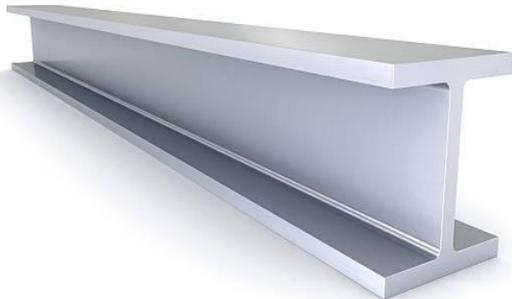


March 5, 2018

REP033 | www.jamapunji.pk



Mughal Iron & Steel (MUGHAL): *Billets Booster*

www.scstrade.com



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Investment thesis: We continue our coverage on Mughal Steel (MUGHAL). Our basis for the continuous coverage is mainly due to 1) Growth in Steel demand 2) Phase I expansion of existing rerolling mill 3) Extension of Grid Station Load 4) Phase II expansion (Capex of Rs.2.27bn) 5) Anti Dumping Duty on Rebar 6) Major Market Player of Northern Zone especially Central Punjab

1) **Growth in Steel:** Local dynamics entail greater demand in rebar given country wide projects. Pakistan is considered as one of the fastest steel producing country as per *World Steel Association* publication. In 2017, Pakistan's steel production increased by 39.3%. We expect this to further increase in FY18-19

2) **Phase I Expansion:** In 2017 company announced a right issue of 100% for an expansion including a) procurement and installation of six engine gas fired electric generators of 3.1MW ~ gross capacity each with cost of Rs500mn and b) Balancing Modernization and Replacement (BMR) of existing bar rerolling mill with capex of Rs.1.25bn

Forecasted earnings and dividend

	FY15	FY16	FY17	FY18E	FY19F	FY20F
EPS	2.45	3.55	3.94	5.58	16.16	22.76
P/E	30.18	20.84	18.79	13.27	4.58	3.25
Payout	20%	84%	66%	54%	31%	33%
DPS	0.5	3	2.6	3	5	7.5
Dividend Yield	1%	4%	4%	4%	7%	10%

Source: SCS Research

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Ticker	MUGHAL
Price	74.46
52 week low	43.35
52 week high	150.43
Beta	1.51
Market Cap (PKR)	18.73bn
FY17 Cash Dividend	Rs.2.6/sh
Source: SCS Research	

References

Phase I Expansion:
<https://www.psx.com.pk/newsattachment/103985.pdf>
World Steel Association statistics:
<https://www.worldsteel.org/en/dam/jcr:3e275c73-6f11-4e7f-a5d8-23d9bc5c508f/Steel+Statistical+Yearbook+2017.pdf>
Extension of Grid Station Load:
<https://www.psx.com.pk/newsattachment/108146.pdf>
Phase II Expansion:
<https://www.psx.com.pk/newsattachment/110822.pdf>

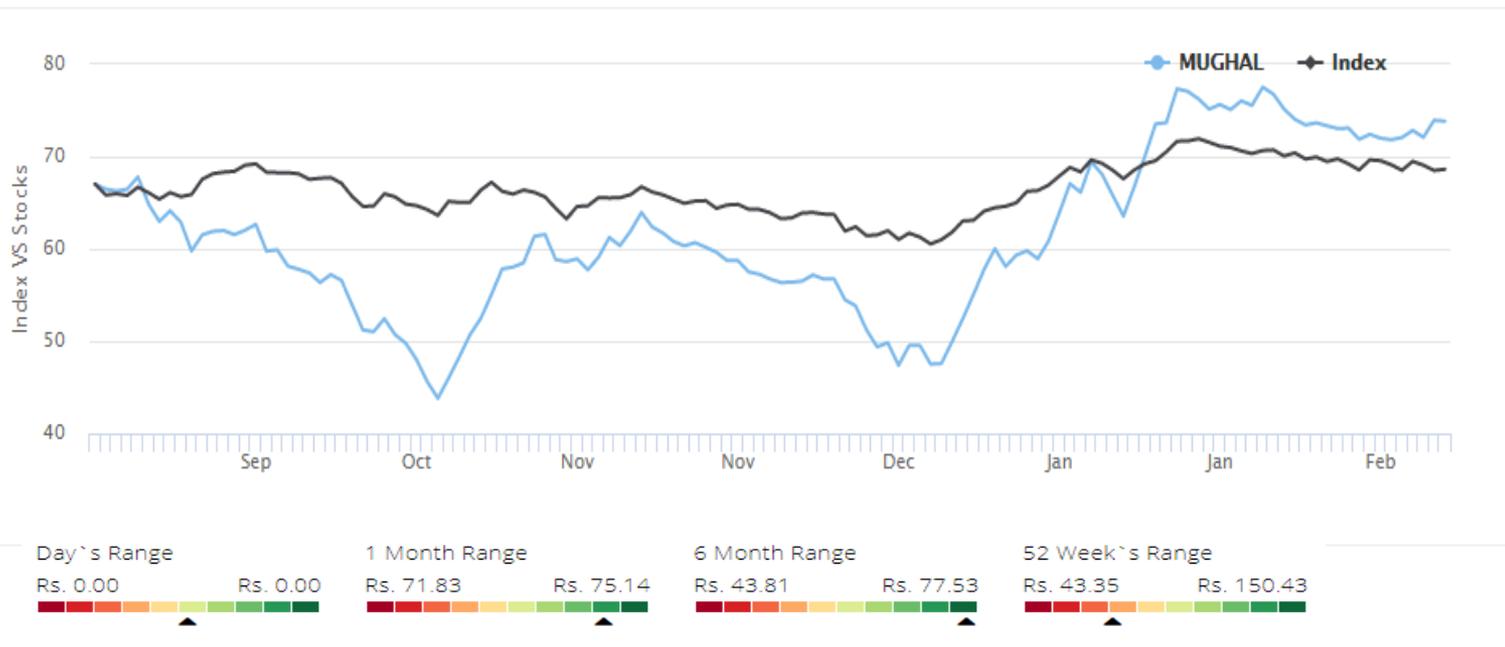
NTC Notice:

ADC NO 36/2015/NTC/CCB
ADC NO 48/2016/NTC/Rebar

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- 3) **Extension of Grid Station Load:** Finally 'energy crisis' will going to an end as LESCO has given technical clearance to extend grid station load from 19.99MW to 59.99MW expected to be fully operational by 1QFY19 as being reported vide PSX notice
- 4) **Phase II expansion:** On February 26 MUGHAL announced a phase II expansion with capex of Rs2.27bn which included an increase in melting capacity, installation of water treatment plant, induction heater, Continuous Casting M/c (CCM) plant etc.
- 5) **Anti Dumping Duty on Rebar:** National Tariff Commission (NTC) has imposed a definitive anti dumping duty on imports of deformed concrete reinforcing steel bars from China
- 6) **Major Market Player of Northern Zone:** MUGHAL is one of the leading manufacturers of rebar and their footprints could be seen in Lahore based public sector projects



Rs50bn turnover company in FY20

- As per our model, MUGHAL will become Rs50bn turnover company in FY20 in lieu of increased capacity utilization (melting + rerolling) due to availability of power that eluded the company in previous years – real game remains utilization of capacities
- We expect MUGHAL to report top line of Rs21.5bn in FY18 i.e. 15% increase yoy; subsequently we see jump in MUGHAL FY18 EPS to Rs5.58/sh vis a vis FY17 reported EPS of Rs3.94/sh
- Real expansion impact will come in 2QFY19, conservative estimates with capacity utilization of 58% melting and 67% rerolling ~ propels our FY19 EPS forecast to Rs16.16/sh thus indicating a noticeable increase
- Expansion impact with full year capacity utilization will be in FY20 ~ indicating a top line of Rs51bn
- MUGHAL is yielding FY18 & FY19 PE of 13.2x & 4.6x respectively

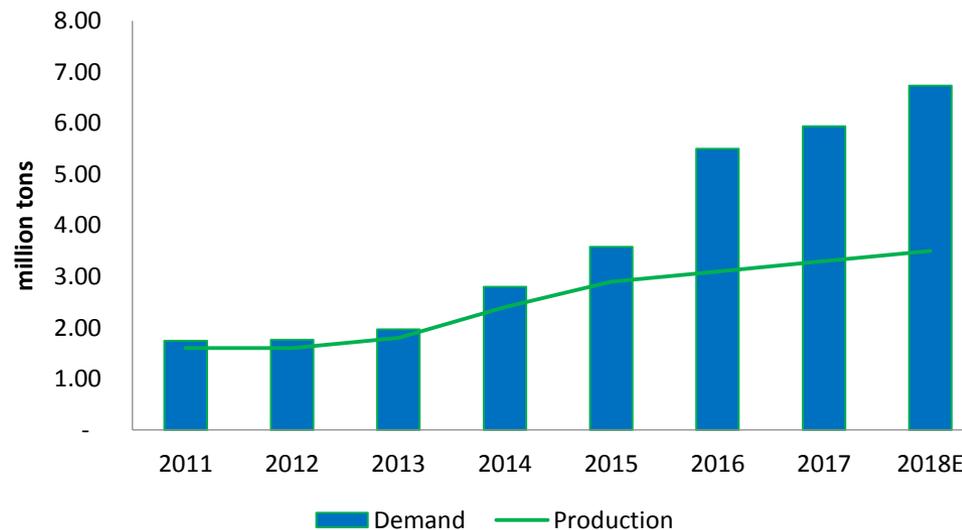
	FY16	FY17	FY18E	FY19F	FY20F
Total active capacity available (MT)					
Melting	155,719	340,688	340,689	495,000	495,001
Re-Rolling	326,563	446,224	446,224	630,000	630,000
Actual production (MT)					
Melting	99,657	116,207	120,000	285,000	410,000
Re-Rolling	245,675	241,773	245,000	421,950	552,900
% Utilization					
Melting	64%	34%	35%	58%	83%
Re-Rolling	75%	54%	55%	67%	88%

Source: SCS Research

1) Growth in Steel Prospects

- Total steel demand in 2017 is ~10mn tons with growth rate of five year CAGR of 24.7% and we are expecting demand to touch around 11mn tons in 2018 as per interaction with industry
- Rebar demand shows a significant jump in 2015 of 3.58mn tons which is 28% up from 2014 however, total demand of reinforcing bars soared up to 5.94mn tons in 2017; this is due to 8% growth in cement dispatches of 35.6mn tons
- Rebar production across the country could be ~3.5mn which shows a growth of five year CAGR of 19% from 2.4mn tons
- In 7MFY18 cement dispatches touched 23.57mn tons; this could be 40mn tons in FY18 witnessing a 13% increase from last year. This entails higher demand of steel rebars as construction activities is in full swing

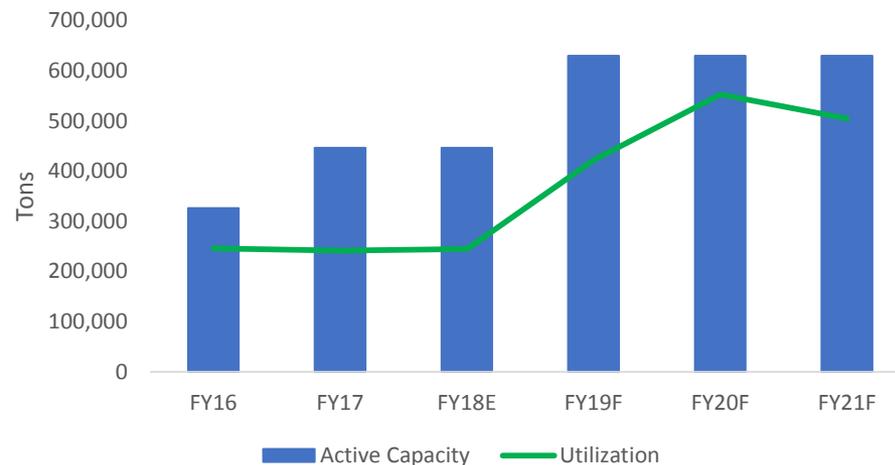
Rebars Demand



2) Phase I Expansion

- Procurement and installation of six engines gas fired electric generators of 3.1MW gross capacity each has been completed successfully vide PSX notices which will add 18.6MW into existing 9.3MW gas captive power plant and now MUGHAL has 27.9MW captive gas power plant
- Also in October 26, 2017, Sui Northern Gas Pipelines Ltd (SNGPL) has approved application filed by the company for the gas captive plant which will now increase from 2.8 MMCFD to 6.3 MMCFD. Conservatively around 22MW would be generated from these gas captive power plant
- The company signs agreement with (NCO) Italy for steel rebar re-rolling mill with a capacity of 430k tons per annum of good quality steel rebar. The estimated installation timeline of re-rolling mill is in 2QFY19. The BMR of re-rolling mill was previously estimated at a cost of Rs1.25bn (cost escalated by Rs336mn due aggravated exchange rate)

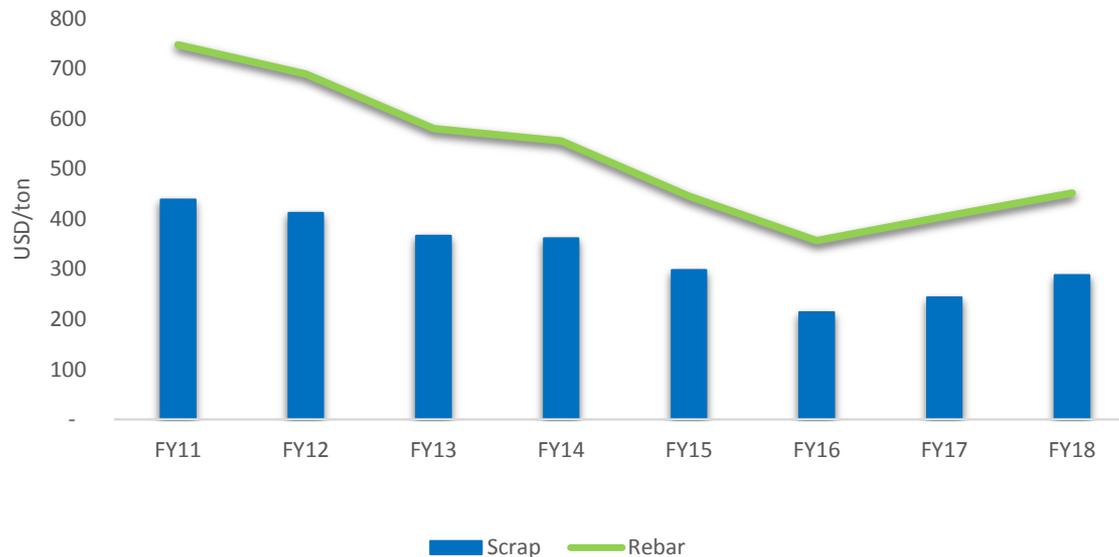
Re-Rolling Capacity Utilization



3) Extension of Grid Station Load

- Finally, on January 4, 2018, Lahore Electric Supply Company (LESCO) has granted an extension of existing grid load from 19.99MW to 59.99MW which will be fully operational by 1QFY19
- MUGHAL can generate 22MW from gas captive power plant; in totality company will going to have power of around 82MW which will be sufficient to utilize even 90% capacity utilization of melting capacity with other operations
- Until now capacities were under-utilized due to shortage of electricity; billets were also outsourced which is nearly 3k to 5k per ton expensive as against in-house billet cost. However, major consumption of energy is used in manufacturing billets ~ 650 units are required in manufacturing of 1 ton billet and 100 to 120 units of rebar. In totality 750 units are required for manufacturing of rebar from scrap

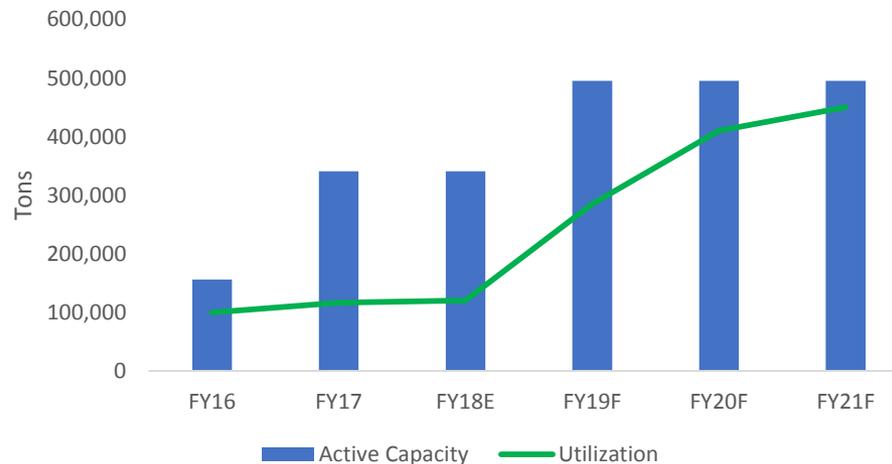
Average Yearly Prices



4) Phase II Expansion

- Company has announced an expansion of phase II with a Capex of Rs2.27bn to be financed through a long term debt
- To increase a melting capacity by 396k tons to 495k tons with a cost Rs500mn. Post expansion this melting capacity will be aligning with the upcoming rebar capacity of 430k tons
- This expansion also includes installation of *Continuous Casting Machine (CCM)* and shearing machine with a total cost of Rs470mn through which casting of billets will be delivered to rerolling mill and shearing machine This will be enhance cutting speed with less wastage
- However, the capex of Rs1.3bn will be utilized for the installation of water treatment plant, roughing area, induction heater and civil works for both phase expansions

Melting Capacity Utilization



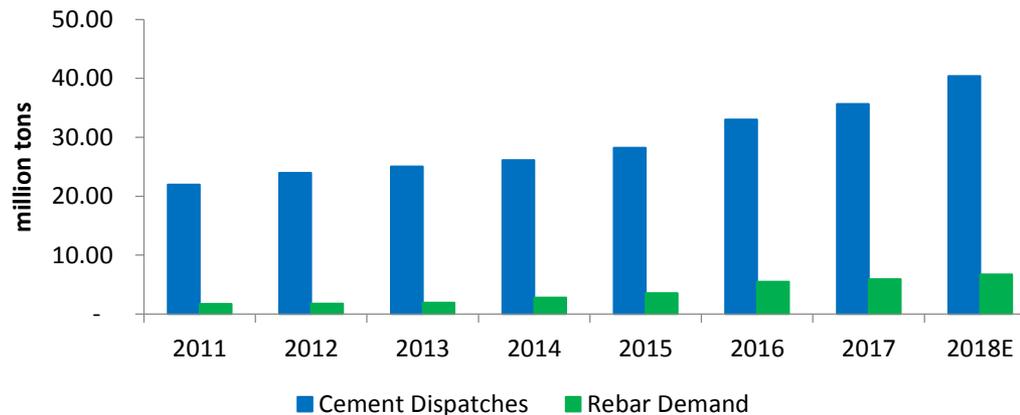
5) Anti Dumping Duty

- National Tariff Commission (NTC) secured local rebar manufacturers by imposing definitive anti-dumping duty of 19.15% on imports of rebar from China for a period of five years on Oct 20, 2017
- NTC has also imposed definitive anti-dumping duty of 27.75% on CC Billets for a period of five years. We believe MUGHAL must increase its melting capacity to maintain margins and since then they have announced expansion

6) Major Market Player of North

- MUGHAL is a manufacturer of long products and variety of different grades which is not only used in residential & commercial construction but also utilized in big infrastructures
- Products of MUGHAL had already used in construction of bridges, flyovers and other projects which had been completed as per company website

Demand relation with Cement



FY18 looked stable so far...

- We are expecting a capacity utilization of 35% & 55% of melting and rebar respectively. We expect around 128k tons of billet may be outsourced and price of the billet in the range of ~Rs66k per ton. We are assuming prices of scrap between \$330 to \$350 per ton in our model for FY18
- In our opinion & taking cue of 1HFY18 reported numbers, we see FY18 to be stable with our estimated top line of Rs21.56bn amid gross and net margin of 15% and 6.5% respectively, this will lead the company to report bottom line of Rs1.4bn resulting an expected EPS of Rs5.58/sh

FY19 towering of steel production

- Going forward company can utilize its melting and rerolling capacity by 58% and 67% respectively in FY19. As per notice by company we have incorporate expansion impact from 3QFY19 however full year impact would be forecasted in FY20
- Average price used in model for FY18 estimation is Rs88k/ton and in FY19 ~ Rs91k/ton with an assumption of scrap price of \$375 & \$395 per ton in FY19 & FY20 respectively.

Margins



2Q review – results above expectations

- MUGHAL reported revenue of Rs5.78bn in 2QFY18 showing a growth of 16% yoy and 7% qoq. Gross margins have sustained during the quarter with 13% as against 12% reported in 1QFY18
- Company has reported a bottom line of Rs315mn which is 45% higher yoy and 3% qoq with stable net margins of 5% in 2QFY18
- Mughal has reported EPS of Rs1.25/sh sequentially 36% higher than the EPS of Re0.92/sh in 2QFY17
- There is an uptick of 29% in sales revenue in 1HFY18 resulting in a growth of 31% in profit after tax.

P&L - reported accounts

(Amount Rs mn)	2QFY18	2QFY17	1QFY18	YoY	QoQ	1HFY18	1HFY17	YoY
Sales	5,788	4,970	5,397	16%	7%	11,185	8,684	29%
Gross Profit	759	423	668	79%	14%	1,427	871	64%
GP Margin	13%	9%	12%	54%	6%	13%	10%	27%
Net Profit	315	217	306	45%	3%	620	474	31%
NP Margin	5%	4%	6%	24%	-4%	6%	5%	2%
Basic & diluted EPS Rs/sh	1.25	0.92	1.22	36%	3%	2.47	2.02	22%

Source: SCS Research

P&L - Reported and Forecasted accounts

(Amount in mn)	FY15	FY16	FY17	FY18E	FY19F	FY20F
Turnover – net	12,241	18,983	18,803	21,560	38,246	51,618
Cost of sales	(10,957)	(16,925)	(16,861)	(18,268)	(30,384)	(41,364)
Gross profit	1,284	2,059	1,942	3,292	7,862	10,254
Gross Profit Margin	10%	11%	10%	15%	21%	20%
Other Income	15	47	34	33	50	50
Distribution costs	(62)	(95)	(164)	(150)	(198)	(267)
Administrative costs	(160)	(208)	(241)	(270)	(479)	(647)
Other Exp	(45)	(87)	(91)	(100)	(167)	(225)
Operating profit	1,032	1,717	1,479	2,805	7,068	9,165
Finance costs	(440)	(425)	(257)	(801)	(1,259)	(986)
Profit before taxation	592	1,292	1,222	2,004	5,809	8,180
Taxation	25	(399)	(232)	(601)	(1,743)	(2,454)
Profit after taxation	617	893	991	1,403	4,066	5,726
Net Profit Margin	5.04%	4.71%	5.27%	6.51%	10.63%	11.09%
EPS	2.45	3.55	3.94	5.58	16.16	22.76
P/E	30.18	20.84	18.79	13.27	4.58	3.25
Payout	20%	84%	66%	54%	31%	33%
DPS	0.5	3	2.6	3	5	7.5
Dividend Yield	1%	4%	4%	4%	7%	10%

Source: SCS Research

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Following research techniques adopted to calculate target price/recommendation

Price to earnings & Price to Book, EV-EBITDA multiple

Discounted Cash flows or Dividend Discount Model or Enterprise Value