COMPANY UPDATE

MUGHAL

Offering a return of 86% Owing to the Debottlenecking of Energy Supply

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We initiate our coverage on Mughal Iron and Steel Industries Limited (MUGHAL) with a DCF based Dec-20 TP of Rs.65 which provides an upside potential of 84%. A dividend yield of 2%, if incorporated gives a total return of 86%

In spite of challenging macroeconomic conditions the company still managed to grow its revenues and earnings at a 5-year CAGR of 39% and 29% respectively

Going forward, we expect the company's revenues and earnings to grow at a 5-year CAGR of 13% and 23% respectively as the ongoing BMR and availability of sufficient electricity post grid expansion will enhance the production capacities

Furthermore, the upcoming expansionary phase of the economy, removal of the ban on high rise buildings, launch of Naya Pakistan Housing Scheme and government's upcoming package for construction industry would uplift the demand for long steel

Sector Overview

According to the World Steel organization, crude steel production in Pakistan has declined by 32% to 3.04mn MT's in 11MCY19 as compared to 4.44mn MT's tons during SPLY. The said decline was caused due to the contractionary monetary and fiscal policies by the SBP and GOP. Moreover, the aforementioned policies caused the sectors' profitability to decline as higher interest rates resulted in lower demand and currency depreciation contributed to higher imported raw material costs along with higher energy costs. However, the recent data of cement dispatches has eliminated most of the investor's concerns regarding future demand as the upcoming expansion of the economy, construction of dams, lifting of a ban on high rise buildings, launch of Naya Pakistan Housing Scheme and government's upcoming package for construction industry would further bolster the steel demand in near future.

Company Overview

Mughal Iron & Steel Industries Limited ("Mughal Steel") was incorporated in 2010 as a public limited company. The Company took over the running business of a partnership concern by the name of "Mughal Steel" which had been in the steel business for over 50 years and was being run by the major sponsors of the Company. Today, the Company is one of the leading steel companies in Pakistan in the long rolled steel sector, equipped with a depth of technical and managerial expertise. The Company is involved in multidimensional activities from making billets of Mild Steel, Spring Steel, Deformed bar, Re-bar, Cold Twisted Rebar and a huge range of Sections such as I.Beams, L.Sections, C.Section, H.Beam, T.Bar, etc. in the downstream industry. Mughal's produc tion facility is situated at Sheikupura Road, Lahore, Pakistan.

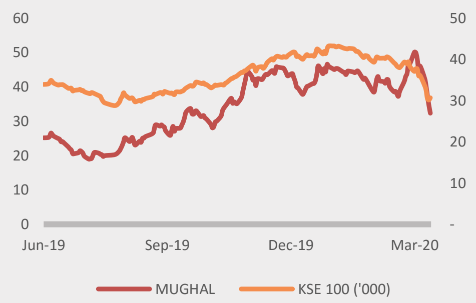
Persistence in Topline Despite Economic Slowdown

Despite an economic slowdown, the company's revenue has remained stable at Rs14.078bn in 1HFY20 as compared to Rs14.076bn during SPLY, following a substantial growth of 39% YoY in FY19. Growth in FY19 was attributed to a hike in prices and increased volumes. Going forward, we expect the company's revenues to grow at a 5-year CAGR of 13% to Rs57bn by FY24 as the upcoming expansion of the economy, building of dams, removal of the ban on high rise buildings and housing projects initiated by the PM of Pakistan will bolster the demand for steel products

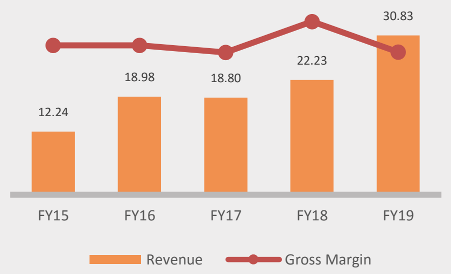
Key Statistics

Symbol	MUGHAL
TP - Dec 20	65.00
LDCP	35.44
Upside (%)	83.41
Free Float ('mn)	63
Market Cap. (Rs.'mn)	8,917

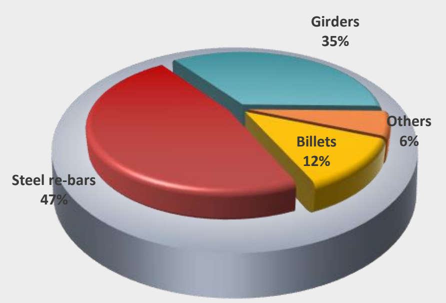
MUGHAL vs KSE 100



Sales (Rs'bn) vs Gross Margin



Product Mix



Sources: ACPL Research, Company Financials, PSX,

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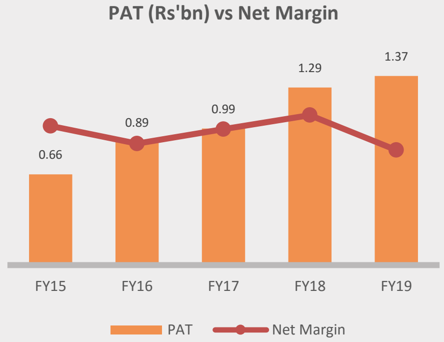
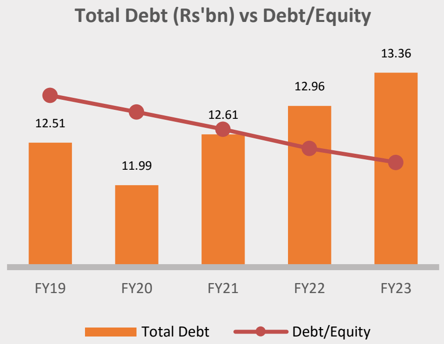
Key Statistics





Sources: ACPL Research, Company Financials,

in near future.

Debottlenecking of Energy Supply will Enhance Capacity Utilization

The company was facing a difficult situation in the past due to an electricity shortage. Its capacity utilization was affected due to a shortage of electricity supply. The company decided in the past to overcome this hurdle by upgrading the 19.99MW grid station to 79.99MW. During FY19 grid station was energized to 31.99MW and it will be fully energized to 79.99MW by the end of FY20. This will allow the company to manufacture in house billets instead of buying them externally which will help it to reduce costs for the final products. As MUGHAL was only manufacturing billets from the excess electricity, available after the production of its main products, the recent debottlenecking will enhance capacity utilization which will reduce operating costs and increase profitability.

Diversified Product Portfolio

MUGHAL has a diversified product portfolio, ranging from billets to girders and re-bars to T-irons. It allows the company to target various sectors and have diversified exposures. During the 1HFY20, the Company also started the export of copper ingots which is expected to further diversify the product and market portfolio of the Company. Along with diversifying product range, it is also focusing on geological diversification and exploring different export opportunities. Going forward, it is planning to maintain its existing share in the retail housing market through girder and G60 rebar. Furthermore, it is eying on increasing its market share in retail housing through Mughal Supreme rebars.

Ongoing BMR to Bring Efficiencies

Ongoing BMR of bar re-rolling mill of Mughal will complete in the second half of FY20. BMR will improve the operational efficiency of the company as it will reduce the operational costs and improve operating margins. Furthermore, the BMR will enhance the capacity and help the company to achieve economies of scale.

Cut in Interest Rate to Ease the Burden from Bottom line

MUGHAL is one of the highly leveraged companies in the industry with long-term debt to equity ratio of 0.45x and total debt to equity ratio of 1.67x. The company has a long-term and short-term debt of Rs3.3bn and Rs9.2bn respectively outstanding on its balance sheet. Therefore, the dovish stance adopted by the SBP in its recent MP announcement would relieve the burden from its bottom line as this would provide a breather to the earnings of the company. According to our sensitivity analysis, a cut of 100bps in KIBOR would increase the earning by Rs0.32.

Valuation

MUGHAL is currently trading at a FY20E P/E of 12.6x. Furthermore, the scrip is also trading at a FY20E P/B of 1.12x which offers a discount of 34% relative to its historical 5-year average of 1.69x. We have a **BUY** stance on the script with a DCF based Dec-20 TP of Rs.65 which provides an upside potential of 84%. A dividend yield of 2%, if incorporated gives a total return of 86%

Key Risks to Valuation

- More than expected depreciation of PKR
- Hike in prices of raw material
- Delayed Policy rate cut to single-digit
- Less than expected growth in demand

Key Ratios

Profitability Ratios		FY15A	FY16A	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
GP Margin	%	10.84	10.85	10.33	12.57	10.34	10.12	11.69	12.39	13.07
OP Margin	%	8.77	9.05	7.87	9.70	8.19	8.25	9.82	10.52	11.20
NP Margin	%	5.38	4.71	5.27	5.81	4.45	2.50	4.61	5.64	6.64
ROE	%	19.36	23.39	18.23	18.30	18.34	9.16	21.17	24.80	27.99
ROCE	%	9.36	14.77	10.64	12.87	12.58	10.21	16.06	17.81	19.67
ROA	%	5.75	7.69	7.13	7.70	6.84	3.09	7.54	9.55	11.66

Liquidity Ratios		FY15A	FY16A	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
Current	x	1.19	1.34	1.34	1.32	1.23	1.19	1.20	1.24	1.31
Acid-test	x	0.28	0.29	0.43	0.30	0.58	0.42	0.27	0.28	0.30
Cash to current liab.	x	0.14	0.12	0.27	0.15	0.28	0.19	0.23	0.24	0.25

Activity Ratios		FY15A	FY16A	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
Inventory Turnover	x	2	2	2	2	2	2	2	2	2
Inventory Days		169	97	127	111	74	100	100	100	100
Receivables Days		14	18	26	21	39	35	35	35	35
Payables Days		153	49	43	9	7	15	15	15	15
Operating Cycle		30	67	110	123	107	120	120	120	120

Investment Ratios		FY15A	FY16A	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
EPS	Rs.	2.62	3.55	3.94	5.13	5.46	2.81	7.31	10.18	13.55
DPS	Rs.	0.50	3.00	2.60	2.20	1.20	1.00	1.50	3.00	6.00
Div. Yield	%	0.77	4.61	4.00	3.38	1.84	1.54	2.31	4.61	9.22
Dividend Cover	x	5.24	1.18	1.51	2.33	4.55	2.81	4.88	3.39	2.26
BVPS	Rs.	13.53	16.83	26.38	29.68	29.82	31.64	37.45	44.63	52.18
Payout	%	19.08	84.49	66.03	42.90	21.99	35.54	20.51	29.48	44.29
Retention	%	80.92	15.51	33.97	57.10	78.01	64.46	79.49	70.52	55.71
No. of Shares	'000	251,600	251,600	251,600	251,600	251,600	251,600	251,600	251,600	251,600
P/E		13.53	9.98	9.00	6.91	6.49	12.60	4.85	3.48	2.62
Sales per share		48.65	75.45	74.73	88.34	122.53	112.73	158.69	180.51	204.11
P/BV		2.62	2.11	1.34	1.19	1.19	1.12	0.95	0.79	0.68
Price to Sales		0.73	0.47	0.47	0.40	0.29	0.31	0.22	0.20	0.17

Gearing Ratios		FY15A	FY16A	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
Debt to Equity	x	0.92	1.07	1.01	1.12	1.67	1.51	1.34	1.15	1.02
L.T. Debt to Equity	x	0.32	0.25	0.00	0.11	0.45	0.37	0.22	0.11	0.03
Interest Cover	x	2.44	4.04	5.76	3.90	3.21	1.61	2.42	3.03	3.86

Source: ACPL Research, Company Financials

Financial Projections

Rupees' millions	FY15A	FY16A	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
Net sales	12,241	18,983	18,803	22,226	30,828	28,363	39,926	45,416	51,355
Cost of sale	10,915	16,925	16,861	19,431	27,639	25,494	35,258	39,788	44,643
Gross profit	**1,326**	**2,059**	**1,942**	**2,794**	**3,189**	**2,870**	**4,668**	**5,628**	**6,712**
Selling and promotion expenses	62	95	164	246	202	129	182	207	234
Administration expenses	160	208	241	313	367	396	557	633	716
Other operating expenses	45	87	91	115	127	56	79	90	102
Operating Profit	**1,059**	**1,670**	**1,445**	**2,120**	**2,494**	**2,288**	**3,850**	**4,697**	**5,659**
Other operating income	15	47	34	36	30	51	71	81	91
Finance cost	440	425	257	552	786	1,454	1,620	1,577	1,490
Profit before taxation	634	1,292	1,222	1,604	1,737	885	2,300	3,201	4,261
Taxation	- 25	399	232	314	364	177	460	640	852
Profit after taxation	**659**	**893**	**991**	**1,290**	**1,373**	**708**	**1,840**	**2,560**	**3,409**
EPS	**2.62**	**3.55**	**3.94**	**5.13**	**5.46**	**2.81**	**7.31**	**10.18**	**13.55**

Source: ACPL Research, Company Financials

Horizontal Analysis

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E
Net sales	109.0%	55.1%	-1.0%	18.2%	38.7%	-8.0%	40.8%	13.8%	13.1%
Cost of sale	112.7%	55.1%	-0.4%	15.2%	42.2%	-7.8%	38.3%	12.8%	12.2%
Gross profit	**82.8%**	**55.2%**	**-5.7%**	**43.9%**	**14.1%**	**-10.0%**	**62.7%**	**20.6%**	**19.3%**
Selling and promotion expenses	479.2%	53.2%	73.2%	50.2%	-18.2%	-35.8%	40.8%	13.8%	13.1%
Administration expenses	96.4%	29.4%	16.4%	29.6%	17.2%	7.8%	40.8%	13.8%	13.1%
Other operating expenses	110.3%	91.8%	5.5%	26.1%	9.9%	-55.6%	40.8%	13.8%	13.1%
Operating Profit	**73.2%**	**57.7%**	**-13.5%**	**46.7%**	**17.6%**	**-8.2%**	**68.3%**	**22.0%**	**20.5%**
Other operating income	303.4%	220.5%	-28.3%	7.0%	-17.5%	68.5%	40.8%	13.8%	13.1%
Finance cost	102.1%	-3.3%	-39.6%	115.3%	42.3%	84.9%	11.5%	-2.7%	-5.5%
Profit before taxation	59.5%	103.8%	-5.4%	31.2%	8.3%	-49.1%	160.0%	39.1%	33.1%
Taxation	-470.3%	-1690.9%	-41.9%	35.4%	16.3%	-51.4%	160.0%	39.1%	33.1%
Profit after taxation	68.6%	35.5%	**10.9%**	**30.2%**	**6.4%**	**-48.4%**	**160.0%**	**39.1%**	**33.1%**
EPS	**-45.0%**	**35.5%**	**10.9%**	**30.2%**	**6.4%**	**-48.4%**	**160.0%**	**39.1%**	**33.1%**

Source: ACPL Research, Company Financials

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TP	Target Price	CAGR	Compound Annual Growth Rate	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	LDCP	Last Day Closing Price

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