RATING REPORT

Mehboob Steel Pipe Industry (MSPI)

REPORT DATE:
Dec 30, 2022

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	BBB-	A-2	BBB-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*30th Dec, 2022*		*10th Jan, 2022*	
Rating Action	Reaffirmed		Initial	

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)

RATING RATIONALE

The ratings assigned to Mehboob Steel Pipe Industry (MSPI) take into account the elevated business risk profile of steel and allied products sector in line with dampened demand due to the slowdown in construction and automobile industries. In view of the weak macroeconomic indicators of the country, high benchmark rates, political uncertainty, inflationary pressure, revised sovereign credit rating and restrictions imposed on quantity of imports of CKD kits, a significant demand slowdown in the automobile industry is forecasted. Demand in other CRC consuming sectors is also likely to weaken in tandem with depressed GDP growth. The business risk profile also incorporates fragmented nature of the sector accompanied by prevailing competition and price sensitivity of raw material to exchange rate. Assessment of financial risk profile incorporates decline in revenues based on volumetric decrease, slight dip in margins and increased leverage indicators on account of higher utilization of short-term borrowings. The company has a conservative capital structure with no reliance on long-term borrowings; moreover, the utilization of short-term funding is also cyclical in nature pegged with timing of bulk import orders made. 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 liquidity profile in terms of cash flow generation sand debt service coverage remains fair. The ratings derive strength from equity injection made by the sponsors during the ongoing year to support growing working capital requirements. However, elevated gearing levels relative to business risk and thin margins remains a rating constraint. Projected improvement in the same through consistent profit retention together with improvement in liquidity position is considered important from the ratings perspective.

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

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.

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. MSPI incurred fixed capital expenditure to the tune of Rs. 31.5m on construction of factory shed and addition of two machines for replacement; the entire cost outlay was met from internal sources. The firm has no plan for expansion in the next three years since it has sufficient idle capacity available for meeting increased demand, if any. Nevertheless, replacement of one machine costing Rs. 20m is planned for FY23 which would be financed solely from equity.

Revenue and margins declined during the outgoing year: MSPI's sales were recorded lower at Rs. 2.3b (FY21: Rs. 2.6b) during FY22 majorly on account of decrease in quantum of products sold as the average prices of the different product types either remained unchanged or increased. The gross margins of the company declined to 5.2% (FY21: 5.8%) 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 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 increase while remaining range bound between 6-7% for FY23; as per the management the company is able to eventually 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 FY23 with a topline of Rs. 2.5b; VIS expects that the target is realistic and achievable given Rs. 1.3b revenue was booked in HY23.

Moreover, administrative expenses amounted to Rs. 42.3m (FY21: Rs. 39.6m) on account of higher deprecation charge along with general inflationary increase in all expense heads. Moreover, despite recording of higher short-term borrowings at year end-FY22 in line with bulk procurement of four months of imported raw material, the finance cost decreased to Rs. 34.1m (FY21: Rs. 55.5m) as the average utilization of short-term credit was lower during FY22 as opposed to preceding year. Subsequently, with dip in revenues offset by rationalized financial expenses, the bottom line of the company was recorded only slightly lower at Rs. 16.0m (FY21: 17.1m) during FY22.

Liquidity position remained unchanged: Liquidity profile of the company remained unchanged as Funds from Operations (FFO) were recorded same at Rs. 25.6m (FY21: Rs. 25.6m) despite reduction in revenue in line with reduced markup expense paid during FY22. On the flip side, on account of increased utilization of short-term debt to finance inventory procurement, FFO to total debt was recorded lower at 0.02x (FY21: 0.10x) at end-FY22; the same is on a lower side. Nevertheless, the company has long-term debt free balance sheet therefore FFO to long-term debt was not calculated. Moreover, the debt service coverage improved and was comfortable at 2.48x (FY21: 1.44x) in line with reduced interest expense paid as there are no long-term repayments. Stock in trade increased to Rs. 1.3b (end-FY21: Rs. 411.9m) at end-FY22 owing to bulk procurement of raw material carried out at end-FY22. 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 reduced during the outgoing year owing to decline in revenues. Advances & deposits were recorded higher at Rs. 591.6m (FY21: Rs. 354.0m) during FY22; the same majorly comprise bank guarantee worth Rs. 159.7.m (FY21: Rs. 130.0m) opened for purchase of imported raw material followed by sales & income tax recoverable from the government amounting to Rs. 238.3m (FY21: Rs. 76.1m) at end-FY22. 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 lower at Rs. 72.3m (FY21: Rs. 132.9m) at end-FY21; the decrease manifested in trade payables is largely in sync with reduction of scale of operations. Furthermore, the current ratio and short-term borrowing coverage were recorded comfortably over 1.0 x during the period under review.

Long-term debt free capital structure: Tier-1 equity of the company increased to Rs. 940.1m (FY21: Rs. 819.4m) at end-FY21 owing to equity introduced by a partner amounting to Rs. 129.3m. On the other hand, drawings of Rs. 24.6 was also made during the outgoing year so the net impact of drawings was Rs. 104.7m at end-FY22. The company has zero reliance on long-term debt therefore debt profile of the company only comprises short-term borrowings. With increase in carryover inventory stocks leading to higher working capital requirements, short-term borrowings of the company increased sizably to Rs. 1.2b (FY21: Rs. 263.2m) by end-FY22. 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. As per the management, short-term funding has an element of cyclicality attached to it given the company's business model entails procurement of imported raw material for four months of forecasted demand. In line with sizable increase in short-term funding obtained, gearing and debt leverage increased to 1.32x (FY21: 0.32x) and 1.42x (FY21: 0.53x) by end-FY22. Nevertheless, 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, with reduction is inventory levels to Rs. 450m at end-Nov'22, the short-term borrowings have scaled down accordingly. In addition, the sponsors have injected additional equity of Rs. 100.0m during HY23 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 trend downwards by end-FY23.

Mehboob Steel Pipe Industry **Appendix I**

FINANCIAL SUMMARY (*Amounts in PKR millions)*

BALANCE SHEET	30-Jun-19	30-Jun-20	30-Jun-21	30-Jun-22
Non-Current Assets	132.1	138.5	127.4	145.7
Stock-in-Trade	411.9	934.2	411.9	1,315.1
Trade Debts	206	335.7	206.6	187.1
Advances and Deposits	749.9	362.6	354	591.6
Cash & Bank Balances	41.3	99.3	154.7	39.6
Total Assets	1,929.10	1,870.30	1,254.00	2,279.1
Trade and Other Payables	14.6	73.8	132.9	72.3
Short Term Borrowings	1,113.50	873.9	263.2	1,237.6
Long Term Borrowings	-	-	-	-
Total Borrowings	1,113.50	873.9	263.2	1,237.6
Total Liabilities	1,223.70	975.2	434.5	1,339.0
Paid Up Capital	-	-	-	-
Tier-I Equity/ Partner's Capital	705.5	895.1	819.4	940.1
Total Equity including Revaluation Reserves	705.5	895.1	819.4	940.1

INCOME STATEMENT	30-Jun-19	30-Jun-20	30-Jun-21	30-Jun-22
Net Sales	2,086.80	1,831.20	2,560.9	2,329.1
Gross Profit	140.1	166	149.7	121.5
Finance Cost	42.1	67.9	54.5	34.1
Profit after Tax	59.3	41.9	55.5	45.2
Profit after Tax	38.3	14.4	17.1	16.0

RATIO ANALYSIS	30-Jun-19	30-Jun-20	30-Jun-21	30-Jun-22
Gross Margin (%)	6.7	9.1	5.8	5.2
Net Margin (%)	0.5	0.8	0.7	0.7
Current Ratio (x)	1.45	1.78	2.59	1.59
Net Working Capital	554.7	756.6	692	794.4
Debt Leverage (x)	1.73	1.09	0.53	1.42
Gearing (x)	1.58	0.98	0.32	1.32
FFO	25.3	11.7	25.6	25.6
FFO to Total Debt (x)	0.02	0.01	0.1	0.02
FFO to Long Term Debt (x)	-	-	-	-
Debt Servicing Coverage Ratio (x)	1.67	1.17	1.44	2.48
Inventory + Receivables/Short-term Borrowings (x)	1.05	1.45	2.35	1.21
ROAA (%)	0.6	0.8	1.1	0.9%
ROAE (%)	1.5	1.8	2	1.8%

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	

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

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

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