RATING REPORT

MUHAMMAD SHAFI TANNERIES (PRIVATE) LIMITED

REPORT DATE:
June 22, 2015

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity	A-	A-2	A-	A-2
Rating Date	*June 17, 2015*		*May 20, 2014*	
Rating Outlook	Stable		Stable	
Outlook Date	*June 17, 2015*		*May 20, 2014*	

COMPANY INFORMATION

Incorporated in 1998	**External auditors:** Avais Hyder Liaquat Nauman Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Muhammad Haleem
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Muhammad Naseem
Mian Amjad Hafeez–22%	
Mian Muhammad Naseem–20%	
Mian Tahir Hanif–13%	
Mian Muhammad Haleem–12%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria *Industrial Corporates (October 2003)*
http://www.jcrvis.com.pk/images/IndustrialCorp.pdf

Muhammad Shafi Tanneries (Private) Limited

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

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RATING RATIONALE

Leather industry in Pakistan is an export-oriented industry contributing ~5.4% of the total export earnings and ~5% of the GDP. During FY14, leather exports grew by 11% to US$ 1,275m vis-à-vis US$ 1,145m in the preceding year. However, the industry is presently facing a number of challenges including slowdown in the Eurozone, which is a major export destination for Pakistan's leather industry. In addition to this, steep decline in Euro/PKR parity subsequent to year-end 2014 (15.6% from end-June 2014 to end-Feb 2015) has impacted margins of industry players. Resultantly, there has been an industry-wide consolidation with smaller players exiting the market which will allow more established players to benefit over the long term.

Despite the challenging operating environment given the slowdown in the Eurozone, operating performance of MST has largely been maintained during FY14. Net sales of the company stood slightly higher during FY14 on account of increase in average sales price while quantity sold declined. Almost the entire top-line pertains to export sales while geographic breakup of sales is relatively diversified. Resultantly, impact on margins of Euro depreciation is expected to be lower than peers. Moreover given that MST produces customized leather for specific uses, margins compare favorably to other industry players. While margins have been impacted during 1HFY15 given the depreciation in Euro, management expects overall margins and operating performance for remainder of FY15 to improve in the backdrop of decline in prices of raw skins. Profitability is also projected to be favorably impacted in terms of lower cost of doing business, in view of the decline in interest rates and oil prices.

Trade debts have grown in absolute terms and in relation to turnover. A sizeable portion of the same pertains to a related party. As per management, a portion of the same has been received during 2HFY15. The company's long inventory holding period entails financial cost. Inventory turnover days have increased and cash conversion cycle has lengthened. Resultantly, utilization of short-term borrowings has also increased. With rise in debt levels, leverage indicators have trended upwards. While borrowings are almost entirely short term in nature and matched by stock-in-trade, further increase in leverage may not be considered prudent. Liquidity profile of the institution is considered adequate in view of stable cash flows from operations and sizeable liquid assets carried on balance sheet, though increase in cash conversion cycle needs to be arrested. Exposure to market risk has increased given that investment in equities has been undertaken during FY14 and in the ongoing year. Investment in equities includes a number of growth and dividend based stocks.

MST is part of Shafi group of companies having presence in the leather, leather garments, specialty chemicals, food and textiles. The assigned ratings draw strength from the considerable experience of the management in the leather business. MST also has sizeable exposure to subsidiaries and associates in form of loans and strategic investments. The management intends to dispose its foreign subsidiary in China; given that the Pakistani rupee has undergone significant depreciation against Chinese Renminbi, management expects to realize capital gain from the sale of the company. Shafi Texcel (MST's largest investment) has remained profitable albeit there are ongoing energy issues, as with other industry players, which is affecting smooth operations. The management expects future funding requirements arising from subsidiaries and associates to remain limited. Of the company's own equity of Rs. 1,774m, almost Rs.740m had been deployed in subsidiaries/associates in the form of loans/investments as of end-June 2014, limiting the loss absorption capacity to that extent.

Muhammad Shafi Tanneries (Private) Limited

Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**DEC 31, 2014**	**Jun 30, 2014**	**Jun 30, 2013**
Non-current Assets	1,087	1,066	1,055
Investments	931	823	781
Stock-in-Trade	1,973	2,054	1,751
Trade Debts	357	325	270
Cash & Bank Balances	104	109	100
Total Assets	4,359	4,262	3,610
Trade and Other Payables	251	371	331
Long Term Debt *(*incl. current maturity)*	19[1]	120	122
Short Term Debt	1,982	1,768	1,274
Tier-1 Equity	1795	1,773	1,562
Total Equity*			
***Adjusted for Loans & Investment in Associates**			
INCOME STATEMENT	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Net Sales	1,728	3,490	3,436
Gross Profit	247	636	665
Operating Profit	110	359	327
Profit After Tax	69	200	213
RATIO ANALYSIS	**DEC 31, 2014**	**DEC 31, 2013**	**DEC 31, 2012**
Gross Margin (%)	14.3%	18.2%	19.3%
Net Working Capital	773	846	651
FFO to Total Debt (x)	-	0.086x	0.102x
FFO to Long Term Debt (x)	-	1.82x	1.38x
Debt Servicing Coverage Ratio (x)	-	1.68x	1.77x
ROAA (%)	3.2%	5.1%	5.8%
ROAE (%)	7.8%	12.0%	12.1%

[1] This is entirely liability against asset subject to finance lease.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Muhammad Shafi Tanneries (Private)Limited
Sector	Leather
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Outlook	Short Term	Rating Action
		RATING TYPE: Entity		
17-Jun-15	A-	Stable	A-2	Reaffirmed
20-May-14	A-	Stable	A-2	Upgrade
18-Mar-13	BBB+	Stable	A-3	Reaffirmed
01-Feb-12	BBB+	Stable	A-3	Initial

Instrument Structure	N/A
Statement by the Rating Team	JCR-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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