RATING REPORT

Muhammad Shafi Tanneries (Private) Limited

REPORT DATE:
July 26, 2021

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Outlook	Negative		Rating Watch - Developing	
Rating Date	*July 26, 2021*		*June 30, 2020*	

COMPANY INFORMATION	
Incorporated in 1972	**External auditors:** RSMAvaisHyderLiaquatNauman, 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
MianAmjadHafeez–22%	
Mian Muhammad Naseem–20%	
MianTahirHanif–13%	
Mian Muhammad Haleem–12%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.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.

RATING RATIONALE

Muhammad Shafi Tanneries (Private) Limited (MSTL) is engaged in the business of converting goat and sheep hides to finished leather which is used in making of shoes, fashion articles (purses and handbags) and gloves. MSTL belongs to Shafi Group which has presence in the textile, food and footwear sectors. MSTL is a family owned organization. The registered office and factory is situated in Karachi.

Key Rating Drivers:

Declining industry trend, further pronounced due to COVID

The ensuing impact of COVID-19 has affected the entire international markets with leather market being more severely hit. In FY20, leather exports declined by 9.3% as compared to the preceding year. It is pertinent to mention that Pakistan's leather exports have followed a declining trend since FY14 due to slowdown in demand from European countries and a shift towards Asia. Moreover, demand dynamics depict a shift towards artificial leather to contain environmental degeneration and diversion from leather due to its comparatively higher prices. In addition to the slow demand, Pakistan's leather industry is characterized by high competition due to presence of large number of small to medium sized players. Local firms have to compete not only with domestic players, but also with Chinese, Indian and Bangladeshi manufacturers. The stiff competition limits ability to extract higher margins within finished leather. Going forward, given subdued leather demand globally, industry is expected to remain under pressure.

Topline of the company increased by 15% during FY20 vis-à-vis FY19; however the impact of COVID-19 induced slowdown led to declining volumes during FY21.

Sales of the company increased by 15% to Rs. 2.1b (FY19: Rs. 1.8b) during FY20 but depicted 55% decline in 11M'FY21 compared to same period last year. Growth in sales in FY20 was a function of both higher export volume and leather prices during FY20. However, in 11M'FY21, given subdued demand of leather amid COVID-19 crisis; sales volumes have been adversely impacted. MSTL sales are primarily export based constituting more than four-fifth of total revenues. Majority of exports are to Germany, Austria and China, accounting for 22%, 12% and 9%, respectively. Given company sales are concentrated in Europe where markets have been more severely affected by COVID lockdown, the impact of slowdown has been more pronounced.

Going forward, management plans to diversify its customer base by exploring new markets as well as diversifying into cow skin based leather (used in making leather garments) which has relatively better demand prospects than sheep and goat. No additional capex will be required for this purpose except for addition of technical expertise.

Profitability to remain under pressure

The company posted Net Profit after tax of Rs. 134m (FY19: Rs.106m) during FY20 on account of higher export volumes and prices. However, attrition in margins was observed with gross margins reducing to 19.1% (FY19: 26.3%) due to increase in raw material prices. During 11M'FY21, while leather prices remained fairly stable, sizeable reduction in volumes impacted margins and in turn profitability, recording a loss of Rs. 27.8m. Investment income from associates and capital markets provided support to the bottom line to some extent (11M'FY21: Rs. 55m; FY20: Rs. 65m).

Going forward, profitability from core business will remain subdued, however management expects profitability to be supported through investment income from associates as well as reduced financial charges on account of de-leveraging of balance sheet in the ongoing year.

Liquidity profile remains adequate

In 2020, FFO was lower in absolute terms at Rs. 89.5m (FY19: Rs. 179.0m), despite higher profitability relative to 2019 due to capital loss impact booked in FY2019. Resultantly, debt service coverage ratio declined to 3.9x (FY19: 4.7x) during FY20. Post year end debt levels have reduced significantly which provides support to debt servicing. However, aging of trade debts is reflective of competitive pressures, with a sizeable portion (27%) in above 60 days bucket. The current ratio is considered strong at 3.3x during 11M'FY21. Stock in Trade and Trade Debts provide good coverage against short term borrowings, further improving at end Mar'21 owing to reduction in short term borrowing. Company also holds short term liquid investments of ~Rs 257.5m which provides additional comfort.

Low leveraged capital structure

Despite sizable decrease in revenues, financial profile of the company is considered manageable. Total equity stands at Rs. 2.48b (FY20: Rs 2.51b; FY19: Rs. 2.37b) at the end of 11M'FY21. Comfort is drawn from significant reduction in debt levels post year end through support from associated companies (Rs. 175m) as well as liquidation of short term investments. Total debt consequently reduced from Rs. 847.6m in FY2020 to Rs. 189.1m at end 11MY'21, improving gearing (adjusted for related party) to 0.08x.The debt profile primarily consists of short term debt including Rs. 81m of SBP refinance salary support scheme. Leverage indicators remain low at0.22x (FY20: 0.44x; FY19: 0.56x). Going forward, maintaining equity base and low leverage will be important for assigned ratings.

Muhammad Shafi Tanneries (Private) Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**11M'FY21**
Fixed Assets	377.2	384.2	347.0	342.1
Long term Investments	882.0	855.4	799.7	1,104.2
Stock-in-Trade	1,015.0	1,199.3	1,074.1	868.1
Short-Term Investments	369.4	239.2	637.4	257.5
Trade Debts	197.5	144.4	199.9	111.0
Cash & Bank Balances	103.6	125.8	130.4	51.3
Total Assets	3,632.1	3,714.0	3,631.5	3,042.7
Trade and Other Payables	249.6	338.2	194.5	111.8
Long Term Debt	5.5	1.0	7.6	7.4
Short Term Debt	1,005.0	926.0	840.0	181.7
Total Debt	1,010.5	927.0	847.6	189.1
Paid-Up Capital	50.0	50.0	50.0	50.0
Total Equity	2,278.5	2,379.8	2,513.3	2,485.2
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**11M'FY21**
Net Sales	1,753.0	1,813.1	2,081.6	875.3
Gross Profit	385.0	476.3	397.3	123.4
Profit Before Tax	136.9	127.2	157.6	(19.4)
Profit After Tax	116.9	106.2	134.4	(27.8)
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**11M'FY21**
Gross Margin (%)	22.0%	26.3%	19.1%	14.1%
Net Margin	6.7%	5.9%	6.5%	-3.2%
FFO	112.3	179.0	98.5	
FFO to Total Debt (%)	11.1%	19.3%	11.6%	
FFO to Long Term Debt (%)	2044%	18016%	1302%	
Current Ratio (x)	1.85	1.94	2.38	3.30
(Stock+ Trade Debts)/ Short term borrowing	121%	145%	152%	274%
Debt Servicing Coverage Ratio (x)	2.78	4.72	3.94	
Gearing (x)	0.44	0.39	0.34	0.15
Adjusted Gearing(x)				0.08**
Leverage (x)	0.59	0.56	0.44	0.22
ROA (%)	3.1%	2.9%	3.7%	-1.1%*
ROE (%)	5.3%	4.6%	5.5%	-1.5%*

**annualized ratios*

*** excluding interest free related party loan*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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	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	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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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Current Rating	Rating Outlook	Rating Action
RATING TYPE: ENTITY			
07/26/2021	A-/A-2	Negative	Maintained
6/30/2020	A-/A-2	Rating-Watch Developing	Maintained
5/02/2019	A-/A-2	Negative	Maintained
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

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Shahid Ahmed	Manager Financial Reporting and Risk	29th-June-2021