RATING REPORT

Mehboob Steel Pipe Industry (MSPI)

REPORT DATE:
August 30, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	BBB-	A-2
Rating Outlook	Stable	
Rating Date	August 27 '19	
Rating Action	Initial	

COMPANY INFORMATION		
Incorporated in 2004	External auditors:	Zaheer Babar & Co. Chartered Accountants
Partnership Concern	Chief Executive:	Mr. Muhammad Ehsan
Partners:		
Mr. Muhammad Ehsan - 25%		
Mr. Zeeshan Mehboob - 25%		
Mr. Imran Mehboob - 25%		
Mr. Rizwan Mehboob - 25%		

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates (May 2019)

https://www.vis.com.pk/kc-meth.aspx

Mehboob Steel Pipe Industry (MSPI)

OVERVIEW OF THE INSTITUTION

Mehboob Steel Pipe Industry (MSPI) was incorporated in 2004 as a partnership concern. Registered office of the company is in Lahore while manufacturing unit is located in Hub, Balochistan.

Profile of CEO

Mr. Muhammad Ehsan is the Chief Executive of the firm and is looking after the affairs of the firm for the last 15 years.

RATING RATIONALE

Mehboob Steel Pipe Industry (MSPI) was established in 2004 as a partnership concern including four real brothers; Mr. Muhammad Ehsan, Mr. Zeeshan Mehboob, Mr. Imran Mehboob & Mr. Rizwan Mehboob. The firm imports hot rolled coils from countries like China, Russia etc. and produces MS Steel tubes and pipes of different sizes & specification according to customers and market demand. The company produces various shapes of tubes & pipes like square, elliptical, rectangular, L type, T type, Z type & D type. These products are mainly used in construction and various other industries like water, oil & gas, automobile, furniture, houses, scaffolding etc. The manufacturing unit of the firm is situated in HUB, Balochistan while the registered office is in Lahore.

The group also operates three other partnership concerns having the same four partners. 'Mehboob Tube Mills' was established in 1998 and is the flagship company of the group. It is the major MS pipe manufacture in Punjab with sales of around Rs. 3b during FY18. It imports hot rolled coils and manufactures MS tubes & pipes. 'Mehboob Engineering Company' is a trading firm of the group and was established in 2013. It buys hot rolled coils, cold rolled coils & galvanized coils from local manufacturers *(Aisha Steel and International Steel)* as a distributor and sells these products to either its group entities or in the local market. 'Mehboob Profile Industries' was established in 2016 and manufactures *Choughat* for doors.

Product Portfolio – focused on manufacturing of MS Steel Tubes and Pipes

MSPI operates five tube making units and manufactures MS Steel tubes and pipes of different sizes from 1/2" to 6" according to the requirements of the customers for different industries. The annual production capacity of the company is around 60,000 metric tons. The company sells its products in the local market mainly to industrial & retail customers. The capacity utilization of the firm remained around 45 - 50% during the last three years. The firm has no plan for further CAPEX in the next three years since it has sufficient idle capacity available for meeting increased demand, if any. As per management, any increase in cost of raw material is passed on to customers.

Sales growth emanating from increase in volumetric sales – Inventory showed reduction amid higher sales

During FY18, the firm reported net sales of Rs. 2.37b (FY17: Rs. 2.04b; FY16: Rs. 1.47b), driven largely by increase in volumetric sales. Although steel sheets are imported from different countries, any increase in price of the steel sheet is mostly passed onto final customers. Gross profit of the firm improved to Rs. 196m (FY17: Rs.127m, Rs. 103m) on account of increase in sales and improvement in gross margins. The operating expenses of the firm increased to Rs. 65m (FY17: Rs. 27m, FY16: Rs. 17m) in FY18 mainly on account of increase in salaries and fuel expenses. The finance cost of the firm increased to Rs. 60m (FY17: Rs. 41m, FY16: Rs. 37m) during FY18 due to increase in average utilization of short term borrowings. The firm was able to generate net profit of Rs. 41m (FY17: Rs. 39m, FY16: Rs. 35m) while net profit margin stood modest at 1.7% (FY17: 1.9%, FY16: 2.3%). Given the increase in finance cost and taxation during FY18, net profit margin reduced. During 9MFY19, the firm reported net sales of Rs. 1.67b (FY18: Rs. 2.37b, FY17: Rs. 2.03b) which is 6% decrease on an annualized basis. The sales are projected to remain stagnant during FY19 mainly on account increased steel coil prices and end products due to rupee depreciation. Gross profit margin of the firm improved to 9% (FY18: 8.3%, FY17: 6.2%) on account of increased prices while net profit margin also stood higher at 2.3% (FY18: 1.7%, FY17: 1.9%) during 9MFY19.

The firm carried out capital expenditure of Rs. 32m on fixed assets during FY18 (FY17: Rs. 1m, FY16: Rs. 57m) which includes expenditure of Rs. 7m on building & Rs. 5m on plant & machinery while Rs. 20m were related to purchase of vehicles for the firm. The firm follows the practice of keeping raw material inventory of around 3-4 months with imports mainly emanating from China, Russia, etc. MSPI held inventory of Rs. 120m (FY17: Rs. 578m, FY16: Rs. 148m) at end-FY18. It is pertinent to note that an amount of Rs. 221m already paid as LC advance for stock in transit was not appearing under inventory. Trade receivables of the company increased to Rs. 487m (FY17: Rs. 251m, FY16: Rs. 240m) as now 75% of goods are sold on credit basis with credit terms upto 30 days while 25% are sold on cash basis. Previously, the firm used to sell around 60% on cash basis. Advances, deposits & prepayments increased to Rs. 886m (FY17: Rs. 377m, FY16: Rs. 335m) which mainly included bank guarantee of Rs. 136m, LC advance against stock in transit of Rs. 221m, customs refund of Rs. 84m and other receivables / prize bonds of Rs. 399m. The amount of Rs. 399m under other receivables / prize bonds relates to amnesty scheme availed by the firm during FY18. The firm did not carry out any capital expenditure during 9MFY19 as capacity utilization remained around 50%. MSPI held inventory of Rs. 96m (FY18: Rs. 120m, FY17: Rs. 578m) and an amount of Rs. 76m already paid as LC advance for stock in transit was not appearing under inventory. There was no major change in trade receivables which increased to Rs. 501m (FY18: Rs. 487m, FY17: Rs. 251m). Advances, deposits & prepayments decreased to Rs. 748m (FY18: Rs. 886m, FY17: Rs. 377m).

Modest coverages and liquidity

Funds from operations (FFO) increased to Rs. 64m (FY17: Rs. 58m, FY16: Rs. 45m) in line with increase in sales during FY18. Overall borrowing which consists of short term debt only increased to Rs. 916m (FY17: Rs. 699m, FY16: Rs. 350m) by end-FY18 mainly utilized to finance inventory & receivables. FFO to total debt ratio remained low at 0.07x (FY17: 0.08x, FY16: 0.13x). The debt service coverage ratio, albeit adequate, decreased to 1.93x (FY17: 2.87x, FY16: 2.22x) due to increase in interest paid. The current ratio remained satisfactory at 1.59x (FY17: 1.50x, FY16: 1.96x). Meanwhile, inventory plus trade receivables to short-term borrowing ratio declined to 0.66x (FY17: 1.19x, FY16: 1.11x) on account of reduction in stocks and increase in short term borrowings. Funds from operations (FFO) (annualized) increased to Rs. 79m (FY18: Rs. 64m, FY17: Rs. 58m) during 9MFY19 in line with increase in net profit. Overall borrowing which consisted of short term debt only decreased to Rs. 750m (FY18: Rs. 916m, FY17: Rs. 699m) by end-9M19. Hence, FFO to total debt ratio improved to 0.11x (FY18: 0.07x, FY17: 0.08x). The debt service coverage ratio stood higher at 3.08x (FY18: 1.93x, FY17: 2.87x). The current ratio remained satisfactory at 1.76x (FY18: 1.59x, FY17: 1.50x). The inventory plus trade receivables to short-term borrowing ratio improved, though remained low at 0.80x (FY18: 0.66x, FY17: 1.19x) on account of reduction in short term borrowings.

Adequate leverage indicators

Total equity base stood higher at Rs. 698m by end-FY18 (FY17: Rs. 527m; FY16: Rs. 492m) on the back of profit retention of Rs. 41m and net capital injection by partners amounting to of Rs. 130m during FY18. Debt leverage of the firm decreased to 1.36x (FY17: 1.53x, FY16: 0.75x) during FY18 while gearing decreased slightly to 1.31x (FY17: 1.33x, FY16: 0.71x) due to increase in total equity. As per 9M19 financials, total equity base increased to Rs. 733m by end-9M19 (FY18: Rs. 698m; FY17: Rs. 527m) on the back of profit retention of Rs. 35m while drawing amounted to Rs. 2.4m. Debt leverage of the firm decreased further to 1.07x (FY18: 1.36x, FY17: 1.53x) during 9M19 while gearing decreased to 1.02x (FY18: 1.31x, FY17: 1.33x) mainly on account of decrease in short term borrowing & total liabilities.

ERP System & Audit

The firm is using internally developed software for tracking inventory and receivables. The external auditor of the company is "Zaheer Babar & Co." which carries out audit on annual basis.

Mehboob Steel Pipe Industry **Appendix I**

FINANCIAL SUMMARY

(Amounts in PKR millions)

BALANCE SHEET	30-Jun-16	30-Jun-17	30-Jun-18	31-Mar-19
Non-Current Assets	135	123	139	132
Stock-in-Trade	148	578	120	96
Trade Debts	240	251	487	501
Advances and Deposits	335	377	886	748
Other Assets	1	1	1	1
Cash & Bank Balances	3	5	13	41
Total Assets	862	1,335	1,646	1,519
Trade and Other Payables	5	89	3	15
Short Term Borrowings	350	699	916	750
Long Term Debt	-	-	-	-
Total Interest Bearing Debt	350	699	916	750
Other Liabilities	15	20	30	21
Total Liabilities	370	808	949	786
Sponsors Loan	-	-	-	-
Tier 1 Equity (Inc. sponsors loan)	492	527	698	733
Revaluation Reserves	-	-	-	-
Total Equity including Revaluation Reserves	492	527	698	733
INCOME STATEMENT	30-Jun-16	30-Jun-17	30-Jun-18	31-Mar-19
Net Sales	1,474	2,039	2,370	1,674
Gross Profit	103	127	196	151
Finance Cost	37	41	60	42
Profit after Tax	35	39	41	38
RATIO ANALYSIS	30-Jun-16	30-Jun-17	30-Jun-18	31-Mar-19
Gross Margin (%)	7.0	6.2	8.3	9.0
Net Margin (%)	2.3	1.9	1.7	2.3
Current Ratio (x)	1.96	1.50	1.59	1.76
Net Working Capital	356	403	558	600
Debt Leverage (x)	0.75	1.53	1.36	1.07
Gearing (x)	0.71	1.33	1.31	1.02
FFO	45	58	64	79
FFO to Total Debt (x)	0.13	0.08	0.07	0.11
FFO to Long Term Debt (x)	-	-	-	-
Debt Servicing Coverage Ratio (x)	2.22	2.87	1.93	3.08
Inventory + Receivables/Short-term Borrowings (x)	1.11	1.19	0.66	0.80
ROAA (%)	4.0	1.8	1.4	1.6
ROAE (%)	7.0	3.8	3.4	3.6

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Mehboob Steel Pipe Industry
Sector	Steel
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see below
Instrument Structure	N/A
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
08/27/2019	BBB-	A-2	Stable	Initial