MUHAMMAD SHAFI TANNERIES (PVT.) LTD.

Chairman: Mr. Muhammad Haleem; Chief Executive: Mr. Muhammad Naseem

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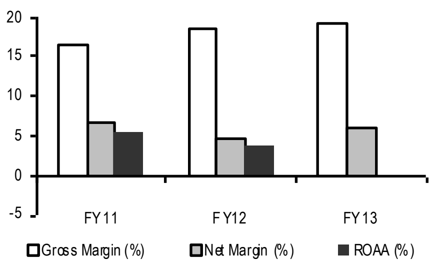
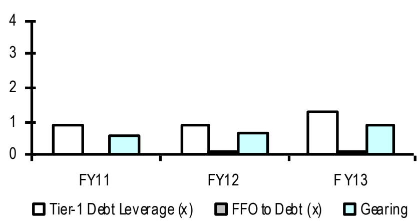
Analysts: Sobia Maqbool, CFA
Talha Iqbal

Category	Latest	Previous
Entity	A-/A-2	BBB+/A-3
	May 20, '14	*Mar 18, '13*
Outlook	*Stable*	*Stable*
	May 20, '14	*Mar 18, '13*

Key Financial Trends





(Rs. in Miillion)	FY11	FY12	FY13
Net Sales	2,405	2,725	3,436
Net Profit	161	125	207
Equity	1,820	1,953	1,564
Total Debt	1,092	1,326	1,395
Debt Leverage (x)	0.86	0.91	1.31
FFO	201	100	164
FFO/Total Debt	18.4%	7.5%	11.7%
ROAA	5.2%	3.5%	5.6%

Rating Rationale

Leather is the fourth largest export sector of the country; contributing 4.9% to total exports. While Pakistan is endowed with a large animal population, the leather industry has not been able to realize its full potential. Almost half of the country's exports comprise tanned leather, with less focus on value added product segments. Total exports stood higher at $1.14b (FY12: $1.05b), comprising largely tanned leather (44%) and leather garments (33%). The remaining portion is contributed by other value added products including gloves and footwear.

Muhammad Shafi Tanneries (Private) Limited (MST) has posted continuous growth in sales over the last four years; sales have increased at a CAGR of 17% over the four year period (FY09-FY13). In FY13, net sales increased by 26% on the back of volumetric growth in sales and higher average selling prices. Over nine-tenth of the total sales comprise exports with the company primarily catering to the lower and mid-tier market segments. Around four-fifth of the clients pertain to the shoe-manufacturing industry. While concentration in sales has declined on a timeline basis, the same continues to be on the higher side with revenues from top ten clients representing around one-third of total revenues. Comfort is drawn from the long term association with major clients though there are no long term contracts in place.

Gross profit margins have witnessed an improving trend in FY13 and 1HFY14 (22.1%) and compare favorably to other leather companies in JCR-VIS Credit Rating Company Limited's rated universe. Despite significant Rupee appreciation in 3QFY14, management anticipates gross margins to remain healthy (around 20%) on the back of product differentiation initiatives taken by the company's research and product development team. Historically, the company has successfully passed on increase in raw material prices to customers.

Given the company's cash conversion cycle, which is characterized by high turnaround time to convert inventory into cash, it requires borrowings to finance raw material acquisition. Debt profile of the company is mostly short-term in nature; 85% of total borrowings have been mobilized under State Bank of Pakistan's export refinance scheme. With improving profitability levels, cash flow position of the company has also improved on a timeline basis. Funds generated from operations provide full coverage against long-term debt while stock-in-trade is in excess of the short term borrowings. No major capex is planned for FY14.

Net equity of the company stood lower at end-FY13 on account of specie dividend paid to shareholders, with strategic investments reduced to Rs. 612.9m from Rs. 1.1b previously. In 1H14, the company has also extended loans of Rs. 149.8m to associates. Strategic investments have been retained in companies having profitable operations. Adjusting for strategic investments, gearing level was maintained in FY13. In 1H14, there has been an increase in gearing on account of additional short term debt mobilized during the period to finance raw material purchases. The company's long inventory holding period entails financial cost. In this backdrop, generating healthy margins is considered essential to generate the desired bottom line results and maintain capitalization within prudent limits. The company's initiatives to pursue product diversification and recognition from more established brands may help in sustaining healthy margins, going forward.

Overview of the Institution

Established in 1952 as a partnership concern, MST was converted into a private limited company in 1998. MST is part of the Shafi group of companies, a diversified business concern having companies in the rice, textile, dairy and real estate business. The company is involved in production and subsequent export of finished leather JCR-VIS