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
24-Sep-2021	AA-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Service Industries Limited (SIL) has a twofold profile; one as a hold-co and second as operate-co. As an operate co it is a renowned and well established name in footwear and tyres & tubes industry. The ratings reflect Company's longstanding presence, emanating from strong foothold in its given business segments. The Company have built itself as a prominent player in the market through provision of high-quality products and affirmation of strong brands under its domain. It distinguishes itself by having reasonable level of diversification in its revenue streams coming from tyres & tubes (2 & 3 wheeler and agri tyres) and footwear Industry, this bodes well for the overall Company's business prospects. Additionally, international presence in its respective niche provides competitive edge to the company's distinct position in the market. Despite COVID-19 outbreak and subsequent lockdown, the Company gained functionality before the other businesses due to its presence in export market. Where pandemic became a hindrance for exports, it was curtailed by rising local demand particularly in tyres segment. The sponsors are keenly focused towards formalized group structure, sustainable business model and eyes for possible expansions in new business avenues. SIL has demonstrated upward trajectory in its business volumes amid stiff competition on a timeline basis. During CY20, revenues witnessed a dip on standalone basis due to the demerger of its Muridke footwear export unit into a newly formed subsidiary; 'Service Global Footwear Limited'. The business arm at consolidated level is a comfort. Moreover, the company is paving its way to enter 'all steel radial tyres of trucks & buses' market soon. This will be through an investment of $250mln - made in phases over six years horizon - with Chinese investors through a joint venture; 'Service Long March Tyres (Pvt) Ltd', established in early 2020 year, sales of which shall be majorly export based as well as to cater the internal demand. This is indeed a significant project. Given the Company's expansion plans, financial risk profile is reflecting this, which the company holds the potential to manage. As a manufacturing concern, overhead costs are inherent to the business hence keeping the Company's bottom-line range bound. The Company en routes low-cost debt funded expansion which along with reduction in interest rates will keep the debt profile adequate. Rating also incorporates strong sponsor support augmented by sound governance practices over the years.

The ratings are dependent on sustenance of Company's leading position in its respective business segments and consistent growth. Profitability in line with business expansion; prudent working capital management and maintenance of coverages amidst expansion is necessitated. Any significant change in the financial risk profile shall remain imperative.

Disclosure	
Name of Rated Entity	Service Industries Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Methodology | Holding Company Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21)
Related Research	Sector Study | Tyres(Oct-20),Sector Study | Holding Company(Aug-21)
Rating Analysts	Raniya Tanawar | raniya.tanawar@pacra.com | +92-42-35869504

Profile

Legal Structure Service Industries Limited (herein referred to as 'the Company' or 'SIL') was incorporated in 1953 under the Companies Act, 1913 (now "Companies Act, 2017"). It's a public listed entity with free float of ~35.23% shares. It was listed on KSE (now "PSX") in 1970.

Background The Company was established in 1953 by three friends, Ch. Muhammad Saeed (Late), Ch. Nazar Muhammad (Late) and Ch. Muhammad Hussain (Late). They initially started the business in late 1930s on a small scale in Lahore. At that time, only hand bags and others sports goods were manufactured, and supplied to large part of the sub-continent. Over time the company grew and became a prominent player in both footwear and tyres market.

Operations The Company's business is categorized under of three segments, (i) Tyres & Tubes: manufacture & sale of agri and 2 & 3 wheeler tyres, (ii) Footwear: varieties of leather shoes & (iii) Technical Rubber Products. It has two manufacturing facilities in Gujrat. The third facility, Muridke based, has been transferred to a newly formed majority owned subsidiary 'Service Global Footwear Limited' (SGFL). Major production at Muridke facility was used for exports whereas 20-25% of footwear production in Gujrat facility is exported and remaining is sold in local market.

Ownership

Ownership Structure Ownership of the company vests with the sponsor family. The directors, CEO, their spouses and children hold ~44.8% shares collectively. These include Mr. Ahmad Javaid (~4.39%), Mr. Omer Saeed (~10.14%), Mr. Hassan Javaid (~19.29%) and Mr. Arif Saeed holds (~10.14%) shares in the company. The remaining shares are held by Public, Associated companies, related parties, Banks, DFIs and NBFIs

Stability The Company has a longstanding strong presence in both domestic and international market, spanning over six decades.

Business Acumen Business acumen of the Sponsors in relation to related businesses is considered strong. The sponsors are seasoned businessmen and have been associated with the group for decades. They also have diversified experience of working with public sector organizations.

Financial Strength Sponsors of the company belong to one of the top niche families of Pakistan. The legacy continues as it stands as one of the largest business groups operating in Pakistan, denoting strong financial strength. Besides holding formidable equity strength in SIL, the sponsors have an extensive investment book, comprising 4 subsidiaries, 2 associated companies and 2 investments in joint ventures, which fortifies their sound financial strength.

Governance

Board Structure BoD consists of nine members with four independent directors, three executive directors and two non-executive directors. Mr. Ahmed Javed is the Chairman of the Board and Mr. Arif Saeed is CEO.

Members' Profile Board members are professionals with experiences of managing business affairs of different companies. Mr. Ahmed Javed the Chairman of the Board holds diverse experience. He worked for National Fertilizer Marketing Limited in marketing department for a decade and served as the Chief Executive Officer of Service Sales Corporation (Pvt.) Limited, which brings comprehensive experience and knowledge on the board.

Board Effectiveness BoD has formed two sub-committees – (i) HR & Remuneration Committee and (ii) Audit Committee. Both are headed by an Independent director and consist of 3 members each.

Financial Transparency An effective Internal Audit department is in place. The External Auditors are M/s. Riaz Ahmad & Company, Chartered Accountants of the Company having satisfactory QCR Rating and also classified in "A" category on the panel of auditors maintained by the SBP. The auditor expressed an unqualified opinion of the company in CY20.

Management

Organizational Structure The Company is organized into various business segments and led by respective business heads who reports directly to the CEO.

Management Team Management of the group comprises qualified and experienced professionals with a wide range of skills and diversified experience. Mr. Arif Saeed, became the CEO of the company from 1st Jan 2019. He holds a profound educational background and has overall experience of over ~3 decades.

Effectiveness A strong 'policy framework' is in place, and the company has two types of committees, (i) Executive and (ii) Management. Executive Committee further include (i) Group Executive Committee, (ii) Business Head Committee and (iii) Core Services committee.

MIS The Company has fully implemented ERP since 2009. Priorly, the company was using an internally designed software. The company is using oracle EBS R12 version for its financing and manufacturing facility, which is used to operate a single data center 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 The Pakistan tyre industry is currently experiencing growth on account of the increasing vehicle ownership in the country. Lately, Covid-19 led to reduced/restricted traffic and trade movements temporarily, though, the situation has gradually reverted. Tyre market spectrum comprises OEMs and Replacement market. Growth in OEMs is dependent on OEM sales, which has witnessed robust growth lately. Replacement market (distributors, wholesalers and retailers) is the secondary market for tyre manufacturers. As per some researcher's estimates, SIL, Panther Tyres and General Tyre makes-up c. 80% of total locally produced sales of tyres and tubes. As of June'20, the contribution of these three players in total sales of tyres and tubes of Pakistan is c. PKR 36bln. The 2 & 3 wheeler tyre market is dominated by the local industry players with SIL, Panther Tyres and Diamond Tyres. On the footwear front, our country is ranked 7th largest in the world, primarily geared to the internal market. The industry is mostly concentrated in the province of Punjab. Out of 481Mn pairs produced in 2019, 463mln were consumed locally.

Relative Position SIL is one of the leading producers of footwear, tyres & tubes (2&3-wheelers and Agri). The market share is strong in both business segments it operates. In local market of footwear the company has developed its brand name however, competition remains intense. Total installed capacity is ~19mln for tyres and ~55mln tubes with a total utilization of ~72% respectively in CY20. In near future, SLM will be the pioneer in TBR tyre manufacturing in Pakistan once it is launched.

Revenues Company's topline constitutes 3 segments: i) footwear ~ 24%, ii) tyres & tubes ~ 74% and iii) technical products. After rising consecutively for almost a decade, revenue contracted for the first time in CY20, by ~6.6% (CY20: PKR 24bln from PKR 26bln, CY19: PKR 26bln). This was largely attributed to two main reasons i) demerger of Service Global Footwear and ii) the Covid-19 pandemic resultant lock down; as a result, the operations of the company were shut down. Globally, trade was also adversely impacted. Hence, having a combined impact of ~69% decrease in footwear exports. On the other hand, sales of tyres were not affected much because of the nature of product. Revenues grew by ~24% (annualized) during 1HCY21 (PKR 15bln).

Margins SIL is a manufacturing concern therefore overhead expenses are inherent, consequently profit margins are subdued. Despite heavy borrowings, finance cost has reduced as the interest rates went down (1HCY21: PKR 580mln, CY20: PKR 1,085mln), keeping the net profits at PKR 191mln during 1HCY21 (CY20: PKR 690mln) as against a loss in same period last year (1HCY20: PKR - 64mln).

Sustainability Tyre market is highly competitive but SIL is expected to retain its market share. The enhanced plant capacity is put to use along with the Tractor tyre production. A joint venture with Chinese company 'Chaoyang Long March Tyre Co ' shall bring additional revenues as it will be mainly export oriented. Successful execution of this project will help the company penetrate into 4-wheeler market and enhance export capacity.

Financial Risk

Working Capital SIL's working capital requirement emanates from inventories and trade receivables for which it relies on both internal cash flows as well as short term borrowings. Net working capital days of the company stood at ~94 days in CY20 as compared to ~81 days in CY19, and now stand at ~100 days at the end of Jun-21

Coverages The improved PBIT for CY20 translated into good free cash flow from operations on YOY basis (CY20: PKR 2.8bln, CY19: PKR 3bln, CY18: 2bln). Increased interest cost due to hike in policy rates during the year 2019 and onwards restricted the interest coverage, however, this reverted in late CY20 hence reflecting in coverages: (1HCY21: 1.7x, CY20: 2.7x, CY19: 2.8x)

Capitalization During CY20, total debt of SIL stood at PKR~13bln (CY19: PKR 10bln) incl. loan from SGFL. the trend continues in 1HCY21 (PKR 15bln). The increase in liabilities over the period has outpaced increase in equity and resultantly gearing ratio increased to ~68% at the end of 1HCY21 (CY20: ~64%, CY19: ~64%).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Service Industries Limited	Jun-21	Dec-20	Dec-19	Dec-18
Tyres	6M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	8,798	7,735	7,628	7,064
2 Investments	150	91	25	22
3 Related Party Exposure	5,932	5,163	2,657	541
4 Current Assets	14,397	11,462	8,840	10,493
a Inventories	*7,256*	*4,878*	*4,247*	*4,044*
b Trade Receivables	*4,673*	*3,938*	*3,021*	*3,300*
5 Total Assets	29,277	24,451	19,150	18,121
6 Current Liabilities	6,309	3,931	2,867	3,130
a Trade Payables	*2,101*	*2,069*	*1,438*	*1,545*
7 Borrowings	11,837	9,756	7,924	8,950
8 Related Party Exposure	3,491	2,980	2,280	-
9 Non-Current Liabilities	460	502	337	525
10 Net Assets	7,181	7,283	5,741	5,516
11 Shareholders' Equity	7,181	7,283	5,741	5,516
B INCOME STATEMENT				
1 Sales	15,118	24,442	26,156	24,080
a Cost of Good Sold	*(12,654)*	*(19,522)*	*(21,272)*	*(19,748)*
2 Gross Profit	2,463	4,921	4,884	4,333
a Operating Expenses	(1,676)	(2,495)	(2,815)	(2,653)
3 Operating Profit	788	2,426	2,069	1,680
a Non Operating Income or (Expense)	*41*	*(180)*	*127*	*115*
4 Profit or (Loss) before Interest and Tax	829	2,246	2,197	1,794
a Total Finance Cost	*(580)*	*(1,085)*	*(1,124)*	*(589)*
b Taxation	*(58)*	*(471)*	*(187)*	*(144)*
6 Net Income Or (Loss)	191	690	886	1,061
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*953*	*2,831*	*3,025*	*2,165*
b Net Cash from Operating Activities before Working Capital Changes	*511*	*1,615*	*2,028*	*1,615*
c Changes in Working Capital	*(1,591)*	*(368)*	*(3,599)*	*(1,358)*
1 Net Cash provided by Operating Activities	(1,080)	1,247	(1,571)	257
2 Net Cash (Used in) or Available From Investing Activities	(1,596)	(2,153)	(842)	(1,565)
3 Net Cash (Used in) or Available From Financing Activities	1,689	2,068	2,398	1,284
4 Net Cash generated or (Used) during the period	(987)	1,163	(14)	(25)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	23.7%	-6.6%	8.6%	15.2%
b Gross Profit Margin	16.3%	20.1%	18.7%	18.0%
c Net Profit Margin	1.3%	2.8%	3.4%	4.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-4.2%	10.1%	-2.2%	3.4%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	5.3%	10.6%	15.7%	20.7%
2 Working Capital Management				
a Gross Working Capital (Average Days)	125	120	102	129
b Net Working Capital (Average Days)	100	94	81	107
c Current Ratio (Current Assets / Current Liabilities)	2.3	2.9	3.1	3.4
3 Coverages				
a EBITDA / Finance Cost	2.3	3.1	3.1	4.5
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	1.1	1.5	1.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	16.9	5.2	3.7	2.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	68.0%	63.5%	63.7%	61.9%
b Interest or Markup Payable (Days)	41.9	13.7	41.0	97.6
c Entity Average Borrowing Rate	7.9%	9.7%	11.6%	6.6%

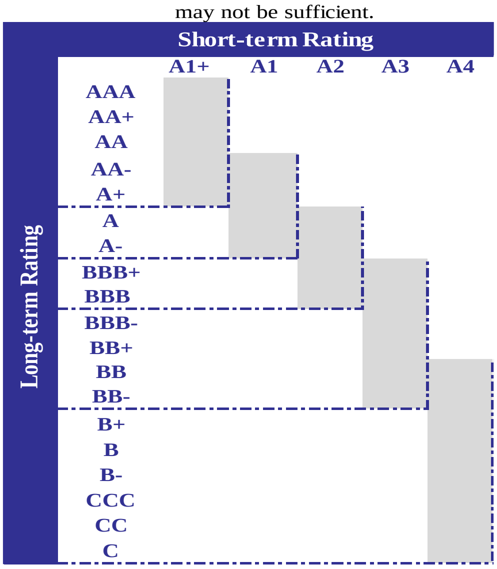
#	Notes
B	***Quaterly accounts are annualised where appicable/required**
A7	**Borrowing includes: Long Term borrowing, short term borrowing, current maturity of long term debt and Lease liabilities)**
D-4a	**Total Borrowings comprises: borrowings+related party exposure**

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):

Entities

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

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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 | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(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 | 18-(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 | 18-(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-(f-VII)
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