

Insight alpha

SGFL: A hidden gem

China is the world's biggest footwear manufacturer and the largest exporter, followed by India. Meanwhile, Pakistan has also made significant strides in the industry and stands at 7th place worldwide. In FY23, footwear exports grew by ~14% to clock in at USD178.5mn compared to SPLY. whereas, In FY22, Pakistan exported USD157mn of footwear compared to USD132mn in SPLY. Being the major exporter of footwears, SGF is well place to capitalize on growing footwear demand.

In addition to that, SGF has entered into TBR (Truck and Buses Radial) tyres market with an equity holding of 18.91% in SLM, which locally manufactures and caters demand of both local and international markets. SLM is the first company to locally manufacture TBR tyres in Pakistan. Previously, the local demand for TBR tyres were mainly met through imports. However, SLM, being a sole manufacturer of all steel radial tyres of trucks and buses in the country, is a valuable addition to SGF portfolio.

We maintain our 'BUY' stance on SGF by assigning June'24 SOTP based target price of PKR54/share, providing a potential upside of 55%. The stock is currently trading at a forward P/E of 5.4x/3.7x for CY23/CY24, respectively. Our liking for SGF stems from the following facts i) Dollarized revenue stream, ii) Strong pricing power, iii) Steady gross margins, iv) SLM to enhance value and offer diversification, v) TERF based loan to provide a cushion against interest rate volatility, vi) Tax exemptions to SLM due to greenfield investment, and vii) Conversion of business on FOB terms, shielding company from abrupt volatility in freight costs

Key risks to our thesis include; i) PKR appreciation, ii) Withdrawal of duty drawback scheme, iii) Slowdown in global footwear demand, iv), Abrupt increase in raw material prices v) Delay in project commissioning, vi) Unavailability of skilled labor and vii) Changes in regulatory regime.

Leading exporter of footwear

SGF is the largest footwear exporter in Pakistan, having a market share of ~35% of Pakistan's total footwear exports. Whereas, company's export sales account for more than 90% of total sales. In CY22, company's topline witnessed a growth of 67% to clock in at PKR11.75bn vs. PKR7.04bn in SPLY. The increase in profitability is mainly attributable to PKR devaluation followed by higher product prices and increased volumetric sales. Whereas, in 1QCY23, company's topline grew by 42% to clock in at PKR3.58bn vs. PKR2.52bn in SPLY. While, profitability also increased by 18% to clock in at PKR250mn compared to SPLY.

Safety shoe segment to unlock value

The demand for safety footwear is growing significantly driven by increasing awareness about workplace safety and stringent government regulations. Due to an increase in safety footwear demand, manufacturers are offering

Service Global Footwear Ltd



BUY

HOLD

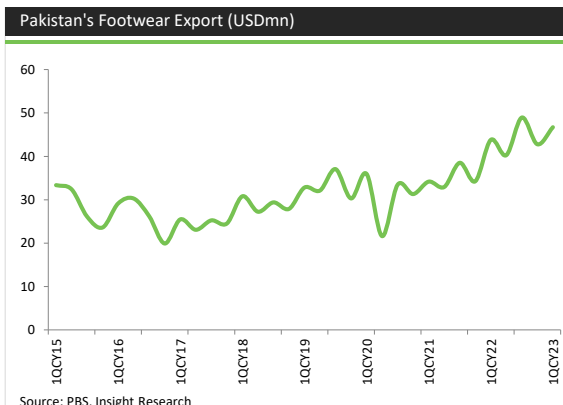
SELL

We recommend 'BUY' with Jun'2024 DCF based target price of PKR54, providing 55% upside.

Current Price	PKR	35
Market cap	PKR b	7.2
Market cap	US\$ m	39
Free Float Market cap	US\$ m	5.1
30-day Avg. turnover	m Shares	0.3
30-day Avg. turnover	PKR m	10.2
52 wk range	PKR	25-44
Shares Outstanding	m	205
Free float	%	20%
Major Sponsors	Service Industries	
Bloomberg Ticker	SGF PA	

Financials (PKR mn)	CY22	CY23F	CY24F
Revenue	11,753	17,711	22,175
Cost of Sales	9,567	14,299	17,438
Gross Profit	2,186	3,412	4,737
Share from SLM	(224)	216	366
Finance Cost	467	734	506
Profit Before tax	688	1,554	2,225
Profit After tax	342	1,318	1,935
Key Ratios	CY21	CY22F	CY23F
EPS	1.67	6.43	9.44
DPS	0.5	2.0	4.0
Gross Margins	18.6%	19.3%	21.4%
P/E	25.0	5.4	3.7
P/BV	1.39	0.75	0.67
ROE	5.5%	13.8%	18.1%

Source: Company Accounts, Insight Research



customizable safety footwear options to meet individual requirements, such as specific foot size, style preferences, and specialized job roles which is contributing to the overall growth in demand. To note, the global industrial safety footwear market size was estimated at US\$10bn in 2022 and is estimated to grow at a CAGR of ~6% to US\$16bn by 2030. Thus, due to robust demand, SGF has started to develop safety shoes as a new category in its product portfolio. This segment has also matured into a solid product line, which is likely to generate a new revenue stream for the company.

Stable gross margins amid better procurement and pricing

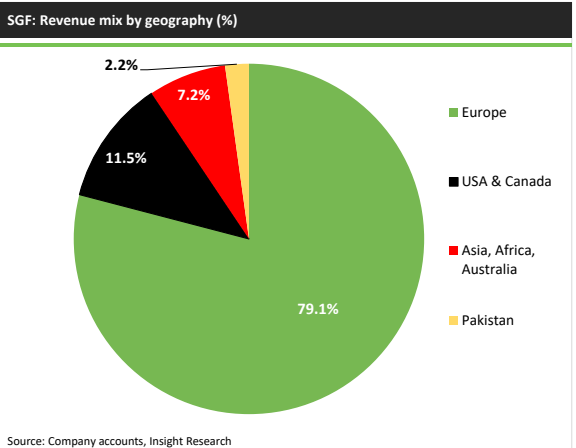
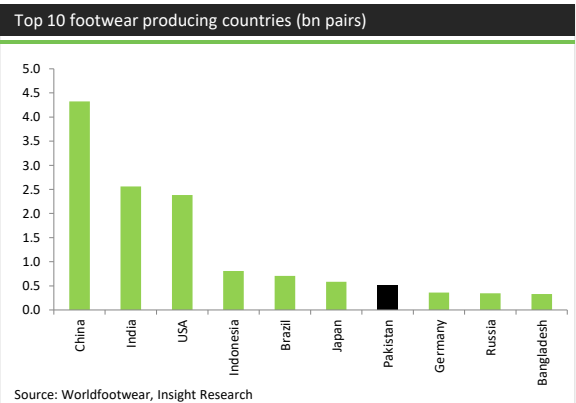
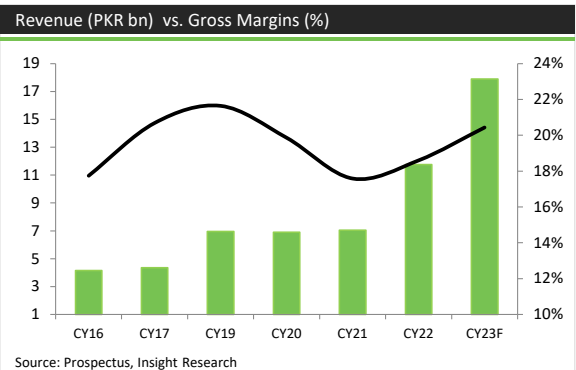
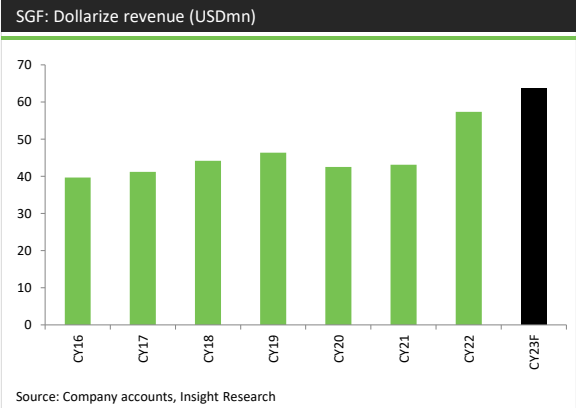
Over the year, company's gross margin remain firm at ~20%. However, In CY22, company's gross margins clocked in at 18ppts due to higher raw material prices and inflationary pressures. However, in 1QCY23, company gross margins rebounded sharply by 900bps to clock in at 19.8% compared to previous qtr. We believe that SGF's gross margins will likely normalize at 20% -22% in upcoming year due to its pricing and strong customer base, which allows the company to pass on the cost pressure, keeping their margins stable. To note, more than 90% of the leather requirement is procured locally, which accounts for ~47% of total raw material cost, shielding company from PKR devaluation. Moreover, company has converted a major chunk of their business to FOB terms, which insulates company from fluctuating freight costs.

SLM: A value addition in SGF portfolio

As the global economy grows, the number of commercial vehicles, such as trucks and buses are rapidly increasing. Moreover, modern commercial vehicles are designed to go longer distances and operate for longer hours. This puts more wear and tear on tyres, requiring fleets to replace TBR tyres more frequently. In Pakistan, demand for TBR tyres is met through imports. However, SLM is the first company to locally manufacture TBR tyres in Pakistan with an annual capacity of 660K. As per our channel checks, company is currently operating at optimal level, catering demand for both local and international markets. Recently, SLM has announced the capacity expansion plans, where SLM plans to increase their investment in PAK JV company to US\$200mn and also plans to move toward exporting USD\$100mn tyre annually. To note, in CY21, SGF raised PKR2.17bn to fund this project.

Growth of E-commerce to fuel footwear demand

One of the primary drivers of the growing footwear demand is the exponential growth of e-commerce and online shopping platforms. Consumers now have easy access to a wide variety of footwear options from around the world, enabling them to make purchases conveniently from the comfort of their homes. This led to surge in footwear demand globally. Moreover, the growth of the footwear industry is closely linked to economic factors such as rising disposable income and urbanization. As global economies develop and per capita income increases, individuals have more purchasing power, leading to higher expenditure on footwear.



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Valuation Methodology: To arrive at our period end target prices, ISL uses different valuation methodologies including

- Discounted cash flow (DCF)
- Relative Valuation (P/E, P/Bv, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Frequently Used Acronyms

TP	Target Price	DCF	Discounted Cash Flows	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DDM	Dividend Discount Model
SOTP	Sum of the Parts	P/E	Price to Earnings ratio	P/Bv	Price to Book ratio
P/S	Price to Sales	EVA	Economic Valued Added	BVPS	Book Value per Share
EPS	Earnings per Share	DPS	Dividend per Share	DY	Dividend Yield
ROE	Return on Equity	ROA	Return on Assets	CAGR	Compounded Annual Growth Rate

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