RATING REPORT

Mannan Shahid Forgings Limited

REPORT DATE:
March 17, 2022

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*March 17, '22*	

COMPANY INFORMATION	
Incorporated in 1989	External auditors: KPMG Taseer Hadi & Co. – Chartered Accountants
Public Limited Unquoted Company	Chairman: Mr. Shahid Ahmad Khan CEO: Mr. Shahid Dad
Key Shareholders (with stake 5% or more):	
Valley Forge (Private) Limited – 100%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (August 2021) *https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf*

OVERVIEW OF THE INSTITUTION

Mannan Shahid Forgings Limited was incorporated in July 1989 as a private limited company under the Companies Ordinance, 1984 (now Companies Act, 2017) and was later converted into unquoted public limited company w.e.f. May 23, 2005. The principal business activity is manufacturing and sale of agricultural and automotive parts.

Profile of Chairman

Mr. Shahid Ahmad Khan serves as Chairman of the Board of Directors. Mr. Khan has over 50 years of experience in automotive industry and holds B.Sc. degree from the Institute of Motor Industry, Shrewsbury College.

Profile of CEO

Mr. Shahid Dad has over four decades of work experience, including 21 years in the Pakistan Air Force. He holds BSc. (Hon) in War Studies from Air War College, BSc. Aeronautics from University of Peshawar, Masters in Government from Harvard University, and MS in Public Policy, Massachusetts University.

Financial Snapshot

Tier-I Equity: end-1HFY22: Rs.1.1b; end-FY21: Rs. 924.8m; end-FY20: Rs. 993.8m.

Assets: end-1HFY22: Rs. 2.6b; end-FY21: Rs. 2.5b; end-FY20: Rs 2.2b.

Profit After Tax: 1HFY22: Rs. 194m; FY21: Rs. 164m; FY20: Rs. 54m.

RATING RATIONALE

The ratings assigned to Mannan Shahid Forgings Limited (MSFL) take into account a moderate business risk profile supported by experienced sponsors who are actively involved in managing company's operations. The company is involved in manufacturing high precision mechanical components for auto parts manufacturers and machining houses in Pakistan as well as in other countries. The ratings also factor in presence of limited number of organized players operating in the country with relevant capacities and technical expertise, giving rise to high customer retention and largely steady demand for relevant products in the local market. The concentration risk in sales has remained high which has been partially offset by high retention levels and induction of some new clients and products in the recent years. Topline exhibits an upward trajectory emanating from higher volumetric sales and uptrend in average selling prices. Nearly half of the sales constituted exports in the outgoing year while its contribution increased further to two-third of revenue during 1HFY22. Profit margins have improved notably amidst higher selling prices and economies of scale along with rationalization of operating costs. The financial risk profile is underpinned by sound cash flow coverages and comfortable leverage indicators. Going forward, growth in revenue is projected to be largely driven by higher export orders. Achieving projected revenue growth and profitability while maintaining liquidity and capitalization profiles would remain key rating drivers. Meanwhile, the ratings also factor in vulnerability of raw material prices to exchange rate fluctuation and any adverse changes in regulatory duties.

Company's overview: MSFL started operations as a small forge shop in 1974, producing forgings for railways and gas companies. The company was formally incorporated in 1989 as a private limited company and was later converted into unquoted public limited company in 2005. MSFL's business model revolves around manufacturing of forged, heat-treated, and machined components for passenger cars & trucks, agricultural tractors, motorcycles, fifth wheels and industrial conveyer system. Mr. Shahid Ahmad Khan is the founding member of the company. Mr. Shahid Dad has had decades long association with MSFL in various facets of administration and management. MSFL is a wholly owned subsidiary of Valley Forge (Private) Limited, which in turn, is owned by Mr. Shahid Dad (51%), Mr. Muhammad Akhtar (15%), Mr. Shahid Ahmad Khan (0.01%) all being the members of the Board of Directors (BoD). Rest of the shareholding is vested with family members of Mr. Shahid Ahmad Khan. Mr. Akhtar also serves as the company's secretary. Mr. Akhtar is a Chartered Accountant by profession with over 30 years of experience and has remained CFO of MSFL for seven years. Regular BoD meetings are held in addition to statutory four meeting and minutes are recorded formally. A management committee exists and holds meetings on daily basis.

Enhanced operations amidst higher demand: MSFL installed production capacity has remained intact over the years at 15,000 MT, comprising thirteen production lines. In line with higher demand, capacity utilization increased to 52% (FY20: 40%; FY19: 46%) in FY21. Production capacity, however, also depends on weight and type of forged and machined parts manufactured where higher weight components taking more time and thus resulting in lower capacity. MSFL has a variety of forging press lines in 300 tons, 700 tons, 1,300 tons, 2,500 tons and 4,000 tons capacity. The company is among the few players in the country with higher range press lines. The company maintains the prestigious QMS certificate - IATF 16949:2016, which is the global technical specification and quality management standard for the automotive industry based on ISO 9001:2015.

MSFL manufactures a wide range of high-precision forged, heat-treated, and machined components from hot-rolled steel bars with varying grades of carbon and steel alloy. Product mix of the company is largely tilted towards component parts and axels of tractors and heavy vehicles (FY21: 73%; FY20: 74%; FY19: 71%), followed by motorcycles (FY21: 12%; FY20: 10%; FY19: 11%) and conveyer system (FY21: 2%; FY20: 5%; FY19: 4%). Proportion of the cars have remained low (FY21: 3%; FY20: 2% and FY19: 5%) due to diseconomies of scale. MSFL uses both local and imported steel bars, however, its mix depends on type of customer orders, prevailing market prices and duty structure. Imported raw material costs relatively less than local due to no import duty levied; however, duty free material can only be used for exports as required under manufacturing bond signed with customs department. Average cost of imported steel bars was lower at Rs. 109.3/Kg (FY20: 112.4/Kg; FY19: 101.6/Kg) in FY21 whereas local steel bars average rates have increased notably to Rs. 179.3/Kg (FY20: Rs. 153.9/Kg; FY19: Rs. 140.5/Kg). Imported steel bars constituted 41% (FY20: 50%; FY19: 37%) of total raw material procured in FY21.

Property, plant, and equipment stood at Rs. 764.8m (FY20: Rs. 759.7m; FY19: Rs. 753.5m). There was an addition of plant and machinery worth Rs. 30m (FY20: Rs. 21.2m; FY19: Rs. 8.3m) in the outgoing year, related to regular capex. While the company does not intend to enhance production capacity in the medium term, the management plans to implement business process reengineering through increasing efficiency of existing lines and dies, measures to reduce wastages and power cost. The company has a power requirement of 5 MW for which the company has sanctioned load from the national grid. The company has recently applied for enhancement of load by 2.5 MW for its heavy lines to address operational bottlenecking. The company also has diesel / gas fired power generators which are used as a backup during power shutdowns. The company has 260 MMBTU load from Sui Northern Gas Pipelines Limited; however, for the past few years, diesel and LPG have been used as alternate fuel to meet gas shortages.

Growth in topline along with improvement in profit margins: Sales exhibited an upward trajectory in FY21 onwards on account of higher volumes coupled with increase in average selling prices. Net sales were recorded higher at Rs. 2.3b (FY20: Rs. 1.66b; FY19: Rs. 1.70b) in FY21. Export sales increased to Rs. 1.1b (FY20: Rs. 890.4m; FY19: Rs. 740.2m) with a contribution of 48% (FY20: 54%; FY19: 43%) in the sales mix. Local sales were recorded higher at Rs. 996.4m (FY20: Rs. 651.4m; FY19: Rs. 839.4m) comprising 44% (FY20: 39%; FY19: 49%) while scrap sales have remained at 8% (FY20: 7%; FY19: 8%) of the net revenue. Revenues decreased by about 2.8% in FY20 due to the impact of economic slowdown during first wave of pandemic. Overall sales have remained concentrated in both local and export markets. Capi Group S.R.L, a foreign client, has alone contributed one-fourth to the topline on a timeline basis while in local sales three clients, including Millat Tractors Ltd., Millat Equipment Ltd., and Atlas Honda Ltd. constituted 40% (FY20: 37%; FY19: 43%) of total sales. However, the said risk is partially mitigated by high retention levels and induction of various new clients and products in the recent years. In terms of geographic distribution of export sales, 25% (FY20: 26%; FY19: 28%) of sales emanated from Italy while the rest has remained well diversified. A list of top-five local and foreign customers along with sales and respective proportion of net sales are tabulated below:

	FY19		FY20		FY21	
	Rs. Mil.	%	Rs. Mil	%	Rs. Mil	%
Capi Group S.R.L	474	28%	423	26%	556	24%
Millat Equipment Limited	295	17%	249	15%	394	17%
Millat Tractors Limited	287	17%	207	12%	275	12%
Atlas Honda Limited	150	9%	158	10%	251	11%
Componenta Pte. Ltd.	36	2%	82	5%	112	5%
Wallace Forge Company Ltd.	22	1%	92	6%	104	5%

The company generated gross profit of Rs. 298.6m (FY20: Rs. 164.6m; FY19: Rs. 202.2m) in FY21 with improvement in gross margins to 13.1% (FY20: 9.9%; FY19: 11.9%) mainly on the back of overall increase in average selling prices. Breakdown of revenue in terms of quantity sold and average rates is tabulated below:

Revenue Breakdown	**FY20**		**FY21**	
	Kgs Sold	**Rs. Per Kg**	**Kgs Sold**	**Rs. Per Kg**
Local	2,605,739	250	3,446,701	289
Exports	3,447,487	258	4,325,225	252

Cost of sales increased to Rs. 2.0b (FY20: Rs. 1.5b; FY19: Rs. 1.5b) in FY21 and was largely rationalized. Raw material consumed amounted to Rs. 1.1b (FY20: Rs. 765m; FY19: Rs. 850.5m) and as a percentage of cost of goods manufactured were 54% (FY20: 49%; FY19: 55%). Salaries, wages and other benefits increased to Rs. 360.1m (FY20: Rs. 274m; FY19: Rs. 275.9m) in line with inflationary adjustments and higher headcount to support enhanced operations. Fuel cost also increased in tandem with higher production and inflationary uptick. Administrative and distribution expenses stood at Rs. 74.3m (FY20: Rs. 84.5m; FY19: 88.4m) and Rs. 5.5m (FY20: Rs.1 0.4m; FY19: Rs. 10.3m), respectively. Despite higher average borrowings, finance cost decreased to Rs. 26.9m (FY20: Rs. 32.4m; FY19: Rs. 23.2m) in FY21 owing to lower average markup rates. Other expenses amounted to Rs. 21.9m (FY20: Rs. 4.8m; FY19: Rs. 7.3m) which largely comprised employee related expenses and realized net exchange loss. Other income of Rs. 39.8m (FY20: Rs. 36.0m; FY19: Rs. 50.0m) mainly included export rebate and interest on loan forwarded to the holding company. Accounting for taxation, net profits were recorded higher at Rs. 163.9m (FY20: Rs. 53.7m; FY19: Rs. 97.6m), with notable increase in net margins to 7.2% (FY20: 3.2%; FY19: 5.7%).

During 1HFY22, net sales amounted to Rs. 1.6b with growth driven by higher exports entailing 66% of the topline. Gross profit was recorded at Rs. 276.9m while higher gross margins of 17.1% were driven by notable increase in average selling prices of both local and export sales to Rs. 377/Kg and Rs. 346/Kg, respectively. In volumetric terms, export sales exhibited 42% growth on an annualized basis. Given rationalization of operating expenses, net margins increased to 12.0% with net profit of Rs. 194.3m during 1HFY22. The management projects the topline to reach Rs. 3.4b in FY22 on the back of increase in quantity sold and uptrend in average selling prices. Being conservative, the management projected some decrease in profit margins in FY22 onwards. Net sales are projected to grow at a CAGR of 21% during 3 years period. The management expects export sales to remain major growth driver, going forward.

Adequate liquidity in terms of cash flow coverages: Funds from operations increased to Rs. 233.5m (FY20: Rs. 59.6m; FY19: Rs. 141.4m) mainly as a result of higher profitability. Resultantly, FFO to total debt and FFO to long-term debt increased to 0.39x (FY20: 0.16x; FY19: 0.42x) and 2.55x (FY20: 1.17x; FY19: 72.31x), respectively. Debt service coverage also remained sizeable at 2.37x (FY20: 2.67x; FY19: 3.03x).

Current asset increased to Rs. 1.6b (FY20: Rs.1.3b; FY19: Rs. 1.3b) primarily due to higher inventory levels. Stock in trade stood higher at Rs. 862.5m (FY20: Rs. 518.2m; FY19: Rs. 745.3m) mainly on account of higher raw material inventory to Rs. 566.4m (FY20: Rs. 320.6m; FY19: Rs. 477.2m) at the end-FY21, which, in turn was in line with scale of operations and higher average cost of material procured. The company usually keeps three months stock of raw material inventory; the stock levels were lower in FY20 due to supply chain disruption from Covid-19 in last quarter of that year. Finished goods inventory and work in progress inventory amounted to Rs. 176.8m (FY20: Rs. 91.0m; FY19: Rs. 103.8m) and Rs. 122.7m (FY20: 110.8m; FY19: Rs. 169.8m), respectively.

Trade debts amounted to Rs. 350.5m (FY20: Rs. 370.1m; FY19: Rs. 277m) and as percentage of net sales accounted for 15% (FY20: 22%; FY19: 16%). Trade debts increased to Rs. 575.7m at end-Dec'21 while aging profile is considered satisfactory given 91% of these receivables are due for less than 3 months. Sales are entirely made on credit basis. Local customers are given a credit of 30 to 40 days. Payment terms for exports are fairly relaxed, with up to 90 days credit on documents against acceptance (DA) basis. As per management, relaxed credit terms with the foreign clients provides the company a competitive edge in retaining and adding new customers. Trade and other payables increased to Rs. 356.4m (FY20: Rs. 204.8m; FY19: Rs. 280.5m) by end-FY21 and as a percentage of cost of sales were 18% (FY20: 14%; FY19: 19%). The company has access to 30 days credit limit from local suppliers while imports are made on sight LC.

As a result of better working capital management, net operating cycle of the company improved to 133 days (FY20: 167 days; FY19: 156 days) in the outgoing year, due to improvement in inventory and receivable turnover during FY21. Loans and advances amounted to Rs. 21m (FY20: 10m; FY19: Rs. 18.8m). Sales tax and income tax refundable amounted to Rs. 200.3m (FY20: Rs. 170.5m; FY19: Rs. 173.6m). Cash and bank balances stood at Rs. 138.3m (FY20: Rs. 113.0m; FY19: Rs. 22.3m) at end-FY21. Current ratio, albeit decreased, remained adequate at 1.67x (FY20: 2.26x; FY19: 2.05x). In addition, coverage of short-term borrowings via trade debts and stock in trade remained sizeable at 2.37x (FY20: 2.67x; FY19: 3.03x). Liquidity position is projected to remain sound on the back of higher profitability and better working capital management.

Low leveraged capital structure: Core equity of the company augmented to Rs. 1.1b (FY21: Rs. 924.8m; FY20: Rs. 993.8m; FY19: Rs. 928.2m) on account of profit retention during 1HFY22. The company paid cash dividend of Rs. 223.5m (FY20 & FY19: Nil) in FY21 and projects a dividend payout of Rs. 75m in the ongoing year (FY23: Rs. 70m; FY24: Rs. 70m). After including revaluation surplus on PP&E, total equity amounted to Rs. 1.5b (FY21: Rs. 1.3b; FY20: Rs. 1.4b; FY19: Rs. 1.3b).

The total borrowings amounted to Rs. 602.5m (FY21: Rs. 602.3m; FY20: Rs. 383.2m; FY19: Rs. 339.4m) at end-1HFY22. The uptick in short-term borrowings from FY21 onwards was largely in line with higher working capital requirements. The long-term financing including current portion stood at Rs. 73.1m (FY21: 91.5m; FY20: Rs. 51.0m; FY19: Rs. 2m); it comprises a long-term facility of Rs. 9.7m (FY20: 13.4m; FY19: Nil) obtained for import of machinery in Oct 2019 at a rate of 5% and repayable in 20 equal quarterly installments, commencing from Jan 25, 2020. The company also obtained a long-term loan of Rs. 110.6m in June 2020, to finance its salaries and wages under SBP refinance scheme at a subsidized markup rate of 3% and repayable in eight equal quarterly installments, commencing from Jan 1, 2021. As a result of strengthened equity base and lower financing burden, debt leverage and gearing have remained fairly comfortable at 1.07x (FY21: 1.31x; FY20: 0.81x; FY19: 0.89x) and 0.55x (FY21: 0.65x; FY20: 0.39x; FY19: 0.37x), respectively, at end-1HFY22. The management does not intend to mobilize any long-term borrowings in the medium term. With higher internal cash flow generation, the company projects lower reliance on bank borrowings to finance its working capital, going forward.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY19	FY20	FY21	1HFY22
Property, Plant & Equipment	754	760	765	782
Stock in Trade	745	518	862	726
Trade Debts	277	370	350	576
Tax Refundable	174	171	200	218
Cash & Bank Balance	22	113	138	111
Other Current Assets	145	225	181	234
Total Assets	**2,117**	**2,157**	**2,496**	**2,647**
Trade & Other Payables	281	205	356	297
Staff Retirement Benefit	136	146	163	170
Short Term Borrowings	337	332	511	525
Long-Term Borrowings *(Inc. current maturity)*	2	51	92	77
Other Liabilities	70	70	92	115
Total Liabilities	**826**	**804**	**1,214**	**1,184**
Paid Up Capital	212	212	212	212
Tier-1 Equity	**928**	**994**	**925**	**1,105**
Revaluation Surplus	362	360	357	357
Total Equity	**1,290**	**1,353**	**1,282**	**1,463**
INCOME STATEMENT	FY19	FY20	FY21	1HFY22
Net Sales	1,704	1,656	2,277	1,616
Gross Profit	202	165	299	277
Operating Profit	103	70	219	230
Other Income	50	36	40	31
Profit Before Tax	123	68	210	226
Profit After Tax	98	54	164	194
FFO	141	60	234	160
RATIO ANALYSIS	FY19	FY20	FY21	1HFY22
Gross Margin (%)	11.9	9.9	13.1	17.1
Net Margin (%)	5.7	3.2	7.2	12.0
Net Working Capital	693	737	668	880
FFO to Long-Term Debt	72.3	1.17	2.55	4.15*
FFO to Total Debt	0.42	0.16	0.39	0.53*
Debt Servicing Coverage Ratio (x)	8.44	2.50	3.09	3.99
ROAA (%)	4.9	2.5	7.0	15.1*
ROAE (%)	11.2	5.6	17.1	38.3*
Gearing (x)	0.37	0.39	0.65	0.55
Debt Leverage (x)	0.89	0.81	1.31	1.07
Current Ratio	2.05	2.26	1.67	1.96
Inventory + Receivable/Short-term Borrowings (x)	3.03	2.67	2.37	2.48

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure 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	Annexure III
Name of Rated Entity	Mannan Shahid Forgings Limited
Sector	Steel Allied
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	
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 Meeting/s Conducted	

Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
17-Mar-22	A-	A-2	Stable	Initial

Due Diligence Meeting/s Conducted:

Name	Designation	Date
Mr. Ali Ahmad Qureshi	CFO	February 25, 2022