RATING REPORT

Mehboob Steel Pipe Industry (MSPI)

REPORT DATE:
Jan 12, 2022

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	10th Jan, 2022	

COMPANY INFORMATION		
Incorporated in 2004	**External auditors:**	Zaheer Babar & 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 (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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

The ratings assigned to Mehboob Steel Pipe Industry (MSPI) take into account the moderate business risk profile of allied steel products sector given its fragmented nature accompanied by prevailing competition and price sensitivity of raw material to exchange rate. Moreover, current low per capita steel consumption and favorable demand outlook from industries (autos, construction and pipelines) catered to by steel tube and pipe industry is expected to keep demand risk of the company mitigated which draws comfort to the ratings. Assessment of financial risk profile incorporates growth in revenues based on volumetric increase, improvement in leverage indicators and adequate debt service coverage. The company has a conservative capital structure with no reliance on long-term borrowings; moreover, the utilization of short-term funding was also largely tapered off during the review period owing to efficient inventory management. The company has no plan of procuring long-term funding in the medium to long-term as no major capital expenditure is in the pipeline; any uptick in demand will be accommodated by the existing capacity. The ratings derive strength from equity injection made by the sponsors during the ongoing year to support growing working capital requirements. The ratings remain sensitive to downward trend witnessed in margins; the same was an outcome of increase in raw material prices coupled with timing differential and delay experienced in transferring price increase to end customers. On account of dip in margins, cash flow generation in terms of outstanding obligations, albeit improved, still remain on a lower side. The ratings remain dependent on improvement of business margins through operational efficiencies, prudent management of working capital cycle and maintenance of leverage indicators at around current levels.

Company & Group Profile: 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 including China, Russia, South Africa etc. and produces steel tubes and pipes of different sizes & specifications 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. 'Mehboob Engineering Company' is a trading firm of the group and was established in 2013. The company 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 mild steel (MS) Tubes and Pipes
MSPI operates five tube making units and manufactures MS tubes and pipes of varying sizes ranging from 1/2" to 6" in diameter as per requirements of their customers for different industries. The company sells its products in the local market mainly to industrial & retail customers. One of the major products, Cold Rolled (CR) steel tubes are predominantly used in the automotive, motorcycle, bicycle, transformer industries and in the manufacturing of fans, furniture, tents and other mechanical & general engineering items. As per the

management, the maximum length of the product is 21 feet. The main clients include United Motorcycle, Ravi Motors, Jameel Autoparts, Saad Autoparts, Arslan Fan Industry, Kami Industries, Steelex, Bilal Steel Industry etc. As per the management, around 70% of sales are made on cash while 30%of customers are extended average credit period of 15 days.

The annual production capacity of the company is around 60,000 MT. The capacity utilization of the firm has remained around 40 - 45% 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.

Sales growth emanating from increase in volumetric sales: Sizable growth was witnessed in the company's topline with the same increasing by almost 40% to Rs. 2.6b (FY20: Rs. 1.8b) during FY21 majorly on account of increase in quantum of products sold; the quantity of products sold was recorded higher at 23,400 MT during FY21 as opposed to 19,000 MT in the preceding year. The increase in quantum of the final products sold contributed around 80% increase to the total revenue in the outgoing year while the remaining was driven by price escalation. The gross margins of the company declined to 5.8% (FY20: 9.1%) during the outgoing year as a combined impact of increase in average input price of imported hot rolled steel coils, constituting 90% of total raw material cost, to USD $855.4/MT from USD $512.6/MT and timing differential and delay experienced in transferring price increase to end customers. As per the management, the company does not immediately shift the price increase to end consumes rather start with passing around 60% of increase at first while the remaining is staggered and forwarded in different tranches with close monitoring of market conditions. Going forward, the margins are expected to remain range bound between 6-8% for FY22; as per the management other than loss of certain basis points on account of contribution margin, the company is able to pass majority of incremental cost to final consumers fairly with ease as the same is a widely accepted phenomenon in the steel sub-segment and practiced by all players in the organized segment. Going forward, the management projects to close FY22 with a topline of Rs. 2.8b; VIS expects that the target is realistic and achievable given Rs. 1.5b revenue was booked in HY22.

Moreover, administrative expenses decreased to Rs. 39.6m (FY20: Rs. 56.8m) on account of decrease in salary and benefits along with lower travelling & conveyance expense. In addition, with decrease in utilization of short-term borrowings in line with offloading of excess inventory carried on books coupled with sharp dip in benchmark interest rates in order to cope with the economic slowdown caused by the pandemic during the outgoing period, the finance cost was reported lower at Rs. 54.5m (FY20: Rs. 67.9m) during FY21. Subsequently, with significant growth manifested in revenues coupled with rationalized operating and financial expenses, the bottom line of the company was recorded higher at Rs.17.1m (FY20: 14.4m) during FY21; however, the increase in profit after tax was substantially scaled down due to drop in margins.

Liquidity position exhibited improvement stemming from enhanced scale of operations: Liquidity profile of the company slightly exhibited slight improvement during the ongoing year in line with growth in scale of operations. Funds from Operations (FFO) were recorded at Rs. 25.6m (FY20: Rs. 11.7m) during FY21 owing to higher revenues reaped. As a result, FFO to total debt improved to 0.10x (FY20: 0.01x) at end-FY21; however, the same is still on a lower side. On the other hand, the company has long-term debt free balance sheet therefore FFO to long-term debt was not calculated. In addition, the debt service coverage improved and was adequate at 1.44x (FY20: 1.17x) in line with growth in FFO; the same depicts that the company is comfortably placed to meet its contractual obligations due in one year. Stock in trade decreased to Rs. 620.8b (end-FY20: Rs. 924.2) at end-FY21 owing to reduction in inventory levels carried forward due to covid-19 related disruptions. The company follows the practice of keeping raw material inventory for around 3-4 months with imports mainly emanating from China, Russia and South Africa. Further, trade debts also increased during the outgoing year owing to increase in revenues; the aging of receivables is considered satisfactory as less than 5% were overdue for more than six months. Advances & deposits were recorded at Rs. 354.0m (FY20: Rs. 362.2m) during FY21; the same majorly comprise bank guarantee worth Rs. 130.m opened for purchase of imported raw followed by sales & income tax recoverable from the government amounting to Rs. 142.2m at end-FY21. Liquidity of the company is impacted due to significant tax refunds due from government however the company is unable to rectify the situation given it is an exogenous factor and inherent in the local steel industry. On the other hand, trade and other payables were recorded higher at Rs. 132.9m (FY20: Rs. 73.8m) at end-FY21; the increase manifested in trade payables is largely in sync with enhancement of scale of operations. MSPI carried out no fixed capital expenditure during the last two fiscal years.

Long-term debt free capital structure: Tier-1 equity of the company reduced to Rs. 819.4m (FY20: Rs. 895.1m) at end-FY21 owing to drawings by the sponsors amounting to Rs. 114.2m. On the other hand, equity injection of Rs. 21.5 was also made during the outgoing year so the net impact of drawings was Rs. 92.8m at end-FY21. The company has zero reliance on long-term debt therefore debt profile of the company only comprises short-term borrowings. With decline in carryover inventory stocks leading to reduced working capital requirements, short-term borrowings of the company decreased sizably to 263.2m (FY20: Rs. 873.9m) by end-FY21. These facilities include running finance (RF) and finance against imported merchandise (FIM) and are locked in at a markup arrangement of 3M-KIBOR+ 0.9%. RF facilities are secured against charge on fixed assets of the company while FIM facilities are secured against present and future current assets of the company. In line with sizable decrease in short-term funding obtained, gearing and debt leverage improved to 0.32x (FY20: 0.98x) and 0.53x (FY20: 1.09x) by end-FY21. The leverage indicators continue to remain on a lower side than peers. Furthermore, the company has no plans of obtaining long-term funding during the rating horizon as there are no capex plans in the pipeline. Moreover, as per the management the sponsors have injected additional equity of Rs. 350.0m during HY22 to ease working capital requirements' and reduce reliance on short-term credit. In addition, the equity injected is projected to remain vested in the company for medium to long-term. Subsequently, as a combined impact of equity injection and internal capital generation, the gearing and leverage indicators are expected to further trend downwards by end-FY22.

Mehboob Steel Pipe Industry **Appendix I**

FINANCIAL SUMMARY

(Amounts in PKR millions)

BALANCE SHEET	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**	**30-Jun-21**
Non-Current Assets	123	139	132.1	138.5	127.4
Stock-in-Trade	578	120	411.9	934.2	411.9
Trade Debts	251	487	206.0	335.7	206.6
Advances and Deposits	377	886	749.9	362.6	354.0
Cash & Bank Balances	5	13	41.3	99.3	154.7
Total Assets	1,335	1,646	1,929.1	1,870.3	1,254.0
Trade and Other Payables	89	3	14.6	73.8	132.9
Short Term Borrowings	699	916	1,113.5	873.9	263.2
Long Term Borrowings	-	-	-	-	-
Total Borrowings	699	916	1,113.5	873.9	263.2
Total Liabilities	808	949	1,223.7	975.2	434.5
Paid Up Capital					
Tier-I Equity/ Partner's Capital	527	698	705.5	895.1	819.4
Revaluation Reserves	-	-	-	-	-
Total Equity including Revaluation Reserves	527	698	705.5	895.1	819.4
INCOME STATEMENT	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**	**30-Jun-21**
Net Sales	2,039	2,370	2,086.8	1,831.2	2,560.9
Gross Profit	127	196	140.1	166.0	149.7
Finance Cost	41	60	42.1	67.9	54.5
Profit after Tax	N/A	70.6	59.3	41.9	55.5
Profit after Tax	39	41	38.3	14.4	17.1
RATIO ANALYSIS	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**	**30-Jun-21**
Gross Margin (%)	6.2	8.3	6.7	9.1	5.8
Net Margin (%)	1.9	1.7	0.5	0.8	0.7
Current Ratio (x)	1.50	1.59	1.45	1.78	2.59
Net Working Capital	403	558	554.7	756.6	692.0
Debt Leverage (x)	1.53	1.36	1.73	1.09	0.53
Gearing (x)	1.33	1.31	1.58	0.98	0.32
FFO	58	64	25.3	11.7	25.6
FFO to Total Debt (x)	0.08	0.07	0.02	0.01	0.10
FFO to Long Term Debt (x)	-	-	-	-	-
Debt Servicing Coverage Ratio (x)	2.87	1.93	1.67	1.17	1.44
Inventory + Receivables/Short-term Borrowings (x)	1.19	0.66	1.05	1.45	2.35
ROAA (%)	1.8	1.4	0.6	0.8	1.1
ROAE (%)	3.8	3.4	1.5	1.8	2.0

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 table 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.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
10-Jan-22	BBB-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Mohd. Safdar	CFO	07-Jan-2022