

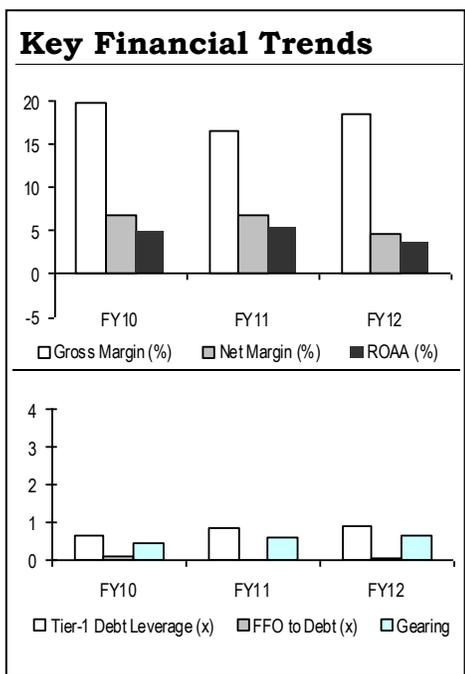
MUHAMMAD SHAFI TANNERIES (PVT.) LTD.

Chairman: Mr. Muhammad Haleem; Chief Executive: Mr. Muhammad Naseem

March 19, 2013

Analysts:	Faryal Ahmad Raza Lakhani
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Category	Latest	Previous
Entity	BBB+/A-3	BBB+/A-3
	Mar 18, '13	Feb 1, '12
Outlook	Stable	Stable
	Mar 18, '13	Feb 1, '12



(Rs. in Million)	FY10	FY11	FY12
Net Sales	1,929	2,405	2,725
Net Profit	129	161	125
Equity	1,639	1,820	1,953
Total Debt	1,735	1,092	1,326
Debt Leverage (x)	0.66	0.85	0.91
FFO	90	48	93
FFO/Total Debt	12%	4%	7%
ROAA	4.8%	5.2%	3.5%

Rating Rationale

The leather industry is one of the most prominent export-oriented industries in Pakistan, having the third largest export volumes in the manufacturing sector after textiles and chemicals & pharma. Export volumes have however come under pressure in recent years given increasing competition from other developing nations, shortage in supply of raw skin and global economic slowdown. Internal weaknesses such as power outages, poor law & order situation and lack of active support at the state level have also affected the industry.

The main production facility of Muhammad Shafi Tanneries (MST), situated in Karachi, has a capacity to produce 2m Sqft of finished leather in a month. Commercial production in the recently established facility in Lahore has also started; the plant has a monthly capacity to produce 0.8m Sqft of semi-finished leather, which is then moved to the Karachi facility for further processing. MST has mainly focused on leather used in manufacturing feminine footwear, sourced from goat skin, given higher margins in the same. Of the company's total sales in FY12, 85% comprised leather made from goat skin, 10% pertained to sheep skin, while remaining were that of bovine animals. While the tannery in Karachi is mainly geared towards production of leather made from goat and sheep skin, drums installed in the Lahore factory are larger in size, equipped for processing of skin of bovine animals. Diversification in product line with the planned use of buffalo/cow hides, going forward, may help in achieving the desired growth in sales volumes.

Net sales value of the company increased by 13.3% to Rs. 2.7b in FY12, given higher average selling price of Rs. 173 (FY11: Rs. 141) per Sqft. In addition to passing on the impact of rising cost of raw-materials to the customers, depreciation of Pak Rupees against US Dollars of 9.7% has also contributed towards higher average selling price in rupee terms. Sales in volumetric terms have declined by 8.5% to 16m Sqft. In the ongoing year, sales volumes have begun to pick pace, and the management has anticipated that the same would increase to 18m Sqft in FY13. Over half of the net sales are made to customers having a long-term association with the company. Ten largest customers of the company accounted for 39% of the total sales made in FY12. Almost one-tenth of the company's sales are made to its own subsidiary in China.

Although average price of raw skin purchased in FY12 was higher by 42.8%, the full impact of increase in prices is not reflected in cost of sales as the company uses weighted average method of inventory costing. With increase in average selling price being higher than the rise in cost of goods sold, gross margin of the company increased to 18.4% (FY11: 16.6%) in FY12. Although gross profit was substantially higher at Rs. 501.8m (FY11: Rs. 398.2m), standalone pre-tax profit has remained around prior year's level at Rs. 134m (FY11: Rs. 126m), given higher financial charges and reduction in income from non-core business operations.

In line with the industry trend, a large portion of the company's current assets is held in form of inventory. These have largely been financed through short term borrowings mobilized under State Bank of Pakistan's export refinance scheme. Net equity of the company increased to Rs. 2b by end-June'12 on account of internal capital generation. MST is the group's holding company; it has investments of Rs. 1.1b in various group entities in dairy, footwear, textile, poultry and real estate sectors. Debt leverage and gearing of the company, adjusted for investment in associates, have also improved to 2.0x and to 1.4x, respectively. Given that most of these companies have been established in the past five years, these have yet to achieve sustainable profitability.

Overview of the Institution

Established in 1952 as a partnership concern, MST was converted into a private limited company in 1998. MST is part of the Shafi group of companies, a diversified business concern having companies in the rice, textile, dairy and real estate business. The company is involved in production and subsequent export of finished leather. JCR-VIS

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