaneously, rebar production capacity utilization declined from 55.5% in FY22 to 33.5% in FY23, stressing subdued demand in the sector.

While the high steel prices somewhat mitigated the impact of reduced capacity utilization on revenue, the sector witnessed a significant decline in profitability. The industry's gross margins were constrained by high input costs, and elevated finance costs further constrained the bottom line. The spike in finance costs was attributed to the rise in policy rates of 825-bps during the year.

However, due to these factors persisting in the country many of the smaller players have exited the industry. This provided larger players with greater pricing power, helping them maintain their overall margins.

Non-ferrous segment diversifies income, supports import needs through exports, providing support to ratings.

The non-ferrous segment contributes approximately 27% to the Company's overall topline, serving as a supplementary income stream that mitigates inherent risks associated with being a player in the long-steel industry of Pakistan. Furthermore, approximately 74% of the revenue from this segment is generated through exports, offering MISIL essential import cover to procure raw materials for its operations.

Going forward, due to recent expansions, management expects an increase in revenue, especially in exports from non-ferrous segment. Management plans to hedge against the USD and provide import cover for raw materials by increasing their exports.

Continued support of the non-ferrous segment in overall performance will be an important consideration for future ratings.

Topline remained stable with higher selling prices despite contraction in volumes. Although higher input costs, PKR depreciation and rising interest rates kept margins constrained.

The Company's topline remained mostly flat as it recorded sale growth of ~2% during the year with revenue of PKR 67.39 bln (FY22: PKR 66.15 bln) in FY23. MISIL was able to maintain its top line, despite a significant reduction in volumes, on the back of higher selling price. However, the Company was unable to completely pass on the impact of inflationary pressure and currency devaluation resulting in lower gross margins. Mughal reported gross margins of 14.4% (FY22: 15.3%) during the period under review. This trend continued in 1QFY24 with reported gross margin of 12% as inflationary pressure sustained and demand remained subdued.

Net margins also further contracted as a result of heightened operating and financial costs from high interest rates in the country during the period under review.

While gross margin has remained healthy, improvement of the bottom-line as well as net margins will be a key sensitivity for ratings going forward.

Capitalization profile is adequate with improvement in metrics in FY23.

In FY23, the Company reported gearing and leverage ratios of 1.2x (FY22: 1.5x) and 1.6x (FY22: 1.8x), respectively. The long-term debt of MISIL was reported at PKR 4.9 bln in FY23, down from PKR 5.3 bln in FY22 as a result of regular debt repayment. However, in 1QFY24 the Company's capitalization deteriorated slightly on account of higher drawdown of short-term debt to meet increasing working capital requirements.

Maintenance of capitalization metrics in line with assigned ratings will remain an important consideration for future ratings.

Liquidity profile strong with slight improvement in FY23. However, coverage metrics report deterioration and ratings will remain sensitive to improvement going forward.

MISIL's liquidity profile continues to provide sufficient cushion with current ratio of 1.5x (FY23: 1.5x, FY22: 1.4x) and short-term debt coverage of 1.6x (FY23: 1.5x, FY22: 1.4x) in 1QFY24. However, in FY23, coverage profile of the Company reported a deterioration in FY23 to 1.4x (FY22: 2.3x) but remained stable in 1QFY24. This decline was on account of higher financial charges as a result of an 825-bps increase in the country's policy rates during FY23.

Going forward, ratings will remain sensitive to the Company's ability to maintain its liquidity profile and improve its coverage profile to commensurate with assigned ratings.

Mughal Iron & Steel Industries Limited Appendix I

FINANCIAL SUMMARY				(PKR Millions)
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**1QFY24**
Property, plant and equipment	15,799.4	16,460.7	19,692.0	19,618.2
Stock in Trade	14,867.9	22,963.0	23,030.3	26,899.1
Trade debts	5,259.1	5,573.6	9,283.1	9,236.2
Cash & Bank Balances	2,216.9	5,175.6	2,885.1	3,324.3
Total Assets	41,799.8	53,085.5	59,832.0	63,130.5
Trade and other payable	1,732.1	2,923.7	3,006.5	4,012.8
Long-term Debt (incl. current portion and lease liability)	4,676.9	5,309.2	4,980.5	4,554.8
Short-Term Borrowings	16,110.9	20,644.0	21,000.7	22,976.4
Total Debt	20,787.8	25,953.2	25,981.2	27,531.2
Total Liabilities	25,294.9	32,238.4	34,459.5	37,243.0
Issued, Subs, and Paid-Up Capital	2,918.6	3,356.3	3,356.3	3,356.3
Equity (excl. Revaluation Surplus)	13,102.5	17,828.9	21,374.1	21,913.0
INCOME STATEMENT	**FY21**	**FY22**	**FY23**	**1QFY24**
Net Sales	44,971.8	66,152.8	67,390.2	21,032.1
Gross Profit	6,691.4	10,127.9	9,671.0	2,517.7
Operating Profit	5,519.9	8,644.2	8,480.0	2,182.5
Finance Costs	1,370.3	2,622.1	4,423.2	1,583.4
Profit Before Tax	4,161.5	6,202.0	4,346.4	722.2
Profit After Tax	3,429.2	5,411.0	3,480.5	515.1
RATIO ANALYSIS	**FY21**	**FY22**	**FY23**	**1QFY24**
Gross Margin (%)	14.9%	15.3%	14.4%	12.0%
Net Margin (%)	7.6%	8.2%	5.2%	2.4%
Funds from Operation (FFO)	3,884.6	6,244.8	4,389.1	1,149.2
FFO to Total Debt* (%)	18.7%	24.1%	16.9%	16.7%
FFO to Long Term Debt* (%)	83.1%	117.6%	88.1%	100.9%
Gearing (x)	1.6	1.5	1.2	1.3
Leverage (x)	1.9	1.8	1.6	1.7
Debt Servicing Coverage Ratio* (x)	2.1	2.3	1.4	1.4
Current Ratio	1.4	1.4	1.5	1.5
(Stock in trade + trade debts) / STD (x)	1.2	1.4	1.5	1.6
Return on Average Assets* (%)	10.2%	11.4%	6.2%	3.4%
Return on Average Equity* (%)	32.3%	35.0%	17.8%	9.5%

**Annualized, if required*

REGULATORY DISCLOSURES	Appendix II
Name of Rated Entity	Mughal Iron & Steel Industries Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Sukuk Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
08-Dec-23	A+	A-1	Stable	Maintained
31-Mar-23	A+	A-1	Rating Watch – Negative	Maintained
25-Nov-22	A+	A-1	Stable	Reaffirmed
28-Dec-21	A+	A-1	Stable	Upgrade
25-Sep-220	A+	A-2	Stable	Initial
		RATING TYPE: SUKUK		
08-Dec-23	A+		Stable	Maintained
31-Mar-22	A+		Rating Watch – Negative	Maintained
25-Nov-22	A+		Stable	Reaffirmed
28-Dec-21	A+		Stable	Final
05-Oct-21	A+		Stable	Preliminary

Instrument Structure	MISIL has issued rated, listed, secured and privately placed long-term Sukuk of amount up to Rs. 3b (inclusive of a green shoe option of Rs. 1b). Tenor of the Sukuk will be 5 years including 1-year grace period. The instrument will be redeemed in 16 equal quarterly payments starting from 15th month from the date of issuance. Besides conventional security structure, a debt payment account (DPA) will be maintained with the agent bank which will be build up with one third of the installment (principal plus profit) each month by the 25th day such that the entire upcoming installment is deposited in the DPA by the 15th day of 3rd month.
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Due Diligence Meetings Conducted

S.No.	Name	Designation	Date
1.	Mr. Muhammad Zafar Iqbal	Chief Financial Officer	29-Nov-23
2.	Mr. Shakeel Ahmed	Chief Operational Officer	
3.	Mr. Fahad Hafeez	Company Secretary	