RATING REPORT

Muhammad Shafi Tanneries (Private) Limited

REPORT DATE:
January 26, 2018

RATING ANALYSTS:
Muniba Khan
muniba.khan@jcrvis.com.pk

RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A-/A-2**	**A-/A-2**
Rating Outlook	Stable	Stable
Rating Date	*Jan 26, '18*	*June 17, '15*

COMPANY INFORMATION	
Incorporated in 1972	**External auditors:** RSM Avais Hyder Liaquat Nauman, Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mian Muhammad Haleem
Key Shareholders (with stake 10% 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 *http://www.jcrvis.com.pk/images/methodology.pdf*

Muhammad Shafi Tanneries (Private) Limited

OVERVIEW OF THE INSTITUTION

Incorporated in 1972, Muhammad Shafi Tanneries (Private) Limited was initially established as a partnership concern. In 1998, it was converted into a private limited company. The main business activity of the company includes manufacturing and export of finished leather. The financial statements for FY17 have been audited by RSM Avais Hyder Liaquat Nauman, Chartered Accountants.

RATING RATIONALE

Muhammad Shafi Tanneries (Private) Limited (MSTL) is involved in the business of converting goat and sheep hides to finished leather. MSTL belongs to Shafi Group comprising established companies present in textile, food and footwear industries. Shareholding of the company remains unchanged and is vested solely by various family members. Current ratings of MSTL account for profile of sponsors who have extensive experience in the leather industry.

Key Rating Drivers:

Sales Mix: Given fall in trade volumes of leather products globally, revenue base of MSTL has weakened on a timeline basis. Top-line of the company has depicted a downward trend with sales declining from Rs. 3.3b in FY15 to Rs. 1.9b in FY17. Majority of sales comprise exports to China and Germany; total volumes exported to these countries were reported lower in line with its sales trend. All sales of MSTL are dove-tailed to orders. Out of total revenue, China represents almost 30% of sales followed by Germany contributing 17.6% of revenues. Both client and country wise concentration in sales is on the higher side with top three countries generating 60% of total revenue. Going forward, the company plans to increase its presence in the local market in order to meet the growing demand. The company also focuses on cow hides in its product portfolio in order to support revenue base.

Profitability: With a slight increase in prices of raw material, gross margins were reported lower on account of significant fall in volumetric sales and average selling prices. As per management, reduction in sales was a deliberate strategy in order to sustain margins, which continue to compare favorably in comparison to peers. Despite a decline in absolute gross profits, bottom line of the company improved to Rs. 177.8m on the back of return from its investments. During FY17, MSTL booked capital gain emanating from sale on its equity portfolio. Going forward, profitability is expected to remain under pressure given subdued demand of leather products. Hence, achieving projected sales volumes is considered important in terms of profitability.

Inventory: Inventory carried on the balance sheet represents half a year of sales and largely comprises raw skins in the conversion phase. Going forward, MSTL has decided to procure raw material from the local market at lower prices. As a result, management anticipates achieving cost efficiencies through this strategy. Stock-in-trade represented 88.8% (FY16: 82.6%) of borrowings at end-FY17. No major capex is planned in the foreseeable horizon.

Liquidity: Liquidity profile of the company has weakened with a decline in operating cash flows. With a decline in Funds from Operations (FFO), FFO to total debt was also reported lower at 4.7% in FY17. Moreover, aging profile of trade debts depicts room for improvement given that a large chunk of receivables lies in more than 60 days bucket. With no long term debt on its books, capital structure of the company is considered strong. The company utilizes funding from short term borrowings only which match inventory levels.

Capitalization: Despite lower sales volumes, financial profile of the company remains strong. Consistent profits earned by the company have resulted in strengthening of its capitalization levels. Total equity (including loan from associates) of MSTL stands at Rs. 2.2b which is on the higher side in comparison to peers. At these capitalization levels, leverage indicators remain on the lower side with gearing and debt leverage reported at 0.7x (FY16: 0.8x) and 0.9x (FY16: 1.0x), respectively at end-FY17.

Muhammad Shafi Tanneries (Private) Limited — Appendix I

FINANCIAL SUMMARY	*(amounts in PKR millions)*		
BALANCE SHEET	**June 30, 2017**	**June 30, 2016**	**June 30, 2015**
Non-current Assets	1,343.8	1,358.7	1,311.9
Stock-in-trade	1,280.1	1,359.0	1,653.2
Trade Debts	92.6	144.1	157.3
Cash & Bank Balances	88.2	95.1	103.7
Total Assets	4,016.0	4,018.6	4,315.7
Short-term borrowings	1,441.3	1,645.6	1,805.3
Long-term borrowings	-	-	85.2
Trade Payables	310.7	277.1	443.9
Total Equity	2,168.3	1,993.3	1,873.2
INCOME STATEMENT	**June 30, 2017**	**June 30, 2016**	**June 30, 2015**
Net Sales	1,916.6	2,336.8	3,342.6
Gross Profit	401.7	514.0	538.5
Operating Profit/(Loss)	172.4	269.2	254.8
Profit/(Loss) After Tax	177.8	120.9	153.3
RATIOS & KEY NUMBERS	**June 30, 2017**	**June 30, 2016**	**June 30, 2015**
Gross Margin (%)	20.7	22.0	16.1
Net Working Capital	913.1	719.7	685.1
FFO	67.5	162.0	65.3
FFO/Total Debt (%)	4.7	9.8	3.5
Leverage	0.9	1.0	1.3
Gearing	0.7	0.8	1.0
Debt Servicing Coverage Ratio	1.7	2.5	1.4
ROAA (%)	4.4	3.0	3.6
ROAE (%)	8.1	6.1	8.2

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	Tanneries and Leather Products
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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.
Probability of Default	JCR-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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Rating History

Rating Date	Current Rating	Rating Outlook	Rating Action
RATING TYPE: ENTITY			
1/26/2018	A-/A-2	Stable	Reaffirmed
6/17/2015	A-/A-2	Stable	Reaffirmed
5/20/2014	A-/A-2	Stable	Upgrade
3/18/2013	BBB+/A-3	Stable	Reaffirmed
2/1/2012	BBB+/A-3	Stable	Reaffirmed