

## RATING REPORT

### Mughal Energy Limited

**REPORT DATE:**

July 05, 2024

**RATING ANALYSTS:**

Saeb Muhammad Jafri

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**RATING DETAILS**

Rating Category	Assigned Rating Long-Term
Instrument (Sukuk)	A+ (plim)
Rating Date	July 5, 2024
Rating Outlook/Rating Watch	Stable
Rating Action	Preliminary

**COMPANY INFORMATION**

Incorporated in 2021	External auditors: Muniff Ziauddin & Co. Chartered Accountants
Public Listed Company	Chief Executive Officer: Mr. Khurram Javaid
Key Shareholders (with stake 5% or more):	
<i>Mughal Iron &amp; Steel Industries Limited – 90% ordinary shares and 100% class-B shares</i>	

**APPLICABLE METHODOLOGY(IES)**

VIS Entity Rating Criteria Methodology – Industrial Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

VIS Entity Rating Criteria Methodology – Rating the Issue

<https://docs.vis.com.pk/docs/Rating-the-Issue-Aug-2023.pdf>

**RATING SCALE(S)**

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

## Mughal Energy Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p><b>Mughal Energy Limited ('MEL' or 'the Company')</b>, a subsidiary of Mughal Iron &amp; Steel Industries Limited (MISIL), was established in February 2021. MEL is financing a 36.5MW dual-fired power plant through a PKR 2,500 million Sukuk. The project, 50% complete, spans civil works, mechanical installation, testing, and trial runs, concluding in 2024.</p> <p><b>Mr. Khurram Javaid</b>, with an MBA from Coventry University, UK, serves as the CEO of Mughal Energy Limited. He has led initiatives for modernization, product diversification, and market expansion, focusing on quality improvement, sales network enhancement, and investment in alternate energy sources.</p>	<p><b><u>Corporate Profile</u></b></p> <p>Mughal Energy Limited ('MEL' or 'the Company'), a subsidiary of Mughal Iron &amp; Steel Industries Limited ('MISIL' or 'the Sponsor'), was established in February 2021. The Company aims to finance a 36.5MW hybrid-fired power plant through the issuance of a PKR 2,500 million Sukuk. The project is funded through both equity and debt, with a capital structure of 60% debt and 40% equity, covering land, plant, civil works, and IDCs. Estimated cost of the project is PKR 6,500 mln.</p> <p>The project, currently ~50% completed with plant components procured, is spread over four phases: civil works, mechanical installation, testing, and trial runs. The civil works phase began in November 2023 and is set to conclude by October 2024. Mechanical installation commenced in February 2024. Testing and commissioning will span the last three months of 2024.</p> <p><b><u>Sukuk Structure:</u></b></p> <p>The proposed sukuk issue by MEL aims to raise PKR 2,500 million, inclusive of a PKR 1,000 million Green Shoe Option. This Medium Term Rated, OTC Listed, Privately Placed, Secured Islamic Certificate has a tenor of three years from the issue date and offers a Base Rate plus 170 basis points per annum. The Sukuk will have a one-year grace period, followed by principal repayments in eight equal quarterly installments starting at the end of the 15th month post-issuance. The proposed sukuk is priced at 3M KIBOR + 170 basis points per annum. The security structure is as follows:</p> <ol style="list-style-type: none"> <li>1. First Pari Passu Hypothecation on fixed assets (excluding land and building) (Note: Initial disbursement will be on a ranking charge followed by an upgrade to pari passu status within 120 days of first disbursement. Valuation of fixed assets to be carried out within this time)</li> <li>2. Corporate Guarantee by Mughal Steel, covering all obligations of the Issuer under the Instrument.</li> <li>3. Exclusive charge &amp; right of set-off on the DPA &amp; DSRA with the Agent Bank.</li> </ol> <p>The Debt Service Reserve Account (DSRA) will be funded monthly by depositing into the Collection Account. The deposited amount will ensure that the DSRA balance equals the amount of the next instalment. Once this balance is achieved, no further debits will be made until the beginning of the next profit payment period. Moreover, 10% of the Issue is to be maintained in an interest bearing DPA with the Agent Bank.</p> <p><b><u>Sponsor Profile</u></b></p> <p>Mughal Iron &amp; Steel Industries Limited 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 Sponsor 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 Sponsor has</p>

manufacturing plants and warehouses on Sheikhpura Road, Lahore, and sales centers in Badami Bagh, Lahore. MISIL has a long-term rating of A+, assigned by both VIS and PACRA.

#### **Key Rating Drivers**

**Rating incorporates Medium to high business risk due to the nature of business of its sole customer and sponsor, Mughal Iron and Steel Limited.**

The Sponsor operates within an industrial sector that is increasingly shifting towards captive power generation due to fuel shortages and high electricity prices. Consequently, the Sponsor initiated the development of its own power plant, MEL. The plant, procured from Germany, has arrived at the installation site and civil work has commenced.

The Company's sole customer will be its sponsor, which operates in the steel sector of Pakistan. VIS considers the risk profile of the steel industry to be medium to high due to its exposure to cyclicity and fragmented nature of the competitive landscape of the sector. MEL's performance will be heavily dependent on the operational performance of its sponsor.

**Rating considers the support of Sponsor.**

The assigned rating takes into account the support provided by the Sponsor, considering its established market position and extensive track record in the long-steel industry. MISIL is a publicly listed company with a strong reputation in manufacturing and sales of long steel products. Rating is further supported by its long-term A+ ratings from VIS and PACRA.

**Rating incorporates the Sponsor's constrained financial performance in FY23 and ongoing FY24. However, the rating also considers the benefit from the successful implementation of the project, providing support to assigned ratings. Nevertheless, sensitivity to achievement of projected plan is acknowledged.**

In FY23, MISIL encountered financial constraints due to a challenging economic environment. Factors such as floods, inflation, currency depreciation, and declining reserves adversely impacted GDP and the sector's size. Despite maintaining its topline through increased selling prices, the Sponsor's coverage metrics deteriorated owing to higher policy rates. In 3QFY24, subdued demand persisted, reflecting constrained construction activity, further stressing the Sponsor's financial profile. The project itself is expected to assist the Sponsor in lowering energy costs, supporting profitability, and maintaining adequate coverage levels sufficient to support MEL. However, coverage levels will remain sensitive to the Sponsor's ability to meet its projected plans.

#### **Considerations for future reviews**

Going forward, ratings will remain sensitive to the implementation of the proposed sukuk structure and will be underpinned by the "full faith" coverage of the Company's obligation by the corporate guarantee provided by the Sponsor. Moreover, achievement of projected plans will also be an important consideration for future review.

**Mughal Energy Limited**
**Appendix I**

<b>Financial Summary</b>			
<b>Balance Sheet (PKR Millions)</b>	<b>FY22</b>	<b>FY23</b>	<b>9MFY24</b>
Property, plant and equipment	1,672.24	3,051.50	3,403.49
Stock-in-trade	0.00	0.00	0.00
Trade debts	0.00	0.00	0.00
Cash & Bank Balances	20.62	60.94	116.38
Other Assets	133.52	277.97	353.49
<b>Total Assets</b>	<b>1,826.38</b>	<b>3,390.41</b>	<b>3,873.36</b>
Trade and Other Payables	0.00	0.00	0.00
Long-term Debt (incl. current portion)	0.00	300.00	300.00
Short-Term Borrowings	0.00	0.00	0.00
<b>Total Debt</b>	<b>0.00</b>	<b>300.00</b>	<b>300.00</b>
Other Liabilities	10.41	9.03	109.75
<b>Total Liabilities</b>	<b>10.41</b>	<b>309.03</b>	<b>409.75</b>
Paid up Capital	451.40	1,972.62	1,972.62
Equity (excl. Revaluation Surplus)	1,815.97	2,017.20	2,399.42
<b>Income Statement (PKR Millions)</b>	<b>FY22</b>	<b>FY23</b>	<b>9MFY24</b>
Net Sales	0.00	0.00	0.00
Gross Profit	0.00	0.00	0.00
Operating Profit	-9.33	-27.57	-18.76
Finance Costs	0.03	-0.01	0.00
Profit Before Tax	-9.36	-27.56	-18.76
Profit After Tax	-9.36	-27.56	-18.76

<b>Ratio Analysis</b>	<b>FY22</b>	<b>FY23</b>	<b>9MFY24</b>
Gross Margin (%)			
Operating Margin (%)			
Net Margin (%)			
Funds from Operation (FFO) (PKR Millions)	-18.30	-51.05	-55.57
FFO to Total Debt* (%)		-17.02%	-24.70%
FFO to Long Term Debt* (%)		-17.02%	-24.70%
Gearing (x)	0.00	0.15	0.13
Leverage (x)	0.01	0.15	0.17
Debt Servicing Coverage Ratio* (x)	-610.00	-2.47	-0.46
Current Ratio (x)	14.81	37.52	4.01
(Stock in trade + trade debts) / STD (x)			0.00
Return on Average Assets* (%)	-0.67%	-1.06%	-0.69%
Return on Average Equity* (%)	-0.68%	-1.44%	-1.13%
Cash Conversion Cycle (days)	0.00	0.00	0.00

\*Annualized, if required

A - Actual Accounts

P - Projected Accounts

M - Management Accounts

**REGULATORY DISCLOSURES**
**Appendix II**

<b>Name of Rated Entity</b>	Mughal Energy Limited														
<b>Sector</b>	Power Industry														
<b>Type of Relationship</b>	Solicited														
<b>Purpose of Rating</b>	Instrument Rating														
<b>Rating History</b>	<table border="1"> <thead> <tr> <th>Rating Date</th> <th>Medium to Long Term</th> <th>Rating Outlook</th> <th>Rating Action</th> </tr> </thead> <tbody> <tr> <td colspan="4" style="text-align: center;"><b>RATING TYPE: SUKUK</b></td> </tr> <tr> <td>05-Jul-24</td> <td>A+ (plim)</td> <td>Stable</td> <td>Initial</td> </tr> </tbody> </table>	Rating Date	Medium to Long Term	Rating Outlook	Rating Action	<b>RATING TYPE: SUKUK</b>				05-Jul-24	A+ (plim)	Stable	Initial		
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<b>Statement by the Rating Team</b>	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.														
<b>Probability of Default</b>	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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<b>Due Diligence Meetings Conducted</b>	<table border="1"> <thead> <tr> <th>S.No.</th> <th>Name</th> <th>Designation</th> <th>Date</th> </tr> </thead> <tbody> <tr> <td>1.</td> <td>Mr. Muhammad Zafar Iqbal</td> <td>Chief Financial Officer</td> <td rowspan="3">June 25, 2024</td> </tr> <tr> <td>2.</td> <td>Mr. Shakeel Ahmed</td> <td>Chief Operational Officer</td> </tr> <tr> <td>3.</td> <td>Mr. Fahad Hafeez</td> <td>Company Secretary</td> </tr> </tbody> </table>	S.No.	Name	Designation	Date	1.	Mr. Muhammad Zafar Iqbal	Chief Financial Officer	June 25, 2024	2.	Mr. Shakeel Ahmed	Chief Operational Officer	3.	Mr. Fahad Hafeez	Company Secretary
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