RATING REPORT

Shafi Lifestyle (Pvt.) Ltd

REPORT DATE:
26th August 2020

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term rating	**Short-term rating**
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Date	26th August 2020	

COMPANY INFORMATION	
Incorporated in 2009	**External auditors:** RSM Avais Hyder Liaquat Nauman
Private Limited Company	**Chairman of the Board:** Muhammad Haleem
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Muhammad Naseem
Shafi Glucochem Pvt Ltd – 45.4%	
Amjad Hafeez – 12.2%	
Muhammad Naseem – 11.1%	
Tahir Hanif – 7.2%	
Muhammad Haleem Sheikh – 6.5%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (April, 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

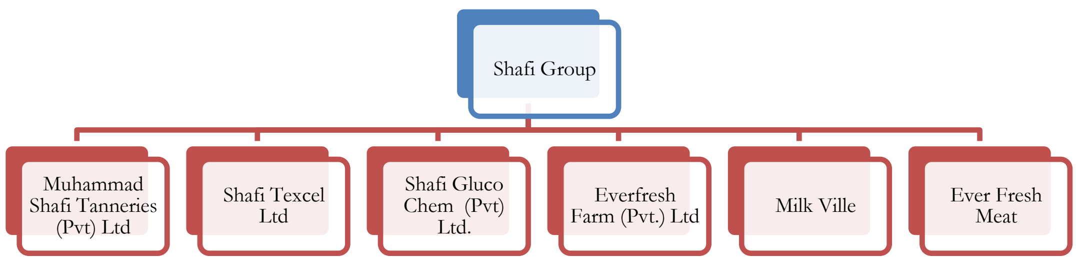
Shafi Lifestyle (Private) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

SLPL was incorporated in 2009, the company was previously known as 'Aisha Sons' partnership firm. The company was later on renamed and was converted into a private limited company.

Financial Statements of the company for FY19 were audited by RSM Avais Hyder Liaquat Nauman

Shafi Lifestyle (Pvt.) Limited (SLPL) is part of Shafi Group. The group has presence in textile, leather, food and footwear industries. SLPL was incorporated in 2009 as 'Aisha Sons' and was subsequently renamed SLPL. The company is principally engaged in manufacturing and selling of leather footwear. The company's regional office is based in Karachi where as the factory is located in Lahore, Punjab. The Company relies on grid-based electricity for its power requirements.



Shafi Texcel Limited (STL)

Incorporated as an unlisted public limited company in 1992, the company is involved in the manufacturing and trading of fabric.

Shafi Gluco-Chem (Pvt.) Limited (SGCL)

The company was incorporated in 1990 as a private limited company and is involved in the manufacturing and trading of liquid glucose and rice protein.

Everfresh Farms (Pvt.) Limited (EFL)

The company was incorporated as a private limited company in 2008. The principal activity of the company is farming, dairies, cultivation of food grains, seeds, foods and manufacturing of products associated with the farming interests.

Milk Ville

The company is engaged in the business of milk pasteurization.

EverFresh Meat

The company is engaged in processors and exporters of chilled meat (Mutton and Beef)

SLPL's Product portfolio

The company's product portfolio is focused towards high-end fashion segment and caters to both men and women. Product portfolio includes ankle boots, ballerina shoes, coat shoes, driving moc, long boot, saddle shoes and wedge shoes. SLPL primarily relies on cow leather for manufacturing shoes which is entirely procured from the local market. Products are made to order on the specific instructions of the client. The Company has a team of 6 designers that support in product development.

Leather exports after a period of consistent decline have recovered in FY18 and FY19

Commodity	Unit	FY15		FY16		FY17	
		Qty	Value	Qty	Value	Qty	Value
Leather Footwear	'000' Pairs	6,919.0	109,761.0	5,744.0	89,151.0	5,339.0	81,384.0
	AUP/Pair		15.9		15.5		15.2
		FY18		FY19		FY20	
		Qty	Value	Qty	Value	Qty	Value
	'000' Pairs	6,018.0	95,150.0	7,008.0	106,464.0	6,708.0	107,170.0
	AUP/Pair		15.8		15.2		16.0

Pakistan's footwear export volumes after a period of consistent decline have recovered in FY18 and FY19. Footwear export volumes continued growth trajectory till 8MFY20 but were impacted in the last 4 months due to Covid-19. Despite the decline in footwear export volumes, footwear exports increased in dollar terms due to higher average selling prices. The footwear exports industry in the country comprises 7 to 8 major players with the single largest player dominating the market and constituting over half of the total exports. Leather footwear industry is labor intensive and enjoys availability of quality leather from the local finished leather industry at competitive rates. Major competing markets include India, Bangladesh, Indonesia and Cambodia.

Continuous capacity enhancement with the plant consistently operating at high capacity utilization levels

Capacity Utilization						
	Units	FY16	FY17	FY18	FY19	FY20
Installed Capacity	Pairs	300,000.0	300,000.0	456,000.0	456,000.0	525,000.0
Actual Production	Pairs	299,473.0	282,459.0	440,101.0	443,922.0	520,768.0
Capacity Utilization		99.8%	94.2%	96.5%	97.4%	99.2%

Over the last four years, the Company has consistently enhanced installed footwear manufacturing capacity which is expected to more than double in the ongoing year. As at end-FY20, the company's cumulative installed capacity stands at around 525,000 units of shoes per annum. SLPL is currently undergoing expansion with installed capacity projected to increase to 720,000 units of shoes per annum in the ongoing year. Over the medium term, the management plans to expand the installed capacity to 1 million units of shoes per annum. Historically, the plant has operated at high capacity utilization level which has resulted in economies of scale for SLPL. The Company's ability to operate at high capacity utilization levels despite significant expansion is considered important from a rating perspective.

Financial Profile

Healthy sales growth on the higher volumes sold and increase in prices

Sales of the company have grown at a 4 year Compound Annual Growth Rate (CAGR) of 46.5% from FY16-FY20. Net Sales of the company grew by 33.3% in FY20 (FY20: Rs. 1.4b; FY19: Rs. 1.1b; FY18: Rs. 0.7b). The increase in net sales was a function of increase average selling price (22.1%) and growth in volumes (16.4%). Sales are primarily geared towards export market and in ladies footwear segment. Focus on high end fashion is reflected in Company's average prices of footwear exports being higher by around 20% vis-à-vis Pakistan's average export price. Client and geographic concentration in sales is on the higher side. As per management, this is a part of a deliberate strategy to focus on target market where business & growth prospects are sound and timely payments are received from client.

Volumetric growth in sales and increasing margins have resulted in improvement in profitability profile

SLPL's gross profit has grown overtime till FY19 and has consolidated to similar levels in FY20. Growth in margins (FY18: 15.6%; FY19: 26.1%; FY20: 24.1%) is attributable to realization of economies of scale due to increase production efficiencies (due to higher production volume), increase in average selling prices due to currency devaluation and shift towards value-added products. Overall profitability improved due to increase in revenues and improvement in margins. Moreover, decline in selling and distribution expenses due Covid related travel restrictions supported bottom line. Going forward, increase in profitability will be a function of volumetric growth in sales over the rating horizon.

Healthy growth in cash flows support liquidity profile; working capital cycle necessities utilization of short-term borrowing. While remaining within manageable levels, leverage indicators are expected to remain within manageable levels.

Given the improvement in profitability, funds generated from operations have increased and was reported at Rs. 308.3m (FY19: Rs. 96.5m). Debt carried on balance sheet is primarily long-term in nature with limited utilization of short-term funding. However, working capital requirements are extensive given sizeable inventory holding period along with upfront payment for imported raw material (represents around of total cost of sales) while sales proceeds are realized in 2 months. Ageing profile is considered satisfactory with no receivable being overdue for more than 90 days. Working capital requirements have been funded through interest free payable from associates which amounted to Rs. 342.7m (FY19: Rs. 371.9m). Given the improving cash flows, management plans to gradually retire the amount. Moreover, working capital requirements are planned to be funded through funds raised from SBP's export refinance scheme. Resultantly, leverage indicators are expected to increase but will continue to remain within manageable levels. Capital expenditure requirements are modest and can be funded through internal cash generation.

Corporate governance framework has room for improvement

The Company has a formal board structure which primarily includes family members. Moreover, an executive committee has also been constituted where discussion regarding future strategy, business environment and funding needs is undertaken. The Company currently does not have an in-house internal audit function but plans to hire separate resources over the same. SLPL has two separate modules for accounts & finance and inventory management.

Financial Summary (amounts in PKR millions)					Appendix I
	FY16	FY17	FY18	FY19	FY20
BALANCE SHEET					
Fixed Assets	146.9	165.9	277.9	289.6	395.3
Other Non-Current Assets	5.3	5.6	3.9	21.5	40.3
Stock-in-Trade	75.5	151.9	175.2	219.6	285.3
Trade Debts	78.2	41.8	143.3	281.2	368.0
Cash & Bank Balances	12.8	38.4	15.7	19.5	125.2
Total Assets	423.2	512.0	814.5	1,034.7	1,467.5
Trade and Other Payables	110.1	102.9	174.0	202.6	262.8
Long Term Debt (including current maturity)	38.9	32.3	22.0	13.6	72.8
Short Term Debt	-	-	-	-	8.0
Total Debt	38.9	32.3	22.0	13.6	80.8
Total Liabilities	329.9	396.7	618.7	594.4	770.8
Paid-Up Capital	374.3	374.3	374.3	374.3	374.3
Total Equity (without surplus revaluation)	93.3	115.4	101.4	346.2	602.6
INCOME STATEMENT					
Net Sales	316.8	302.4	717.1	1,094.9	1,460.0
Gross Profit	-104.5	-6.4	112.0	285.9	351.6
Profit Before Tax	-140.5	-53.0	-4.3	101.2	284.2
Profit After Tax	-143.6	-52.7	-13.0	92.3	265.4
RATIO ANALYSIS					
Gross Margin (%)	-33.0%	-2.1%	15.6%	26.1%	24.1%
Net Profit Margin	-45.3%	-17.4%	-1.8%	8.4%	18.2%
Net Working Capital	(24.3)	(30.6)	(69.5)	135.5	321.7
Current Ratio	0.9	0.9	0.9	1.2	1.5
FFO	(123.9)	(39.1)	15.4	96.5	308.3
FFO to Total Debt (%)	-318.6%	-121.0%	69.7%	707.9%	381.6%
FFO to Long Term Debt (%)	-318.6%	-121.0%	69.7%	707.9%	423.5%
Debt Servicing Coverage Ratio (x)	-	(3.1)	1.4	6.1	14.4
ROAA (%)	0.0%	-11.3%	-2.0%	10.0%	21.2%
ROAE (%)	0.0%	-50.5%	-12.0%	41.2%	55.9%
Gearing (x)	0.4	0.3	0.22	0.04	0.1
Leverage (x)	3.5	3.4	6.10	1.72	1.3

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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.

<table>
<tr><th colspan="6">REGULATORY DISCLOSURES — Appendix III</th></tr>
<tr><td>Name of Rated Entity</td><td colspan="5">Shafi Lifestyle (Pvt.) Ltd</td></tr>
<tr><td>Sector</td><td colspan="5">Leather</td></tr>
<tr><td>Type of Relationship</td><td colspan="5">Solicited</td></tr>
<tr><td>Purpose of Rating</td><td colspan="5">Entity Rating</td></tr>
<tr><td rowspan="3">Rating History</td><td>Rating Date</td><td>Medium to Long Term</td><td>Short Term</td><td>Rating Outlook</td><td>Rating Action</td></tr>
<tr><td colspan="5">RATING TYPE: ENTITY</td></tr>
<tr><td>26/08/20</td><td>BBB+</td><td>A-2</td><td>Stable</td><td>Initial</td></tr>
<tr><td>Instrument Structure</td><td colspan="5">N/A</td></tr>
<tr><td>Statement by the Rating Team</td><td colspan="5">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.</td></tr>
<tr><td>Probability of Default</td><td colspan="5">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.</td></tr>
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<tr><td rowspan="4">Due Diligence Meetings Conducted</td><td></td><td colspan="2">Name</td><td>Designation</td><td>Date</td></tr>
<tr><td>1</td><td colspan="2">Mr. Zahid Haleem</td><td>CFO-Shafi Group</td><td>11/08/20</td></tr>
<tr><td>2</td><td colspan="2">Mr. Hamza Hafeez</td><td>Executive Director</td><td>11/08/20</td></tr>
<tr><td>3</td><td colspan="2">Mr. Mustafa Hafeez</td><td>CFO</td><td>11/08/20</td></tr>
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