RATING REPORT

Mannan Shahid Forgings Limited

REPORT DATE:
April 22, 2019

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	*April 18, '19*	

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 (May 2016) *https://www.vis.com.pk/kc-meth.aspx*

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). 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 serves MSFL as the CEO. Mr. Dad has over 42 years 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:
1HFY19: Rs. 880m;
FY18: Rs. 823m;
FY17: Rs. 658m.

Assets:
1HFY19: Rs. 1.92b; FY18: Rs. 1.85b;
FY17: Rs 1.51b.
Profit After Tax:
1HFY19: Rs. 55m;
FY18: Rs. 162m;
FY17: Rs. 85m.

RATING RATIONALE

The ratings assigned to Mannan Shahid Forgings Limited (MSFL) take into account a moderate business risk profile underpinned by experienced sponsors who are actively involved in day to day operations of the company, and established relations with the all stakeholders. Barriers to entry in the forging industry are high because of capital intensive nature of machinery, high setup costs, longer payback time and the requirement of precise technical expertise. For customers, switching cost are high due to costs involved in development of products with new suppliers and a long product development time. This explains the existence of a limited number of competing forging companies with relevant capacities and technical expertise to manufacture high-precision components for original equipment manufacturers (OEMs). This fact is also reflected in high customer retention rate attained by MSFL. The high barriers to entry for suppliers and high switching costs for customers ensure a degree of stability for MSFL in terms of market players operating in the industry and also MSFL retaining its leadership position in the industry.

The ratings draw comfort from steadily growing sales and profitability emanating from high customer satisfaction levels and increasing demand for existing and new components. MSFL has recently increased diversity in its customer base, primarily in the export sector, as concentration risk for local business is considered high and slowdown in demand from major customers can negatively impact sales and profitability. The ratings also factor in sound liquidity position and coverages and low leverage indicators in the absence of long-term borrowings and low burden of short-term borrowings. The ratings also consider susceptibility of margins to steel prices, and the corporate governance framework.

Rating Drivers

Sales and profitability
Sales and profitability of the company continue to augment on the back of positive demand and pricing trends. Net sales were recorded higher during FY18 on account of increase in orders from both local and foreign customers and higher selling prices. Proportion of local sales in overall sales mix stood lower in FY18 due to recovery in exports. MSFL witnessed further augmentation of profits during FY18 on the back of higher sales and improved gross margins. The improvement in gross margins on a timeline basis is attributable to a combination of the uptrend in selling prices and cost efficiencies emanating from economies of scale. The increase in operating expenses was mainly due to some increase in general administration expenses and higher freight & forwarding charges. Finance cost was recorded higher during FY18, which is in line with higher utilization of short-term borrowings. Despite higher tax charge, net profit of the company improved as net margins strengthened further during FY18.

The overall profitability of the company was under pressure during 1HFY19 mainly on account of lower sales due to slowdown in production of a major buyer. Gross margins are projected to improve in the second half of FY19 due to restoration in economies of scale (higher local and export orders), lower international prices of steel bars, and depreciating PKR.

Healthy liquidity and debt coverage emanating from improved cash flows
MSFL's overall liquidity and cash flows position has improved on a timeline basis. The company exhibited healthy growth in funds from operations during FY18. However, due to seasonality impact and slow sales momentum, FFO stood lower during 1HFY19. Current ratio of the company strengthened by end-1HFY19 mainly on account of slightly lower utilization of short-term borrowings and positive impact of higher loans & advances to suppliers. Cash conversion cycle also improved during 1HFY19 as the impact of lengthening of days' receivables and flat days payables was offset by lower inventory days during the period. In the absence of long-term borrowings, MSFL

capacity to timely meet its financial obligations is considered strong, as depicted by higher debt service coverage and FFO to total debt ratios at end-1HFY19.

Financial risk profile underpinned by low debt burden

MSFL witnessed further augmentation of its equity base during 1HFY19 with the continued retention of profits. The debt profile comprises short-term borrowings only which decreased during 1HFY19. Meanwhile, trade & other payables increased as the company availed a higher credit period. With the augmentation of equity and slightly lower debt financing, MSFL's gearing and debt leverage indicators continue to remain low at end-1HFY19. Given no immediate plan insight to mobilize long-term borrowings and expected continuation of profits accumulation, the leverage indicators are expected to remain low, going forward.

Mannan Shahid Forgings Limited — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**1HFY19**
Property, Plant & Equipment	747	728	777	773
Stock in Trade	237	265	546	449
Trade Debts	160	183	226	277
Tax Refundable	185	212	195	194
Cash & Bank Balance	11	21	40	20
Other Current Assets	71	99	65	203
Total Assets	**1,411**	**1,508**	**1,849**	**1,916**
Trade & Other Payables	83	122	172	182
Staff Retirement Benefit	97	106	122	130
Other Liabilities	58	75	86	101
Short Term Borrowings	281	231	281	259
Long-Term Borrowings *(Inc. current matur)*	-	-	-	-
Total Liabilities	519	534	661	672
Tier-1 Equity	**569**	**658**	**823**	**880**
Revaluation Surplus	**324**	**315**	**365**	**364**
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**1HFY19**
Net Sales	1,105	1,243	1,781	898
Gross Profit	158	221	351	141
Operating Profit	66	124	234	75
Profit After Tax	34	85	162	55
FFO	59	114	219	94
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**1HFY19**
Gross Margin (%)	14.3	17.8	19.7	15.6
Net Working Capital	286	397	558	626
FFO to Long-Term Debt	-	-	-	-
FFO to Total Debt	0.21	0.49	0.78	0.73*
Debt Servicing Coverage Ratio (x)	3.15	7.14	11.08	9.98
ROAA (%)	2.1	5.8	9.7	5.9
ROAE (%)	6.3	13.8	21.9	13.0
Gearing (x)	0.49	0.35	0.34	0.29
Debt Leverage (x)	0.91	0.81	0.80	0.76
Current Ratio	1.76	2.04	2.08	2.21
Inventory + Receivable/Short-term Borrowings (x)	1.41	1.94	2.75	2.81

**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 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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
18/04/2019	A-	A-2	Stable	Initial