RATING REPORT

Mannan Shahid Forgings Limited

REPORT DATE:
May 6, 2024

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	Stable		Stable	
Rating Date	*May 6, 2024*		*May 11, 2023*	
Rating Action	Upgrade		Reaffirmed	

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

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.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. 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

RATING RATIONALE

Corporate Profile

Mannan Shahid Forgings Limited ('MSFL' or 'the Company') 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 (VFPL) which is in turn owned by Mr. Shahid Dad (51%), Mr. Muhammad Akhtar (15%) and Mr. Shahid Ahmad Khan (0.01%), all of whom are members of the Board of Directors (BOD). The remaining shareholding is vested with family members of Mr. Shahid Ahmad Khan. The management has decided to merge VFPL into MSFL. All formalities have been completed; Lahore High Court decision is expected in June 2024.

Operational Profile

The Company's available production capacity has remained consistent at about 15,000 MT/year on a timeline basis and consists of thirteen forging lines. During FY23, capacity utilization decreased notably owing to lower volumetric demand, particularly from the local market due to the challenging macroeconomic scenario. In 1HFY24, utilization has remained muted, despite ease in economic environment during the period. Breakdown of capacity utilization can be seen below:

Production Capacity and Utilization	FY22	FY23	1HFY24
Installed Capacity	15,000	15,000	7,500
Actual Production	8,482	6,423	3,243
Utilization	56.55%	42.82%	43.24%

Key Rating Drivers

Medium business risk profile characterized by exposure to cyclicality and exchange rate volatility. However, many of these risks are mitigated by low competition and the Company's focus on exports.

VIS characterizes the business risk profile of the engineering segment as medium, 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, which is cyclical in nature and demand will vary with economic conditions. This domestic demand risk, however, is mitigated through the Company's focus on exports with ~75% (FY22: ~65%) of net sales comprising of export sales.

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. 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.

High supplier concentration risk, mitigated by long-standing relationship.

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 their long-standing relationship.

Peshawar, master's in government from Harvard University, and MS in Public Policy, Massachusetts University.

Elevated client concentration risk, mitigated by long-standing relationship.

Moreover, notable client concentration risk is present as about 81% (FY22: 83%) of net sales emanated from the Company's top ten clients during FY23, out of which ~31% is contributed by a single client. However, this risk is partially mitigated through the long-standing relationships with clients.

Topline supported by export sales. Currency depreciation impacted both sales and costs, overall inflationary and rising raw material costs constrained gross margins in FY23. In 1HFY24, gross margins recovered with continued price increases and easing raw material costs.

In FY23, with a significant decline in local automobile sales, the Company faced volumetric pressure on sales. With majority of its sales constituting exports, MSFL topline was supported by rupee depreciation which limited overall deterioration. The topline eroded by 0.7% in FY23. In 1HFY24, revenue improved by an annualized growth rate of 20.6%, mostly attributed to continued selling price increases, while volumes remained constrained during the period, albeit recording slight improvement.

Similarly, gross margin eroded in FY23 to 12.8% (FY22: 14.8%). Although, in 1HFY24 gross margins have rebounded to 15%. Meanwhile, net margin showed an inverse trend as it improved to 14.1% (FY22: 11.9%) in FY23 and subsequently declining to 7.5%. This was on account of significant increase in other income supported by notable exchange gains in FY23.

Conservative capitalization profile.

The Company maintains a conservative capitalization profile with low leverage and gearing levels. 5-year average gearing and leverage ratios of MSFL are at 0.4x and 1.0x, respectively. In 1HFY24, while gearing remained at the 5-year average of 0.4x (FY23: 0.3x, FY22: 0.5x), leverage has improved to 0.7x (FY23: 0.8x, FY22: 1.0x). This is supported by the Company's low debt levels, with sufficient profit generation to sustainably strengthen equity despite regular dividend payout.

Healthy coverage profile.

With low debt levels the coverage profile of the Company is healthy. However, in 1HFY24, Funds from Operations (FFO) were constrained on account of a surge in finance cost paid. This was on account of higher average short-term debt drawdown during the period, despite overall borrowings only increasing slightly as of December 2023. As a result, the debt service coverage ratio (DSCR) deteriorated to 3.9x (FY23: 6.1x, FY22: 6.8x) albeit still considered healthy. Meanwhile the short-term debt coverage also remained sufficient at 3.1x (FY23: 3.1x, FY22: 2.7x) in 1HFY24.

Strong liquidity profile.

Historically, the Company maintains a strong liquidity profile while maintaining a 5Y average current ratio of 2.1x. In 1HFY24, the current ratio improved to 2.5x (FY23: 2.3x, FY22: 2.0x), this is on account of gradual build up in inventory between FY21-1HFY24, while current liabilities remained stable with working capital financing met through internal cash generation. As a result of this buildup in stock in trade, the cash conversion cycle between FY21-1HFY24 has also increased to 127 days (FY23: 113 days, FY22: 107 days) in 1HFY24 from 111 days in FY21.

Considerations for Future Reviews

Going forward, ratings will remain sensitive to MSFL's ability to maintain its financial metrics to be commensurate with assigned ratings. Moreover, strengthening of the external reporting framework will also be an important consideration for future reviews.

Mannan Shahid Forgings Limited — Annexure I

Financial Summary				
Balance Sheet (PKR Millions)	**FY21**	**FY22**	**FY23**	**1HFY24**
Property, plant and equipment	764.8	1,843.8	1,830.4	1,834.5
Stock-in-trade	862.5	886.5	1,123.7	1,281.2
Trade debts	350.5	518.9	481.7	490.6
Cash & Bank Balances	138.3	166.4	458.5	286.8
Total Assets	2,496.2	3,893.8	4,341.0	4,487.5
Trade and Other Payables	358.6	404.7	474.8	340.3
Long-term Debt (incl. current portion)	96.9	64.2	26.0	17.2
Short-Term Borrowings	510.8	514.5	536.4	623.2
Total Debt	607.8	578.6	562.4	640.4
Total Liabilities	1,213.9	1,262.6	1,340.7	1,334.2
Paid up Capital	212.3	212.3	1,500.0	1,500.0
Equity (excl. Revaluation Surplus)	924.8	1,265.8	1,640.5	1,793.5
Income Statement (PKR Millions)	**FY21**	**FY22**	**FY23**	**1HFY24**
Net Sales	2,276.8	3,426.7	3,404.2	2,052.2
Gross Profit	298.6	507.2	436.0	308.0
Operating Profit	218.7	390.4	311.8	241.1
Finance Costs	26.9	39.2	86.5	62.6
Profit Before Tax	209.7	435.5	527.6	181.9
Profit After Tax	163.9	406.7	481.1	153.0
Ratio Analysis	**FY21**	**FY22**	**FY23**	**1HFY24**
Gross Margin (%)	13.1%	14.8%	12.8%	15.0%
Operating Margin (%)	9.6%	11.4%	9.2%	11.7%
Net Margin (%)	7.2%	11.9%	14.1%	7.5%
Funds from Operation (FFO) (PKR Millions)	233.5	442.2	572.1	190.9
FFO to Total Debt* (%)	38.4%	76.4%	101.7%	59.6%
FFO to Long Term Debt* (%)	240.9%	689.3%	2196.2%	2213.5%
Gearing (x)	0.7	0.5	0.3	0.4
Leverage (x)	1.3	1.0	0.8	0.7
Debt Servicing Coverage Ratio* (x)	3.0	6.8	6.1	3.9
Current Ratio (x)	1.7	2.0	2.2	2.5
(Stock in trade + trade debts) / STD (x)	2.3	2.7	3.1	3.1
Return on Average Assets* (%)	7.0%	12.7%	11.1%	6.8%
Return on Average Equity* (%)	17.1%	37.1%	29.3%	17.1%
Cash Conversion Cycle (days)	111.1	106.5	112.5	126.8

REGULATORY DISCLOSURES	Annexure II
Name of Rated Entity	Mannan Shahid Forgings Limited
Sector	Forgings
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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.
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Due Diligence Meeting/s Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
06-May-24	A	A-2	Stable	Upgrade
11-May-23	A-	A-2	Stable	Reaffirmed
17-Mar-22	A-	A-2	Stable	Initial

Due Diligence Meeting/s Conducted

Name	Designation	Date
Mr. Ali Ahmad Qureshi	CFO	April 24, 2024