The Pakistan Credit Rating Agency Limited

Rating Report

Service Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Sep-2024	AA	A1+	Stable	Upgrade	-
19-Sep-2023	AA-	A1	Stable	Maintain	-
24-Sep-2022	AA-	A1	Stable	Maintain	-
24-Sep-2021	AA-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Service Industries Limited (“SIL” or “the Company”) operates with a dual profile, functioning both as a holding company and an operating company. As the holding company, SIL has investments in Service Long March Tyres (Pvt.) Ltd (SLM) and Service Global Footwear Ltd (SGFL). Furthermore, SIL holds two wholly owned subsidiaries, Service Tyres (Pvt.) Ltd and Service Retail (Pvt.) Ltd to which it has transferred its tyre/tube and footwear retail businesses respectively as part of the recent demerger. This restructuring has further solidified the holding company aspect of SIL and is expected to enhance efficiency and control emanating from specialized management teams. On the operating front, SIL will focus exclusively on managing the footwear manufacturing facility located in Gujrat. The ratings upgrade reflects the group's leading presence in all segments of its operations, well-established investment portfolio engendering diversity in revenue streams and growing export avenues leading to notable growth in consolidated revenue and profitability. Additionally, a robust governance structure and effective risk management at the group level also lend support to the ratings. In the local footwear retail segment, the group aims to strengthen its market presence by opening new retail shops and expanding its product range. Similarly, in the local tyre & tube business the Company will continue to enjoy a dominant share in 2, 3 wheelers, and Light Commercial Vehicles (LCV) Bias Tyre categories. In the truck & bus radial (TBR) segment, SLM has proved instrumental in capturing a sizeable market share by providing import substitution to the local market. On the export front, SLM and SGFL have also played a pivotal role in the materialization of the group’s vision to enhance its global outreach. CY23 remained a turbulent year owing to various macroeconomic challenges including soaring inflation increased energy tariffs, and elevated interest rates that kept the growth of the LSM sector stagnant and eroded the purchasing power of consumers. However, the situation started to improve gradually in 1HCY24 as reflected by the reduction in interest rates and inflation augmented by PKR/USD stabilization however, high energy prices pose a significant challenge going forward. During 1HCY24, SIL’s consolidated topline registered an impressive growth of ~41% and recorded at PKR 61bln compared to PKR 43bln SPLY primarily on the back of price inflation and improved volumes. Furthermore, the profitability margins also showed improvement at all levels. The revised ratings also take into account the improved financial risk profile of the company which is characterized by adequate coverages, cashflows, and a slightly stretched working capital cycle Further, the capital structure is leveraged as the company has availed concessionary debt to fund its expansion. Going forward, the sponsors are keenly focused on enhancing revenue streams through import substitution and expanding export avenues through sustainable business models.

The ratings are dependent on the sustenance of the Company’s leading position in its respective business niches and consistent growth under a challenging business environment. Profitability in line with business expansion; prudent working capital management and maintenance of coverages shall remain imperative along with sustained dividend flow from the investments.

Disclosure	
Name of Rated Entity	Service Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Rating Modifiers(Apr-24),Methodology | Holding Company Rating(Jul-24),Methodology | Corporate Rating(Jul-24),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-24)
Related Research	Sector Study | Tyres(Oct-23),Sector Study | Footwear(Sep-24)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure Service Industries Limited ('SIL' or 'the Company') was incorporated in 1957 under the Companies Act, 1913 (now 'Companies Act, 2017'). The company is listed on the Pakistan Stock Exchange (PSX) with a free float of ~44.77% shares.

Background SIL was founded in 1953 by Ch. Muhammad Saeed, Ch. Nazar Muhammad, and Ch. Muhammad Hussain. Incorporated as a private limited company in 1957, the business initially began in the late 1930s in Lahore, focusing on manufacturing and supplying handbags and sports goods to many parts of the subcontinent. Over the years, SIL evolved into a major player in the tyre and footwear markets.

Operations SIL maintains a dual profile both as a holding and an operating entity. As a holding company, SIL has investments in Service Long March Tyres (Pvt.) Ltd (SLM) and Service Global Footwear Ltd (SGFL). Furthermore, SIL also holds two wholly owned subsidiaries, Service Tyres (Pvt.) Ltd and Service Retail (Pvt.) Ltd, to which SIL has transferred its tyre/tube and footwear retail businesses respectively which has further solidified the holding company aspect of SIL. On the operating front, SIL will exclusively focus on the footwear manufacturing facility located in Gujrat.

Ownership

Ownership Structure The sponsoring family holds a majority stake in SIL. The directors, CEO, their families and through associated concerns collectively hold ~53.42% shares. These include Mr. Hassan Javaid (~19.29%), Mr. Omer Saeed (~10.14%), and Mr. Arif Saeed (~10.14%). Other major stakeholders include NIT (11.29%) and he general public (~33%).

Stability The ownership structure is deemed stable, supported by strong leadership capabilities emanating from the sponsoring family and a well-structured succession plan. Furthermore, the company has maintained a longstanding presence in both domestic and international markets for over seven decades.

Business Acumen Business acumen of the sponsors in relation to related businesses is considered strong reflected by decades long industry specific experience and demonstrated strategic thinking capabilities evident from robust business growth and successful investment ventures.

Financial Strength SIL’s consolidated asset base stands at ~PKR 92.4bln as of June’24 while equity stood at PKR 23.3bln. Additionally, the group has substantial investments in Service Long March Tyres (Pvt.) Ltd and Service Global Footwear Ltd which provide ample financial strength to the company.

Governance

Board Structure The board consists of 9 members with 3 independent directors, 2 executive directors and 4 non-executive directors. The chairperson of the board is Ms. Uzma Adil Khan.

Members’ Profile All Board of Directors (BoD) members are seasoned professionals with experience in managing diverse business affairs. The chairperson has held leadership roles in both public and private sectors. The independent directors are well-regarded experts with broad industry knowledge and diverse expertise.

Board Effectiveness The Board of Directors holds regular meetings with a pre-defined agenda to guide the company’s strategic objectives and oversee management performance. Detailed minutes are recorded, including directions and action plans. The BoD has also established two sub-committees—the HR & Remuneration Committee and the Audit Committee—each chaired by an independent director and comprising three members, which enhances the board’s effectiveness.

Financial Transparency The external auditors are M/s. Riaz Ahmad & Co., Chartered Accountants, who are listed in category “A” on the SBP's panel of auditors. The auditors expressed an unqualified opinion on the financial statements of the Company for the year ending December 31st, 2023.

Management

Organizational Structure The Group is organized into multiple operational entities, each led by a specialized management team tailored to its specific functions. Clear reporting lines and well-defined roles and responsibilities ensure efficient oversight and coordination. Currently, all key positions are filled, maintaining a stable and effective organizational structure.

Management Team The Group's management consists of qualified professionals with extensive skills and diverse experience. Mr. Arif Saeed (the CEO), is a graduate of the Oxford University and brings with him extensive experience. Mr. Badar Ul Hassan, the Group CFO. He is a Chartered Accountant with over 25 years of varied industry experience.

Effectiveness A robust policy framework is established, supported by two main types of committees: (i) Executive and (ii) Management. The Executive Committee is further divided into three specialized groups: (i) the Group Executive Committee, (ii) the Business Head Committee, and (iii) the Core Services Committee. These committees enhance operational decision-making efficiency by bridging inter-departmental gaps and ensuring alignment with strategic objectives.

MIS The Company has fully implemented ERP and using the Oracle EBS R12 version for its financing and manufacturing facilities, which is used to operate a single data centre with a single database, similar to other ERP products.

Control Environment An effective Internal Control System and clear lines of responsibilities & authorization, accompanied by a robust technological infrastructure for all its manufacturing and support functions.

Business Risk

Industry Dynamics Pakistan's tyre industry has three segments: (i) 2 & 3-wheeler tyres, (ii) tyres for cars and Light Commercial Vehicles, and (iii) tyres for trucks, buses, and tractors. Tyre demand is affected by new vehicle sales and the replacement market performance. In CY23, demand remained low due to high inflation, PKR depreciation, and elevated interest rates. However, recent decline in interest rates and inflation are expected to enhance industry prospects. Furthermore, FY24 footwear exports totaled 21.5 million pairs, a decrease from 22.4 million in FY23, with export value falling 9.5% to USD 162 million.

Relative Position Service Group is one of the leading producers of tyres, tubes and footwear and enjoys a dominant market share in both business segments it operates. The group has a capacity to manufacture ~25mln tyres, 63mln tubes and ~8.2mln pairs of footwear which are among the highest installed capacities in respective industries.

Revenues SIL’s consolidated revenue is divided into three segments: tyres & tubes (~66%), footwear (~30%), and spare parts & technical products (~4%). In CY23, consolidated revenue surged by 56.5% to PKR 96.5bln, up from PKR 61.7bln in CY22, driven by increased sales and higher prices. For the first half of CY24, sales rose by 26.5% year-over-year, reaching approximately PKR 61bln.

Margins The company's gross margin improved to ~25.6% during 1HCY24, up from ~22.6% in CY23 and 16.6% in CY22. SIL reported a net profit of PKR 4.3bln during 1H CY24 (PKR 4.3bln, CY23), a significant turnaround from a net loss of PKR 1.2bln in CY22. SIL is inherently reliant on imports to fulfill its raw material needs which exposes its profitability matrix to foreign exchange fluctuations.

Sustainability The Group employs a robust budgeting, forecasting, and variance monitoring system, enhancing strategic foresight and implementation. SIL's investments in export-oriented entities, SLM and SGFL, align with the group's vision to boost exports and achieve import substitution. As of June 2024, SLM and SGFL have achieved revenue growth of approximately 135% and 12%, respectively, with improved profitability margins across the board.

Financial Risk

Working Capital SIL's consolidated working capital requirements emanate from inventories and trade receivables for which it relies on both internal cash flows as well as borrowings. The net working capital days of the Company stood at ~78 days in 1HCY24 (CY23: ~87 days, CY22, 100 days).

Coverages The Company's consolidated free cash flow from operations (FCFO) improved to PKR 14,554mln in CY23 (CY22: PKR 5,965mln). Moreover, during 1HCY24, SIL recorded FCFO of PKR 10,966mln. It has reported interest and core coverage ratios at 2.2x and 1.3x, respectively in CY23 (CY22: 1.5x and 0.9x, respectively). At end Jun'24, the ratios improved to 3.4x and 2.1x, respectively.

Capitalization During 1HCY24, the consolidated debt of SIL stood at PKR~45.6bln (CY23: PKR 47bln, CY22: PKR 41.8bln). The gearing ratio improved to ~66.1% at end of Jun-24 (CY23,71.3%: CY22: 73.2%). The debt book comprises a mix of short-term borrowings and long-term borrowings. The company has also availed concessionary funding to fund its expansion.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Service Industries Ltd	Jun-24	Dec-23	Dec-22	Dec-21
Tyres	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	42,959	41,107	36,483	29,416
2 Investments	182	883	182	156
3 Related Party Exposure	718	709	627	597
4 Current Assets	48,619	43,134	36,065	24,426
a Inventories	*23,002*	*21,052*	*19,481*	*11,622*
b Trade Receivables	*12,091*	*9,717*	*8,582*	*4,468*
5 Total Assets	92,478	85,833	73,357	54,595
6 Current Liabilities	16,379	13,787	11,955	8,058
a Trade Payables	*7,086*	*6,698*	*6,020*	*4,482*
7 Borrowings	45,595	47,152	41,762	27,919
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	7,103	5,923	4,341	3,264
10 Net Assets	23,400	18,970	15,299	15,354
11 Shareholders' Equity	23,400	18,970	15,299	15,354
B INCOME STATEMENT				
1 Sales	61,038	96,521	61,669	39,385
a Cost of Good Sold	*(45,428)*	*(74,670)*	*(51,407)*	*(32,911)*
2 Gross Profit	15,610	21,850	10,262	6,474
a Operating Expenses	(5,810)	(9,308)	(6,709)	(4,590)
3 Operating Profit	9,800	12,543	3,553	1,884
a Non Operating Income or (Expense)	*(18)*	*720*	*393*	*659*
4 Profit or (Loss) before Interest and Tax	9,782	13,263	3,946	2,543
a Total Finance Cost	*(3,552)*	*(7,547)*	*(4,014)*	*(1,525)*
b Taxation	*(1,954)*	*(1,404)*	*(1,157)*	*(433)*
6 Net Income Or (Loss)	4,276	4,312	(1,225)	585
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*10,966*	*14,554*	*5,965*	*2,104*
b Net Cash from Operating Activities before Working Capital Changes	*7,153*	*7,775*	*3,282*	*1,202*
c Changes in Working Capital	*(3,102)*	*(2,363)*	*(12,552)*	*(2,878)*
1 Net Cash provided by Operating Activities	4,052	5,412	(9,270)	(1,676)
2 Net Cash (Used in) or Available From Investing Activities	(2,523)	(6,533)	(8,277)	(17,756)
3 Net Cash (Used in) or Available From Financing Activities	(1,533)	4,712	15,000	19,830
4 Net Cash generated or (Used) during the period	(5)	3,590	(2,548)	398
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	26.5%	56.5%	56.6%	26.4%
b Gross Profit Margin	25.6%	22.6%	16.6%	16.4%
c Net Profit Margin	7.0%	4.5%	-2.0%	1.5%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	12.9%	12.6%	-10.7%	-2.0%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	40.4%	25.2%	-8.0%	4.6%
2 Working Capital Management				
a Gross Working Capital (Average Days)	98	111	131	125
b Net Working Capital (Average Days)	78	87	100	90
c Current Ratio (Current Assets / Current Liabilities)	3.0	3.1	3.0	3.0
3 Coverages				
a EBITDA / Finance Cost	3.4	2.2	1.5	2.2
b FCFO / Finance Cost+CMLTB+Excess STB	2.1	1.3	0.9	0.6
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	66.1%	71.3%	73.2%	64.5%
b Interest or Markup Payable (Days)	58.6	68.2	106.8	76.5
c Entity Average Borrowing Rate	14.9%	16.5%	11.2%	6.9%

Together. Creating Value.

Corporate Rating Criteria

Scale

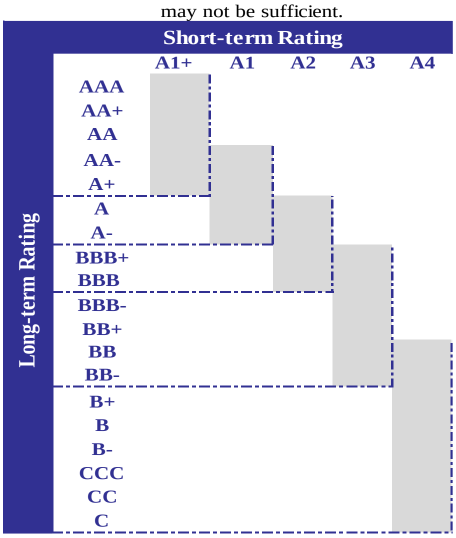
Credit Rating
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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