RATING REPORT

Mehboob Steel Pipe Industry

REPORT DATE:
April 17, 2024

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		Rating Watch – Developing	
Rating Date	*April 17, 2024*		*March 31, 2023*	
Rating Action	Upgrade		Maintained	

COMPANY INFORMATION

Incorporated in 2004	**External auditors:** Zaheer Babar & Chartered Accountants
Partnership Concern	**Board Chairman:** Mr. Muhammad Adnan Afaq
Partners:	**Chief Executive Officer:** Mr. Muhammad Ehsan
Mr. Muhammad Ehsan – 25%	
Mr. Zeeshan Mehboob – 25%	
Mr. Imran Mehboob – 25%	
Mr. Rizwan Mehboob – 25%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

RATING SCALE(S)

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

Mehboob Steel Pipe Industry

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

Company & Profile:

Mehboob Steel Pipe Industry ('MSPI' or 'Mehboob' or 'the Company') was incorporated in 2004 as a partnership concern. The Company imports hot rolled coils from various sources including China, Russia, and South Africa. MSPI produces steel tubes and pipes in various sizes and specifications based on customer requirements and market trends. The product portfolio encompasses a range of shapes including square, elliptical, rectangular, L-type, T-type, Z-type, and D-type. These products find application primarily in the construction sector, with additional uses in water, oil & gas, automobile, furniture, housing, and scaffolding industries. Mehboob's manufacturing unit is in Hub, Balochistan, while the registered office is situated in Lahore.

Group Profile

The four founding partners of MSPI are also involved in three other partnership concerns. Established in 1998, Mehboob Tube Mills ('MTM') serves as the group's flagship company. Mehboob Engineering Company ('MEC'), founded in 2013, functions as a trading arm, distributing hot rolled coils, cold rolled coils, and galvanized coils procured from local manufacturers (*Aisha Steel and International Steel*) to group entities or within the local market. Mehboob Profile Industries ('MPI'), incorporated in 2016, manufactures door components (*Choughat*).

Key Rating Drivers

High business risk profile characterized by sensitivity to economic cyclicality and exposure to fluctuation in exchange rates and international commodity prices.

VIS considers the business risk profile of the steel pipes & tubes industry to be 'High', largely due to its susceptibility to fluctuations in economic environment and dependence on various factors such as raw material prices, exchange rates, inflation, and financing costs. Moreover, the industry is competitive with ~50 plus units operating across the country. However, out of which only two are listed on the Pakistan Stock Exchange (PSX).

A significant portion of the raw material costs for pipe manufacturing involves the procurement of Hot Rolled Coils (HRC), primarily imported from countries such as China. These coils are processed into pipes through continuous or semi-continuous production lines and tailored to meet customer requirements.

Major Business Risk Factors:

1. **Low-Capacity Utilization:** In recent years, companies operating in the tubular sector have been operating at reduced capacity utilization, reflecting diminished demand for tubular products. For instance, during FY23, the industry's combined capacity of pipes stood at approximately 785,000 metric tons, yet the actual utilization was only 146,174 metric tons, translating to a utilization rate of 18.6% in FY23, down from 22.0% in the previous year. Low demand resulted from economic recession, reduced new housing and infrastructure development projects, elevated steel prices, inflation, and higher financing costs.

2. **Revenue and Profitability:** The industry's revenue (as per listed clients) decreased from PKR 46,157 million in FY22 to PKR 32,068 million in FY23. Although steel pipe prices remained high during the year, lower demand led to reduced sales revenue. The sector remained profitable, with profits largely attributable to other income and income from investments rather than core operations.
3. **Taxation Challenges:** The steel sector is heavily taxed in Pakistan due to the importation of a significant portion of its raw materials. Custom duty, with additional regulatory duty, sales tax, income tax, and other levies impact steel product prices. The current tax structure is expected to persist going forward, necessitating efficient procurement and inventory management to sustain profitability.
4. **Higher Financing Costs:** Increased policy rates by the State Bank of Pakistan to control inflation have impacted industries heavily reliant on bank financing, including the steel sector. The higher policy rate has resulted in sharply rising finance costs for companies in the industry, with no significant rate reduction expected in the near term.
5. **Rupee Depreciation:** The substantial depreciation of the Pakistani Rupee (PKR) against the US Dollar has elevated the working capital requirements for domestic manufacturers. This, coupled with higher benchmark rates, has increased finance costs for the steel industry.
6. **Gas and Electricity Price Increases:** Rising gas and electricity prices significantly influence sales and profitability in the steel sector. Recent rate hikes in both gas and electricity have led to increased unit prices for steel products, impacting sales and profitability.

The outlook for the steel sector remains uncertain in the short to medium term, with several challenges on the horizon, including macroeconomic concerns, inflation, raw material costs, energy expenses, exchange rate fluctuations, and high financing rates. Industry reforms and government support for fuel prices, inventory management, energy-efficient machinery, import restrictions, and anti-dumping measures will be crucial for reviving the sector's outlook.

Ratings are constrained by the Company's Corporate Structure

Ratings are constrained by the corporate structure of the Company as a partnership. This structure presents various limitations that affect the overall sensitivity of the Company's ratings. Partnerships typically entail shared ownership and management responsibilities among partners, which can impact decision-making processes and operational efficiency. Risk is exacerbated by the potential of internal disputes as well as weaker corporate governance compared to other corporate structures. Additionally, partnerships may face challenges in raising capital compared to corporations, inhibiting the Company's access to finance.

Topline improved despite the slowdown in economic activity in the country, gross and operating margins reported improvements while net margins remained stable.

In FY23, the revenue of the Company was recorded at PKR 3.5 bln (FY22: PKR 2.3 bln), registering an uptick of ~53%. This increase was mainly driven by upward adjustments in pricing, while volumes reported only a slight decline as per the management. As a result of upward adjustment in selling prices and inventory gains, gross margins and operating margins enhanced to 7.1% (FY22: 5.2%) and 5.8% (FY22: 3.4%), respectively, in FY23.

However, the Company's net margins remained steady at 0.7% (FY22: 0.7%) as elevated finance costs, stemming from an 825-basis point increase in local policy rates, offset the gains from improved operational margins on the bottom line.

Adequate capitalization profile characterized by short-term borrowing to meet working capital requirements.

The Company's capitalization profile noted improvement in FY23, with gearing and leverage ratios declining to 1.0x (FY22L 1.3x) and 1.0x (FY22: 1.4x), respectively. Mehboob's debt structure relies solely on short-term borrowings, with Nil utilization of long-term debt. This reliance on short-term borrowing is inherent to MSPI's business model, which involves procuring raw materials to cover four months of forecasted demand, resulting in a substantial working capital requirement. However, in FY23, improvement in the cash conversion cycle led to a decrease in the working capital requirement, consequently reducing the overall short-term debt drawdown.

Coverage profile under pressure with higher financial burden with heightened interest rates.

In FY23, despite an improvement in cash flow from operations, heightened interest rates during the year increased the financial burden, resulting in constrained funds from operations (FFO). As a result, the debt servicing ratio (DSCR) of the Company experienced severe pressure, deteriorating to 1.0x (FY22: 2.5x). Similarly, MSPI's FFO/Total Debt remained under stress, weakening further to 0.0% (FY22: 2.1%), in FY23. Additionally, Mehboob's short-term debt coverage profile deteriorated to 1.0x (FY22: 1.2x) due to a significant decrease in stock in trade by 38% and a reduction in short-term borrowing by 22%.

Healthy liquidity profile.

The Company maintains a strong liquidity profile, evidenced by a current ratio of 1.8x (FY22: 1.6x) and a healthy quick ratio of 1.0x (FY22: 0.6x). The improvement in liquidity metrics is supported by enhancements in the cash conversion cycle, advances to supplies and a reduction in short-term debt drawdown.

Key Rating Considerations

Going forward, assigned ratings will be sensitive to MSPI's ability to recover its coverage profile to historical levels. Moreover, continued improvement in the capitalization, and profitability profile will also remain important considerations for future reviews.

REGULATORY DISCLOSURES — Appendix I

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				
17-Apr-24	BBB	A-2	Stable	Upgrade
31-Mar-23	BBB-	A-2	RW-Dev	Maintained
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.
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Due Diligence Meetings Conducted

Name	Designation	Date
Muhammad Safdar	CFO	April 03, 2024