The Pakistan Credit Rating Agency Limited

Rating Report

Service Global Footwear Limited

Report Contents

Rating History					
Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Dec-2023	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Service Global Footwear Limited ('SGFL' or 'the Company') is a public limited company specialized in the manufacturing and marketing of footwear products. It is a prominent export-oriented footwear entity based in Pakistan. The Company is a subsidiary of Service Industries Limited ('SIL') – an acclaimed group with 50+ years of experience in tyres & tubes/spare parts for automobiles under eminent brand name 'Servis', followed by footwear exposure in local and export markets and technical rubber products. The ratings draw direct comfort from longstanding presence of group in given industry environment underpinned by SGFL's evolving position as a trusted footwear atelier for its expanding network of global partners. Pakistan's footwear making industry has made reasonable progress in the last decade. Yet, the sector is majorly comprised of unorganized players (~80%) where craft manufacturers/cobblers possess considerable stake and local retail shops are dependent on the informal supply. Footwear exports represent less than one percent of the Pakistan's total exports. Percentage of export increase in terms of US Dollar over last year is 13.74% as export for FY23 recorded at $178.5mln (FY22: $156.9mln). The exports mainly encompass of leather footwear and are highly concentrated to Europe (Germany, Italy, Netherlands, Spain, & France), UK, & USA. Almost 20% sector comprises organized players where renowned shoe manufacturers in the country fall under this segment including Servis. Accordingly, SGFL holds ~35% of market share, primarily channeling footwear, leather & allied items to various international brands. It has intensified its outreach to Europe (forms ~70% of its current exports), and also working to spread its clientele base in the USA and other countries. In 9MCY23, SGFL witnessed a topline growth of ~35.4% on annualized basis with ~98% derived from export sales. Its profitability matrix at all levels has improved over the years as procurement of materials is mainly done locally, thus offering ample sales margin. Financial risk profile is demonstrated by adequate working capital management, better cash cycle, & modest coverages. Capital structure is considered leveraged, nonetheless major portion of debt is covered via short-term borrowings under export refinance schemes / export finance facilities. Assigned rating also incorporates strong sponsor support augmented by sound governance practices and methodical internal control system. Going forward, SGFL intends to add value by delivering finest quality of footwear through continuous advancements in its processes, achieving sustained supply chain, ensuring culture inclusivity with more designs, and adopting innovative technology. The ratings incorporate profitability matrix and growth prospects of SGFL in line with financial projections coupled with expansion plans.

The ratings are dependent on sustenance of Company's leading share in its respective niche and consistent growth amid changing environment. Prudent financial performance and effective liquidity profile shall remain imperative.

Disclosure	
Name of Rated Entity	Service Global Footwear Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Leather(Mar-23)
Rating Analysts	Iqra Toqeer | iqra.toqeer@pacra.com | +92-42-35869504

Profile

Legal Structure Service Global Footwear Limited ('SGFL' or 'the Company') was incorporated as a public limited entity on July 19th, 2019 under the Companies Act, 2017 and got PSX listing on April 28th, 2021. It has a free float of ~20.00pc as of Oct'23. The Company's registered office is located at 2-Main Gulberg, Lahore.

Background SGFL is a subsidiary entity of Service Industries Limited (SIL). The BoD of SIL decided to demerge and transfer one of its manufacturing units, SIL - Muridke unit, along with its facility and all relevant assets, operations, and liabilities etc. to a subsidiary, Service Global Footwear Limited, through a court sanctioned scheme. Subsequent to this decision SGFL was incorporated in 2019. During 2021, as per the devised strategy, proceeds from the SGFL's IPO were mainly utilized for making an investment in another associated company named Service Long March Tyres (Pvt.) Limited – SLM Tyres. Currently, SGFL owns ~18.91% stake in SLM Tyres. Recently, SGFL has also incorporated a wholly owned subsidiary by the name of Dongguan Service Global Limited (DSGL) to undertake procurement, marketing and product development activities.

Operations The principal business activities of SGFL are manufacturing, sale, marketing, import, and export of footwear, leather, and allied products. Its manufacturing facility is located at 10-KM, Muridke-Sheikhupura Rd, Lahore.

Ownership

Ownership Structure Majority stake of the Company (~79.7%) rests with Service Industries Limited, followed by the general public (~19.2%), and then individual investors (~1.1%).

Stability SGFL's ownership structure seems stable as no major change in the pattern of shareholding is expected in near future. Prime stake is with the prominent group company (SIL).

Business Acumen Service Group is considered to have strong business acumen. It has been operating in Pakistan for a number of decades now by venturing businesses into diversified sectors of economy; including tyres, footwear, power, radial technology, trading, investments, and many more.

Financial Strength SGFL, being the entity of Service Group maintains healthy financial profile with substantial access to domestic and international markets. This indicates Sponsors' ability to provide support is considered good, if need arises.

Governance

Board Structure The board comprises nine members, out of which three are executive, three are non-executive, & three are independent directors. Mr. Arif Saeed who has more than 3 decades of diverse industry exposure, chairs the Company's board. Mr. Hassan Javed, the CEO, also serves the board as an executive member. SGFL's board is following good corporate governance structure.

Members' Profile Four members involved in the business are representatives of Service Group and carry with them decades of diversified sectors' exposure. Remaining board members also come with solid experiences. Mr. Arif Saeed (Chairman) is a graduate of Oxford University. He is currently serving as the CEO of Service Industries Limited and a Director on the Board of Service Long March Tyres (Private) Limited as well as Servis Foundation. He has been Chairman of the "All Pakistan Textile Mills Association" (APTMA) as well as the Lahore Stock Exchange.

Board Effectiveness The board has formed two sub-committees; i) Audit Committee and ii) Human Resource & Remuneration Committee. The board meetings are held quarterly in compliance with the principles of corporate governance, and all meeting minutes are documented properly.

Financial Transparency M/S. Riaz Ahmad and Co., SBP category 'A' auditor, is the external auditor of the Company. The auditors have expressed an unqualified audit opinion on the financial statements of SGFL for the year ended December 31st, 2022.

Management

Organizational Structure A well-defined organizational structure exists in the Company. All the functions are reporting directly or indirectly to the CEO.

Management Team Mr. Hassan Javed, CEO of SGFL, is a leather technologist from Nene College UK and Shoe Technologist from ISMS School Czech Republic. He is also serving as a Director on the Boards of Service Industries Limited, Service Long March Tyres (Private) Limited, and Servis Foundation. Mr. Hassan has also served Service Industries Limited in various capacities, most notably as the Resident Director of Gujrat for more than 15 years. He has also served as the Chairman of Pakistan Footwear Manufacturers Association.

Effectiveness With the support of an experienced team of professionals, SGFL is building up the business strengths and increasing its foot print across different countries abroad, and also tends to grow its exposure domestically. Functions of the management are clear and well-defined to effectively achieve its underlying goals and objectives.

MIS The Company is presently using Oracle EBS Version 12.2.7 as the main software for Enterprise Resource Planning (ERP).

Control Environment For operational efficiency and appraisal of internal controls, the Company has in-house team of qualified professionals at all levels to implement and monitor the policies and procedures. SGFL has an effective mechanism for identification, assessment and reporting of all types of risks arising out of the business operations.

Business Risk

Industry Dynamics Pakistan has a growing footwear market. Pakistan's footwear industry comprises a mix of small and medium-sized enterprises (SMEs) and larger manufacturers. Notable companies in the industry include Bata Pakistan, Service Industries Limited, Stylo, Service Global Footwear Limited, and Service Sales Corporation. On export front, the country has a portion of its footwear products, primarily leather shoes to international markets. Major export destinations include Europe, the Middle East, and the United States. According to Pakistan Footwear Manufacturer's Association, total footwear export for July-Jun 2023 stood at 178.550 Million US Dollar.

Relative Position Service Global Footwear Limited is the largest footwear exporter of Pakistan, presently working with globally renowned brands like Caprice and Docker. The Company accounts for almost 40% of the total leather footwear exports. SGFL exports over 90% of its total production to 20+ countries in 5 continents.

Revenues SGFL's topline clocked at ~PKR 11,753mln in CY22 (CY21: ~PKR 7,040mln, CY20: ~PKR 6,895mln) registering CAGR of ~66.9%. The export sales made up ~97% of total revenue figure. During 3QCY23, revenue recorded at ~PKR 11,940mln out of which sales of ~PKR 11,740mln contributed through export channel. Meanwhile, the Company is prone to high concentration risk as it holds export-related customers that constitute more than ~10% of its total revenue.

Margins In CY22, SGFL's gross margin stood at 18.6% with gross profit reported at PKR 2,186mln (CY21: 17.6%, CY20: 19.9%). Further, its net profit margin stood at 2.9% only owing to reduced Profit Before Taxes (PBT) during review period (CY21: 5.7%, CY20: 10.3%). However, in 3QCY23, the Company's gross and net margins improved to 22.1% and 6.6%, respectively.

Sustainability SGFL's management envisage sustainable footing in the international and local markets by investing in new technology to facilitate its existing production lines. The Company is also Asia's first solar powered shoe manufacturer with a total solar electricity generation capacity of 2 MW.

Financial Risk

Working Capital The Company's capital needs emanate from financing inventories and trade receivables for which it relies on both internal cash flow generations and short-term borrowings. In CY22, gross working cycle stood at 126 days (CY21: 136 days, CY20: 123 days). Subsequently, net working cycle stood at 91 days in CY22 (CY21: 88 days, CY20: 72 days). At end Sep'23, the Company's gross and net cycle stood at ~130 and 87 days, respectively.

Coverages In CY22, SGFL's free cash flows from operations (FCFO) marked at PKR 1,212mln (CY21: PKR 473mln, CY20: PKR 814mln) on account of gross profit incurred in corresponding years. Interest and core coverage ratios stood at 2.9x & 1.4x, respectively (CY21: 3.4x & 0.9x). In 3QCY23, both the ratios deteriorated and stood at 1.9x and 1.1x, respectively on account of high finance cost incurred.

Capitalization In CY22, SGFL held leveraged capital structure with a ratio of ~48.9% (CY21: ~39.1%, CY21: ~53.0%) and total borrowings recorded at PKR 5.8bln, out of which PKR 5.4bln is attributed to short-term debt, from which further SGFL has provided a portion of 2.3bln loan to its holding company. At end Sep'23, the levering ratio stood at ~51.5%.

PKR mln

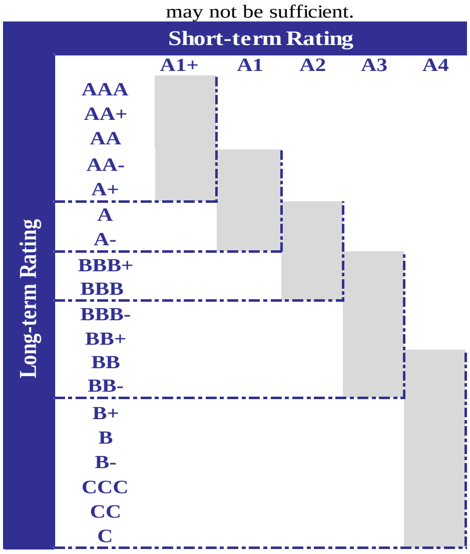
Service Global Footwear Limited	Sep-23	Dec-22	Dec-21	Dec-20
Footwear	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	3,035	2,619	2,152	2,101
2 Investments	-	-	-	-
3 Related Party Exposure	5,374	4,475	5,325	2,914
4 Current Assets	9,511	7,271	5,085	5,506
a Inventories	*3,606*	*3,360*	*2,093*	*1,381*
b Trade Receivables	*2,564*	*1,840*	*818*	*936*
5 Total Assets	17,920	14,365	12,561	10,522
6 Current Liabilities	3,762	2,153	1,393	1,411
a Trade Payables	*2,194*	*1,349*	*884*	*949*
7 Borrowings	7,199	5,890	4,322	4,777
8 Related Party Exposure	-	-	0	-
9 Non-Current Liabilities	183	157	117	102
10 Net Assets	6,776	6,165	6,729	4,231
11 Shareholders' Equity	6,776	6,165	6,729	4,231
B INCOME STATEMENT				
1 Sales	11,940	11,753	7,040	6,895
a Cost of Good Sold	*(9,302)*	*(9,567)*	*(5,802)*	*(5,525)*
2 Gross Profit	2,637	2,186	1,238	1,369
a Operating Expenses	(1,397)	(1,444)	(982)	(820)
3 Operating Profit	1,241	742	256	549
a Non Operating Income or (Expense)	*733*	*414*	*501*	*369*
4 Profit or (Loss) before Interest and Tax	1,974	1,155	757	918
a Total Finance Cost	*(797)*	*(467)*	*(184)*	*(140)*
b Taxation	*(386)*	*(346)*	*(170)*	*(69)*
6 Net Income Or (Loss)	792	342	403	709
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,384*	*1,212*	*473*	*814*
b Net Cash from Operating Activities before Working Capital Changes	*631*	*895*	*306*	*681*
c Changes in Working Capital	*(477)*	*(2,925)*	*37*	*1*
1 Net Cash provided by Operating Activities	154	(2,030)	344	682
2 Net Cash (Used in) or Available From Investing Activities	(864)	601	(2,277)	(727)
3 Net Cash (Used in) or Available From Financing Activities	1,113	655	1,612	1,293
4 Net Cash generated or (Used) during the period	403	(774)	(321)	1,248
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	35.4%	66.9%	2.1%	0.0%
b Gross Profit Margin	22.1%	18.6%	17.6%	19.9%
c Net Profit Margin	6.6%	2.9%	5.7%	10.3%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	7.6%	-14.6%	7.3%	11.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sl*	16.3%	5.3%	7.4%	16.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	130	126	136	123
b Net Working Capital (Average Days)	90	91	88	72
c Current Ratio (Current Assets / Current Liabilities)	2.5	3.4	3.6	3.9
3 Coverages				
a EBITDA / Finance Cost	2.2	2.3	4.5	8.0
b FCFO / Finance Cost+CMLTB+Excess STB	0.9	1.4	0.9	2.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.6	1.0	1.9	1.0
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	51.5%	48.9%	39.1%	53.0%
b Interest or Markup Payable (Days)	83.0	151.4	80.3	85.4
c Entity Average Borrowing Rate	14.3%	8.3%	3.1%	2.3%

Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating	
Scale	**Definition**
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC **CC** **C**	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating	
Scale	**Definition**
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 17-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument;| Chapter III | 17-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past; | Chapter III | 14-3(f)(vii)
Proprietary Information