RATING REPORT

Mannan Shahid Forgings Limited

REPORT DATE:
May 11, 2023

RATING ANALYSTS:

Asfia Aziz
asfia.aziz@vis.com.pk

Basel Ali Assad
basel.ali@vis.com.pk

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	Stable		Stable	
Rating Date	*11th May, 2023*		*17th March,2022*	
Rating Action	Reaffirmed		Initial	

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*

Mannan Shahid Forgings Limited

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 an unquoted public limited company w.e.f. March 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-1HFY23: Rs.1.3b; end-FY22: Rs.1.3b; end-FY21: Rs. 925m.

Assets: end-1HFY23: Rs. 3.9b; end-FY22: Rs. 3.9b; end-FY21: Rs 2.5b.

RATING RATIONALE

Corporate Profile

MSFL was incorporated as a private limited company in 1989 and was later converted into an unquoted public limited company in 2005. The company's primary operations pertain to the manufacturing of forged, heat-treated, and machined components for passenger cars & trucks, agricultural tractors, motorcycles, fifth wheels and industrial conveyer system. The company is a wholly-owned subsidiary of Valley Forge (Private) Limited (VFL) which is in turn owned by Mr. Shahid Dad (51%), Mr. Muhammad Akhtar (15%) and Mr. Shahid Ahmad Khan (1%), all of whom are members of the Board of Directors (BoD). The remaining shareholding is vested with family members of Mr. Shahid Ahmad Khan. Going forward, the management has plans to merge both MSFL and VFL into a single entity.

Business risk

The engineering segment is characterized by medium business risk keeping in view its cyclicality, price volatility of key raw materials and fixed operating costs. According to management, the company classifies a dominant player in the forging industry for forged, machined and heat-treated parts (particularly for auto industry) facing competition only from several small-scale entities. With demand being contingent largely on the automotive sector, local demand outlook is subdued in view of severe macroeconomic challenges in the country brought by import restrictions, currency devaluation, high interest rates, soaring inflation and increased power costs. This is evident through the decline of 47.6% in total automotive unit sales during 8MFY23. This domestic demand risk, however, is mitigated through the company's focus on exports that have shown robust volumetric growth on a timeline basis. According to management, the company's sound international reputation has helped grow its export base along with the diversion in demand following the recent Russia-Ukraine war. However, the company faces stiff competition from international players, particularly from China and India, which have lower power costs that allow them to be more cost-effective.

On the supply-side front, MSFL primarily utilizes imported raw materials, carbon & alloy steel bars to meet quality requirements for exportable goods. The company has been largely unaffected by import restrictions due to its sizeable export base relative to import requirements. However, according to management, certain difficulties pertaining to payments to suppliers were faced from Jan'23 onwards. Competitive advantage of the Company stems from the ability to import duty-free raw material for its export orders backed by a manufacturing bond signed with the customs department. However, the company's reliance on imported raw materials exposes it to notable exchange rate risk. International prices for hot-rolled coils (HRC) witnessed significant volatility reaching a record high of $1950/MT during Sep'21 before gradually declining to about $600-700/MT by end-Dec'22 owing to reduced demand caused by China's zero-COVID policy, a downturn in the real estate construction industry, and global restrictive monetary policies. However, prices have begun to rebound to around $1100-1200 during end-March'23 due to fluctuating demand.

For local sales, on the other hand, the company procures raw material locally from a single supplier exposing MSFL to significant supplier concentration risk; however, the same is moderated through

Profit After Tax:
1HFY23: Rs. 73m;
FY22: Rs. 407m;
FY21: Rs. 164m.

their long-standing relationship. Payment terms for imports are mostly Letter of Credit (LC) at sight or advance payment in certain cases and 30 days for local supplies. Additionally, the company is able to partly transfer higher costs on to clients through quarterly price adjustment.

Reduction in capacity utilization on the back of lower demand

The company's available production capacity has remained consistent at about 12,000 MT/year on a timeline basis and consists of thirteen forging lines with capacities ranging from 250 MT to 4,000 MT. During the ongoing year, capacity utilization decreased notably owing to lower volumetric demand, particularly from the local market due to the challenging macroeconomic scenario. Breakdown of capacity utilization can be seen below:

	FY21	FY22	1HFY23
Installed Capacity (Tons)	12,000	12,000	6,000
Actual Production (Tons)	7,772	8,482	3,237
Capacity Utilization	64.8%	70.7%	54.0%

The company's total power requirement is around 5MW (which is met primarily through the national grid 2.5MW additional shall be available shortly) while backup diesel/gas power generators are available. Additionally, total sanctioned gas load was about 260 MMBTU.

Double-digit topline growth in FY22 supported by higher exports sales, however with challenging macroeconomic environment and global inflation led demand slowdown revenue growth has been limited in 1HFY23.

Sales revenue of the company reported an increase of 51% in FY22 and was reported at Rs. 3.4b (FY21: Rs. 2.3b). This increase was attributable to a 39% rise in average prices and volumetric growth of 8.1%. Revenue breakdown in terms of volume and average prices can be seen below:

Revenue Breakdown						
	FY21		FY22		1HFY23	
	Kgs sold	Rs. /Kg	Kgs sold	Rs. /Kg	Kgs sold	Rs. /Kg
Local	3,446,701	289	2,183,593	398	472,556	493
Exports	4,325,225	252	6,219,662	360	2,764,564	459
Total	**7,771,926**	**293**	**8,403,255**	**408**	**3,237,120**	**508**

Net Sales Breakdown					
	FY19	FY20	FY21	FY22	1HFY23
Net Exports	720	890	1,090	2,239	1,288
Net Local Sales	839	651	996	869	234
Net Sale of Waste Material	125	115	189	319	141
Total Net Sales	1,684	1,656	2,276	3,427	1,662
% Breakdown					
Net Exports	43%	54%	48%	65%	77%
Net Local Sales	50%	39%	44%	25%	14%
Net Sale of Waste Material	7%	7%	8%	9%	8%
Total Net Sales	100%	100%	100%	100%	100%

Export sales doubled in value to Rs. 2.2b (FY21: Rs. 1.1b) during FY22, contributing about 65% to the topline whereas local sales declined to Rs. 869.4m (FY21: Rs. 996.4m), constituting 25% of net sales. The remainder pertained to proceeds from waste material. The shift in sales mix was accounted for a 44% volume jump in exports and 43% price increase led by currency devaluation. Higher export volumes were a function of greater international demand. In terms of geographic locations for export sales, majority of the proceeds were generated from Italy (FY22: 44%, FY21: 51%) and Germany (FY22: 25%, FY21: 20%) while the rest is diversified over several markets.

Moreover, notable client concentration risk is present as about 83% of net sales emanated from the company's top ten clients during FY22 (FY21: 89%). However, this risk is partially mitigated through the long-standing relationships with clients as well as onboarding of new clients to improve diversification, according to management. Breakdown of net sales in terms of client concentration can be seen below:

FY21			FY22		
Company	**Net Sales (Rs. m)**	**%**	**Company**	**Net Sales (Rs. m)**	**%**
Capi Group S.R.L	556	24%	Capi Group S.R.L	981	29%
Millat Equipment Limited	394	17%	Millat Equipment Limited	300	9%
Millat Tractors Limited	275	12%	Wallace Forge Company	241	7%
Atlas Honda Limited	251	11%	Componenta Pte. Ltd.	232	7%
Rafiq Brothers Steel Re-Rolling Mills	130	6%	Millat Tractors Limited	218	6%
Componenta Pte. Ltd.	112	5%	Atlas Honda Limited	205	6%
Wallace Forge Company	104	5%	Rasche Unformtechnik GMBH & Co KG	200	6%
Rasche Unformtechnik GMBH & Co KG	81	4%	Walterscheid Powertrain Group	170	5%
Walterscheid Powertrain Group	75	3%	Madina Steel Industry	167	5%
Agriauto Industries Limited	57	2%	Iqbal Induction Furnace	134	4%
Others	243	11%	Others	578	17%
Total	**2,277**	**100%**	**Total**	**3,427**	**100%**

During 8MFY23, the topline witnessed a 0.9% decline on an annualized basis to Rs. 2.3b as local demand decreased due to weak macroeconomic environment. However, export sales continued its upward trend, rising 15% on an annualized basis, albeit on the account of higher sales prices. Meeting projected growth topline targets and further enhancing export base will be vital, going forward.

Improvement in profitability margins during FY22 were a function of inventory gains; however, in 8MFY23 the same were impacted due to limited ability to pass on the increase in input costs to the customers due to challenging macroeconomic environment and elevated finance costs.

Gross margins improved to 14.8% (FY21: 13.1%) in FY22 mainly on the account of higher selling prices and inventory gains. Total cost of sales rose to Rs. 3.1b (FY21: Rs. 2.1b) with raw materials constituting about 55.3% of cost of goods manufactured (FY21: 54.4%) in FY22. About 60% of raw materials were imported (FY21: 42%) and were procured at lower average prices of about Rs. 191/kg (FY21: Rs. 109/kg) as compared to local raw materials costing about Rs. 264/kg (FY21: Rs. 179/kg). This is due to the company's manufacturing bond which allows MSFL to purchase imported raw materials without duties. Additionally, net margins increased notably to 11.9% (FY21: 7.2%) in FY22 owing to higher other income of Rs. 115.5m (Rs. 39.8m), attributable largely to exchange gain, as well as lower taxation due to prior year adjustments. Additionally, financing costs increased to Rs. 39.2m (FY21: Rs. 26.9m) during FY22 despite lower debt levels owing to higher policy rate.

Raw material costs increased to about Rs. 218/kg for imported supplies and Rs. 319/kg for local purchases in 1HFY23 due to significant currency devaluation which offset any decline in international prices. This, combined with increase in salaries and wages expense due to rise in minimum wages and higher power costs in line with hikes in tariffs, resulted in gross margins dipping to 10.4% in 8MFY23. Consequently, net margins also declined to 4.4% due to higher financing costs on the back of rising policy rates. Improving profitability margins will be important over the rating horizon.

Sound liquidity coverages

Funds from Operations (FFO) declined to Rs. 115.8m during 1HFY23 (FY22: Rs. 442.2m, FY21: Rs. 233.5m) due to lower overall profitability. Although remaining sound, FFO-to-total debt dipped to 0.36x (FY22: 0.77x; FY21: 0.39x) in 1HYFY23, however, FFO-to-long-term debt remained sizeable at 6.95x (FY22: 6.98x; FY21: 2.55x) owing to minimal long-term borrowings. Additionally, debt-service coverage ratio, albeit lower, was still substantial at 4.04x (FY22: 5.08x; FY21: 3.09x) in HYFY23.

Stock-in-trade stood at Rs. 928.3m at end-Feb'23 (FY22: Rs. 887m; FY21: Rs. 862m) out of which 58.1% pertained to raw materials (FY22: 49.5%; FY21: 65.7%). Trade debts were recorded at Rs. 605m at end-Feb'23 (FY22: Rs. 519m; FY21: Rs. 350.5m) and were manageable relative to the topline, accounting for about 18% of net sales (FY22: 15.1%; FY21: 15.4%). Aging schedule is considered manageable with about 60% of receivables due between 0-60days, 37% due between 61-120 days and only 2% due above 120 days. Additionally, current ratio and short-term borrowing coverage remained satisfactory, standing at 1.98x and 2.07x, respectively (FY22: 2.01x, 2.73x FY21: 1.67x, 2.37x) at end-Feb'23. Moreover, net operating cycle, increased on the account of decline in receivable turnover and higher payment turnover. Maintaining liquidity profile over the rating horizon will be important.

Low leverage levels reflect a conservative financial policy

The company's tier-1 equity remained stable at Rs. 1.3b at end-Dec'22 after increasing in FY22 (FY22: Rs. 1.3b; FY21: Rs. 925m) owing to subdued internal capital generation. Going forward, management envisages dividend payout in the range of Rs. 90-100m. Total borrowings stood at Rs. 648.6m (FY22: Rs. 577.8m; FY21: Rs. 602.3m) at end-Dec'22 out of which 95% pertains to short-term borrowings amounting to Rs. 615.2m (FY22: Rs. 514.5m; FY21: Rs. 510.8m). Long-term borrowings remained minimal, declining to Rs. 33m (FY22: Rs. 63m; FY21: Rs. 91m) and constitute largely of financing obtained at subsidized finance costs through TERF facility and SBP Refinance Scheme for salaries and wages. In lieu of rising finance costs, management plans to reduce its reliance on bank financing and utilize internal cash flows to meet working capital requirements going forward. Gearing and leverage both remained on the lower side due to the company's internal capital generation and low debt utilization, standing at 0.49x and 0.9x, respectively (FY22: 0.46x, 1x; FY21: 0.65x; 1.31x) at end-Dec'22. Maintaining low leverage levels will be critical to sustain the ratings.

Mannan Shahid Forgings Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**1HFY23**
Property, Plant & Equipment	754	760	765	1,844	1,842
Stock in Trade	745	518	862	887	727
Trade Debts	277	370	350	519	508
Tax Refundable	174	171	200	201	239
Cash & Bank Balance	22	113	138	166	340
Other Current Assets	132	152	106	264	146
Total Assets	**2,117**	**2,157**	**2,496**	**3,894**	**3,874**
Trade & Other Payables	281	205	356	385	217
Staff Retirement Benefit	136	146	163	183	200
Short Term Borrowings	337	332	511	514	615
Long-Term Borrowings *(Inc. current maturity)*	2	51	91	63	33
Other Liabilities	70	70	93	117	127
Total Liabilities	**826**	**804**	**1,214**	**1,263**	**1,191**
Paid Up Capital	212	212	212	212	212
Tier-1 Equity	**928**	**994**	**925**	**1,266**	**1,318**
Revaluation Surplus	362	360	357	1,365	1,365
Total Equity	**1,290**	**1,353**	**1,282**	**2,631**	**2,683**
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**1HFY23**
Net Sales	1,704	1,656	2,277	3,427	1,662
Gross Profit	202	165	299	507	130
Operating Profit	103	70	219	390	77
Other Income	50	36	40	115	50
Profit After Tax	98	54	164	407	73
FFO	141	60	234	442	116
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**1HFY23**
Gross Margin (%)	11.9%	9.9%	13.1%	14.8%	7.8%
Net Margin (%)	5.7%	3.2%	7.2%	11.9%	4.4%
Net Working Capital	693	737	668	1,022	1,033
FFO to Long-Term Debt (x)	72.31	1.17	2.55	6.98	6.95
FFO to Total Debt (x)	0.42	0.16	0.39	0.77	0.36
Debt Servicing Coverage Ratio (x)	8.44	2.50	3.09	5.08	4.04
ROAA (%)	4.9%	2.5%	7.0%	12.7%	3.8%
ROAE (%)	11.2%	5.6%	17.1%	37.1%	11.3%
Gearing (x)	0.37	0.39	0.65	0.46	0.49
Debt Leverage (x)	0.89	0.81	1.31	1.00	0.90
Current Ratio	2.05	2.26	1.67	2.01	2.12
Inventory + Receivable/Short-term Borrowings (x)	3.03	2.67	2.37	2.73	2.01
Net Operating Cycle (days)	156	167	133	109	117

**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	Forgings
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
11-May-23	A-	A-2	Stable	Reaffirmed
17-Mar-22	A-	A-2	Stable	Initial

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

Name	Designation	Date
Mr. Ali Ahmad Qureshi	CFO	March 24, 2023