RATING REPORT

Shafi Lifestyle (Pvt.) Ltd

REPORT DATE:

30 December, 2022

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A-/A-2**	**BBB+/A-2**
Rating Date	*December 30, '22*	*January 31,'22*
Rating Outlook	Stable	Positive

COMPANY INFORMATION	
Incorporated in 2009	**External auditors:** RSM Avais Hyder Liaquat Nauman
Private Limited Company	**Chairman of the Board:** Mr. Muhammad Haleem
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Muhammad Naseem
Shafi Glucochem Pvt Ltd – 65.81%	
Mr. Amjad Hafeez – 7.63%	
Mr. Muhammad Naseem – 6.93%	
Mr. Tahir Hanif – 4.48%	
Mr. Muhammad Haleem Sheikh – 4.10%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Corporates (August, 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Shafi Lifestyle (Private) Limited

OVERVIEW OF THE INSTITUTION	RATNG 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. The company's regional office is based in Karachi while its factory is located in Lahore.

Financial Snapshot

Tier-1 Equity: *FY22: Rs. 1.3b, FY21: Rs. 924m, FY20: Rs. 578.2m*

Assets: *FY22: Rs. 3.2b, FY21: Rs. 2.2b, Rs. 1.4b*

Net Profit (Loss): *FY22: Rs. 353.3m, FY21: Rs. 349.2m, FY20: Rs. 231.7m*

SLPL is a part of 'Shafi Group', having presence in textile, leather, food and footwear. The company is primarily engaged in production and sale of high-end leather footwear primarily targeting export markets. The assigned ratings take into account positive momentum in revenue driven by growth in volumetric sale and average prices. While notable client concentration is present, the risk is largely subsided as the primary client base constitutes of wholesalers with whom the company has long-standing relationships underpinned by quality and pricing. The company has been able to largely transfer the impact of cost escalation in raw material prices owing to the premium nature of their products and weakening PKR provides support to exporters. Gross margins have remained sizeable whilst faced some pressure on the account of growing inflation and some lag in passing on its impact.

The liquidity profile remained satisfactory in terms of cash flow coverages and working capital management. Capitalization indicators have remained within manageable levels despite increase in short-term borrowings, reflecting adequate risk absorption capacity of the company. Furthermore, the ratings factor in higher production capacity emanating from continued capacity enhancement and optimization of manufacturing processes to meet growing demand. The new facility, with addition of another production line, is projected to be completed by end-Jun'23; the company has been financing majority of these capital expenditure through own sources. Going forward, the ratings will remain dependent on achieving projected growth in revenues and profitability while maintaining liquidity and capitalization profile.

Continued expansion and high capacity utilization rate: The production capacity has augmented by almost three times over the last six years. At present, production capacity stands at 840,000 pairs (FY21: 660,000 pairs). The additional capacity came online in last quarter of the outgoing year. Capacity utilization have also been consistently high (FY22: 94.6%; FY21: 90%) due to optimization of production processes. The company is currently undertaking capital expenditure to construct a new production hall facility and addition of new line to reach 1.0m pairs manufacturing capacity per annum. The project is expected to be completed in two phases with an estimated total cost of Rs. 574.8m, funded entirely through own sources. The first phase of the project, which pertains to the production hall facility itself, is expected to be completed by end-June'23 and total expenditure incurred is estimated at Rs. 300m. New production line costing Rs. 122.2m is also contemplated to start commercial operations by end-June'23. Meanwhile, in the second phase, a warehouse will be constructed with an estimated cost of Rs. 152.6m. The warehouse conduction may get delayed till end-Jun'24 depending upon availability of cash flows.

Capacity Utilization

	Units	FY19	FY20	FY21	FY22
Installed Capacity	Pairs	456,000	525,000	660,000	840,000
Actual Production	Pairs	443,922	520,768	593,876	794,676
Capacity Utilization		97.40%	99.20%	90.00%	94.60%

Property, plant and equipment increased to Rs. 1b (FY21: Rs. 739.2m) mainly due to additions related to the aforementioned capacity enhancement. Capital work in progress of Rs. 43.9m (FY21: Rs. 23.2m) pertained to ongoing capex of the production facility. Total power requirements of the company amount to approximately 500-600kW and is met primarily through diesel generators and solar power setup while the company also has sanctioned load from national grid for the required capacity.

Positive momentum in topline backed by volumetric growth and higher average prices, however, gross margins decreased primarily due to the impact of inflationary pressure amidst local currency devaluation: During FY22, the company recorded a sizeable increase in net sales to Rs. 2.9b (FY21: Rs. 2b) primarily led by volumetric growth of ~32%. while overall average selling prices posted an increase of 7.4%. The company remained focused on export sales, which comprised around 97% (FY21: 99%) of net sales owing to stable demand and high margins. The company product portfolio is focused towards high-end fashion segment, which majorly included ladies' footwear (FY22: 88%; FY21: 90%). The rest included men's and kids' product lines. The product mix is expected to remain largely same while the management also intend to enhance its kids' category line, going forward. Breakdown of product mix is presented below:

Product Wise Sales	FY21			FY22		
	Volume (units)	Avg. Price (Rs.)	Sales (Rs. mln)	Volume (units)	Avg. Price (Rs.)	Sales (Rs. mln)
Men Close	33,824	3,501	118	41,729	4,033	168
Ladies Close	424,600	3,623	1,538	556,979	3,912	2,179
Men Sandal & Slippers	17,347	2,918	51	29,718	3,089	92
Ladies Sandals and Slippers	95,510	2,984	285	112,533	3,072	346
Kids (close & open)	13,380	3,183	43	30,329	3,215	98
Total	**584,661**	**3,481**	**2,035**	**771,288**	**3,737**	**2,882**

Germany and Holland remained the primary export markets for company's products while share of Australia, Austria and USA was limited. Breakdown of geographic export sales is seen below:

	FY21				FY22			
Country	Vol. (units)	Avg. Price (Rs.)	Sales (Rs. mln)	%	Vol. (units)	Avg. Price (Rs.)	Sales (Rs. mln)	%
Germany	218,649	3,315.9	725.0	35.6%	378,175	3,739.2	1,414.1	49.1%
Holland	340,938	3,608.7	1,230.3	60.5%	358,414	3,748.2	1,343.4	46.6%
Austria	1,000	2,470.0	2.5	0.1%	8,006	2,756.6	22.1	0.8%
Australia	1,800	2,662.1	4.8	0.2%	6,922	3,915.0	27.1	0.9%
USA	22,274	3,241.5	72.2	3.5%	19,771	3,831.0	75.7	2.6%
Total	**584,661**		**2,035**	**100.0%**	**771,288**		**2,882**	**100.0%**

Moreover, the company's client concentration risk seems to be high as the top two clients contribute about 80% (FY21: 80%) to total sales. However, the risk is largely mitigated as these clients are one of the largest shoe production and distribution companies in Europe dealing with numerous national and international retailers. Additionally, the company has maintained a longstanding relationship with its clients underpinned by quality and better pricing. As per management, exclusive agreements are in place with its major clients, with a clause to increase sales volume by 20% annually while the agreements are subject to renewal each year. Nonetheless, the management is also striving to further diversify its client base. Client-wise breakdown of sales for FY22 is presented below:

Top 10 Clients (Exports)	Sales (Rs. mln)	%
Poelman	1,425.5	49.5%
Marco Tozzi	880.9	30.6%
Dockers	18.7	0.6%
Gortz	178.8	6.2%
Deichmann	147.9	5.1%
Kazar	10.8	0.4%
Ziengs	78.8	2.7%
DSW	75.7	2.6%
Giesswein	22.1	0.8%
Josef Seibel	43.2	1.5%
	2,882.4	**100.0%**

During FY22, gross profits were recorded higher at Rs. 840.8m (FY21: Rs. 703.4m) while gross margins, albeit remained high, decreased to 29% (FY21: 34.4%) due to rising production costs and some lag in passing on its impact amidst sharp local currency devaluation. Cost of sales increased to Rs. 2.1b (FY21: Rs. 1.3b) primarily on the account of rise in the consumption of raw materials which constituted around 72% (FY21: 71%) of the cost of goods manufactured. Other cost components including factory overhead and salaries and wages also increased mainly in line with inflationary pressure. About 44.3% of raw materials, primarily consisting of sole material and accessories, were imported. Around 5% of raw materials are purchased from associated companies.

Administrative expenses increased to Rs. 70.5m (FY21: Rs. 56.9m) and were largely rationalized. Selling and distribution expenses were recorded higher at Rs. 360m (FY21: Rs. 249.6m) mainly due to increase in freight charges and commission on export sales. Financial charges amounted to Rs. 22.9m (FY21: Rs. 20.3m). Other expenses stood at Rs. 34.4m (FY21: Rs. 29.1m) which mainly included employees related fund contributions. Other income amounting Rs. 33.2m (FY21: Rs. 26.1m) mainly comprised of dividend income on short-term investments. Accounting for taxation, net profit was reported slightly higher at Rs. 353.3m (FY21: Rs. 349.2m) while net margin decreased to 12.2% (FY21: 17.1%) on account of inflationary impact on operating expenses along with some increase in effective tax rate. During 4M'23, the company has generated revenue of about Rs. 1.4b and has orders in hand worth Rs. 500m till Jan'23. Net sales are projected to increase by around 1.3 times in the ongoing year backed by higher volumetric sales from incremental production and some increase in product prices.

Adequate liquidity profile in terms of cash flow coverages and working capital management: The company has maintained healthy cash flows in relation to its outstanding obligations on a timeline basis. Funds from Operations (FFO) amounted to Rs. 388m (FY21: Rs. 396.1m) in FY22. FFO to total debt albeit decreased to 0.44x (FY21: 0.72x) due to higher short-term borrowings, has remained adequate. Debt-service coverage ratio remained sizeable at 4.75x (FY21: 12.1x).

Trade receivables increased to Rs. 747.8m (FY21: Rs. 603.1m) by end-FY22. Aging profile of receivables was satisfactory as the entire amount was outstanding for less than three months. The company normally provides credit of 60-70 days to its clients. Total advances increased to Rs. 66.2m (FY21: Rs. 27.9m) on account of higher payments to suppliers. Other receivables of Rs. 93.2m (FY21: Rs. 141.7m) consists primarily of export rebate receivable. Additionally, stock in trade stood higher at Rs. 694.9m (FY21: Rs. 351.9m) in line with scale of operations and higher average cost. Short-term investments which majorly constitute money market funds stood at Rs. 88.7m (FY21: Rs. 132.9m). Cash and bank balances amounted to Rs. 87.6m (FY21: Rs. 42.5m). Current ratio and short-term borrowing coverage ratio remained adequate. Net operating cycle remained manageable and shorter than the industry median (FY22: 95 days; FY21: 76 days).

Adequate capitalization indicators on the back of strong retained earnings despite growing borrowings on timeline basis: Tier-1 equity increased to Rs. 1.3b (FY21: Rs. 924m) on the account of internal capital generation. Total equity, including revaluation surplus, amounted to RS. 1.5b (FY21: Rs. 1.2b). Total liabilities increased to Rs. 1.5b (FY21: Rs. 966m) mainly due to higher short-term borrowings and trade and other payables. Trade and other payables increased to Rs. 690.7m (FY21: Rs. 465.5m) mainly due to higher creditors for suppliers and services. Payment terms with suppliers for raw materials involves Letters of Credit for imports and 50-60 days credit for most of the locally procured materials except for leather which is purchased on 90 days credit.

The company meets its working capital requirements through istisna and running mushrika facilities; the outstanding amount stood higher at Rs. 770m (FY21: 425m) at end-FY22. The aggregate unavailed financing facilities available to the company were Rs. 130m (FY21: Rs. 175m). These borrowings are secured against pari passu hypothecation charge over company movable and receivables of Rs. 1.5b, lien over export LCs, personal guarantees of all directors as well as parent company. These facilities are subject to SBP refinance rate plus 0.75% to 1% per annum while effective markup rate during the year ranged from 2.75% to 7.25% per annum (FY21: 2.75% to 3% per annum). Long-term financing, inclusive of current portion, comprised only 13% (FY21: 23%) of the debt mix. These included diminishing musharika facilities amounting Rs. 117.7m (FY21: Rs. 128.7m); around three-fourth of which were obtained to finance capital expenditure on plant and machinery while the rest were to finance salaries and wages under subsidized financing scheme by SBP. All facilities were contributed by the bank and the company in the range of 80-95% and 5-20%, respectively. The effective markup rate ranged from 3% to 9.5% per annum. Gearing and leverage remained manageable at 0.70x (FY21: 0.60x) and 1.30x (FY21: 1.14x), respectively. Capitalization indicators are expected to remain at comfortable level supported by strengthening equity base on the back of profit retention.

Financial Summary (amounts in PKR millions)				Appendix I
	FY19	FY20	FY21	FY22
BALANCE SHEET				
Fixed Assets	289.6	395.4	739.2	1,007.0
Other Non-Current Assets	21.5	40.3	25.4	45.5
Stock-in-Trade	219.6	276.0	351.9	694.9
Trade Debts	281.2	372.3	603.1	747.8
Cash & Bank Balances	19.5	125.1	42.5	87.6
Total Assets	1,034.7	1,463.8	2,227.9	3,166.3
Trade and Other Payables	202.6	350.6	465.5	690.7
Long Term Debt (including current maturity)	13.6	72.8	128.7	117.7
Short Term Debt	-	8.0	425.0	770.0
Total Debt	13.6	80.8	553.7	887.7
Total Liabilities	594.4	791.9	1,051.3	1,647.2
Tier-1 Equity	346.2	578.2	924.0	1,267.3
INCOME STATEMENT				
Net Sales	1,094.9	1,531.0	2,043.7	2,903.6
Gross Profit	285.9	481.5	703.4	840.8
Profit Before Tax	101.2	246.9	373.6	386.1
Profit After Tax	92.3	231.7	349.2	353.3
RATIO ANALYSIS				
Gross Margin (%)	26.1%	31.4%	34.4%	29.0%
Net Profit Margin	8.4%	15.1%	17.1%	12.2%
Net Working Capital	135.5	302.3	494.6	548.0
Current Ratio	1.23	1.42	1.51	1.36
Short-term borrowing Coverage Ratio	NA	81.04	2.25	1.87
FFO	96.5	265.5	396.1	388.0
FFO to Total Debt (%)	707.9%	328.6%	71.5%	43.7%
FFO to Long Term Debt (%)	707.9%	364.7%	307.8%	329.5%
Debt Servicing Coverage Ratio (x)	6.15	12.49	12.12	4.75
ROAA (%)	10.0%	18.5%	18.9%	13.1%
ROAE (%)	41.2%	50.1%	46.5%	32.2%
Gearing (x)	0.04	0.14	0.60	0.70
Leverage (x)	1.72	1.37	1.14	1.30
Cash Conversion Cycle	101.43	62.8	76.8	94.7

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.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Shafi Lifestyle (Private) Limited
Sector	Leather Footwear
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30/12/22	A-	A-2	Stable	Upgrade
31/01/22	BBB+	A-2	Positive	Maintained
26/08/20	BBB+	A-2	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Mustafa Hafeez	Executive Director – Finance	09/12/22
2	Mr. Mazhar Iqbal	Sr. Manager Accounts & Finance	09/12/22