



The Pakistan Credit Rating Agency Limited

## Rating Report

### Eastern Garments (Pvt.) Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Feb-2019	BBB+	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect the adequate business profile of Eastern Garments (Pvt.) Limited, an export-oriented knitwear and woven garments unit. In the past, the company's sales mix predominantly comprised knitwear. However, given the volatility in Pakistan's knitwear industry in recent years, the company recently expanded into woven denim garments. This enabled it to diversify its sales while increasing revenues and margins which were further complimented by the currency devaluation. Business risk remains high owing to the global knitwear industry's reliance on few key players as well as competitive international denim market. On standalone basis, the company's customer concentration remains high. However, comfort is drawn given its relationships with established international brands. Ratings account for the stable financial profile characterized by modest leveraging and strong coverages. The company has utilized the State Bank's concessionary lending rates, which have provided respite in rising interest rate environment. Ratings further reflect professional management team as well as sponsors ability to provide support when required, as demonstrated in the past. Meanwhile, corporate governance framework needs improvement.

The ratings are dependent upon the management's ability to capitalize on growth opportunities in a competitive landscape and sustainability of profitability and margins. Excessive borrowing, leading to higher leverage, and deterioration in coverages can impact the ratings negatively. Meanwhile, improvement in governance framework remains important.

#### Disclosure

<b>Name of Rated Entity</b>	Eastern Garments (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-18),Methodology   Criteria   Rating Modifier(Jun-18),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
<b>Related Research</b>	Sector Study   Textile(Oct-18)
<b>Rating Analysts</b>	Muhammad Hassan   muhammad.hassan@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Eastern Garments (Pvt.) Limited (Eastern Garments) is a private limited concern incorporated in February, 1980.

**Background** Mr. Noor Mohammed – founder and Chairman of the company – established Eastern Garments in 1976 as a small stitching unit in collaboration with another individual. Later, Mr. Noor became the sole owner of the company. Mr. Noor was joined in the business by his son, Mr. Nizar Noor Mohammed, in 1987.

**Operations** Eastern Garments is a textile unit involved in the manufacturing and export of knitwear and woven garments. The company's production facilities are spread into six units, all located in Sindh Industrial Trading Estate, Karachi. Annual energy requirement clocks in at ~4.5MW and is met through a dedicated line from K-Electric as well as gas and diesel generators.

## Ownership

**Ownership Structure** The company's shareholding is directly held equally by Mr. Noor Mohammed and Mr. Nizar Noor Mohammed.

**Stability** Mr. Nizar, the only son of Mr. Noor, is the sole successor of the business. The third generation has no stake or involvement in the company as yet.

**Business Acumen** The Noor family has been in the textile business for over four decades and possess expertise in the value-added textile segment. It has also been part of technological ventures, including Tameer Microfinance Bank (now Telenor Microfinance Bank) and Planet N. Furthermore, the family also trades in financial securities and real estate.

**Financial Strength** Apart from Eastern Garments, the sponsors wholly own Eastern Holding Company (Private) Limited, an investment vehicle involved in real estate and stake in Planet N Group, an investment holding firm dedicated towards tech-based ventures in emerging markets. The sponsors have shown willingness and ability to support the business in case the need arises.

## Governance

**Board Structure** Eastern Garments' Board comprises two members, Mr. Noor Mohammed and Mr. Nizar Noor. The Board is small in size and lacks independent oversight.

**Members' Profile** Mr. Noor Mohammed is an entrepreneur based in Karachi. With previous experience in the banking sector, Mr. Noor began trading in waste of garment factories before establishing Eastern Garments. Mr. Noor was also a founding member and shareholder in Tameer Microfinance Bank. Mr. Nizar also has over three decades of textile experience.

**Board Effectiveness** The company has no Board Committees in place to assist decision making. Furthermore, Board meetings are held informally with no documentation of minutes. Addition of independent directors would improve governance structure.

**Financial Transparency** Faruq Ali & Company are the external auditors of Eastern Garments. The auditor is QCR rated, however, does not appear on the list of State Bank's panel of auditors. They have expressed an unqualified opinion on the financial statements of the company for the year ended June 30th, 2018. The company has an internal audit function in place which reports to the CEO, compromising the effectiveness of the function.

## Management

**Organizational Structure** Eastern Garments' organizational structure is broadly divided into various functional departments. The Manager of each department reports to one of three Executive Directors. The Executive Directors in turn report to the Managing Director – Mr. Nizar Noor Mohammed – who reports to the CEO – Mr. Noor Mohammed.

**Management Team** Mr. Nizar Noor Mohammad has been the Managing Director of Eastern Garments since 1997 and oversees the production and marketing aspects of the business. He currently serves on the Board of Planet N Group. The executive directors also have extensive experience in the textile sector. The overall management team has been associated with the company for a significant period of time.

**Effectiveness** The company is professionally managed, with significant autonomy resting with senior management to execute day-to-day decision making. Although there are no formal management committees in place, the production and marketing departmental heads meet with the Managing Director daily to discuss performance, development and issues.

**MIS** Eastern Garments has an in-house ERP system in place to aid the flow of information from all production units. Reports are generated regularly and reviewed by senior management.

**Control Environment** The company places focus on quality control which enables it to adhere to international quality standards. Quality control is centrally managed while separate teams for quality control are also in place at each production unit. Radio Frequency Identification (RFID) technology has been installed to aid real time data monitoring and tracking of sewing and finishing departments.

## Business Risk

**Industry Dynamics** Textile exports of the country grew by ~9% for FY18. During 1HFY19, however, textile exports stagnated despite ~15% rupee devaluation during the period. Knitwear showed a relatively stronger performance (up 10.5% YoY). The devalued currency, recently announced relief in gas and electricity tariffs for zero-rated sectors, removal of duties on imported cotton and disbursement of tax refunds promised by the government in the recently announced minibus is expected to boost exports, going forward.

**Relative Position** Eastern Garments contributed ~2% to the country's total export of ready-made garments during FY18. The company faces competition from peers in textile finishing and garment makers which are also export-oriented units focusing on value added products, particularly garments.

**Revenues** The company's sales mix equally comprises knitwear and woven garments to renowned fashion apparel and sportswear brands. ~55% of the company's exports are to USA followed by Germany (21%) and Italy (10%). While customer concentration is currently high, the company is focusing on diversifying its customer base. For FY18, revenue clocked in at ~PKR 4,021mln, an increase of ~27% YoY driven by currency devaluation. In 1HFY19, the company's revenue amounted to ~PKR 3,259mln, a ~48% YoY increase owing to further currency depreciation and increased sales of recently expanded woven denim segment.

**Margins** Gross margin witnessed a decrease during FY18 (FY18: 11.1%, FY17: 12.6%) due to tough competition in the international market as well as high costs. Interest income from investment in in term deposit receipts has contributed significantly to the bottom line in recent years. Net margin has taken a hit recently as the company availed a long-term loan in FY17 to finance BMR and expansion (FY18: ~0.6%, FY17: ~0.5%). The company booked a profit of ~PKR 210mln in 1HFY19 with gross margin amounting to ~14% on the back of ~42% YoY growth in revenue.

**Sustainability** In the past three years, the company has used a mix of internal resources and long-term financing for capex including energy efficient gas generators, sewing machinery and a water reclamation plant, resulting in significant cost savings. Going forward, it plans to further invest in energy-efficient machinery and BMR. It is also focusing on its marketing side and has hired a team in Italy to direct its marketing efforts in Europe.

## Financial Risk

**Working Capital** Eastern Garments' finances its working capital needs through internal cash flows as well as short term borrowings. During FY18, Eastern Garments' net cash cycle decreased by approximately one month (FY18: 134 days, FY17: 158 days) owing to better management of inventory and timely payment to suppliers. Borrowing capacity at trade assets level remains adequate.

**Coverages** During FY18, Eastern Garments' free cash flows grew YoY to stand at ~PKR 172mln (FY17: PKR 144mln), owing to better profitability. Debt service coverage improved to 3.0x compared to 2.5x in the previous year while core debt coverage deteriorated due to increase in short-term borrowings to stand at ~1.9x compared to 2.0x in FY17. Core debt coverage improved significantly to 6.6x in 1HFY19 due to high profitability and partial repayment of long-term borrowing.

**Capitalization** At end-Jun18, the company had a significantly leveraged capital structure with a leveraging ratio of ~59% (FY17: 57%). Total debt comprises ~93% of short-term borrowings, majorly comprising export refinance while long-term financing wholly comprises the State Bank's LTFF facility. In FY19, the company plans to avail further long-term financing amounting to ~PKR 100mln to finance capex which will increase leveraging to slightly above 60%.



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**Eastern Garments (Pvt.) Limited**

BALANCE SHEET	31-Dec-18	30-Jun-18	30-Jun-17	30-Jun-16
	6M	FY	FY	FY
<b>Non-Current Assets</b>	<b>895</b>	<b>893</b>	<b>827</b>	<b>621</b>
<b>Investments (Incl. Associates)</b>	<b>312</b>	<b>205</b>	<b>256</b>	<b>276</b>
Equity	-	-	-	-
Loans to Associates/Debt Securities	312	205	256	276
Investment Property	-	-	-	-
<b>Current Assets</b>	<b>2,770</b>	<b>2,538</b>	<b>2,294</b>	<b>2,048</b>
Inventory	1,550	1,616	1,607	1,463
Trade Receivables	350	194	37	93
Others	870	728	650	491
<b>Total Assets</b>	<b>3,978</b>	<b>3,636</b>	<b>3,377</b>	<b>2,945</b>
<b>Debt/Borrowings</b>	<b>1,875</b>	<b>1,920</b>	<b>1,703</b>	<b>1,269</b>
Short-term	1,743	1,753	1,524	1,269
Long-term (Incl. Current Maturity of Long-Term Debt)	131	167	178	-
Other short-term liabilities	558	381	365	382
Other long-term liabilities	-	-	-	-
<b>Shareholders' Equity</b>	<b>1,545</b>	<b>1,335</b>	<b>1,309</b>	<b>1,294</b>
<b>Total Liabilities &amp; Equity</b>	<b>3,978</b>	<b>3,636</b>	<b>3,377</b>	<b>2,945</b>

**INCOME STATEMENT**

<b>Turnover</b>	<b>3,259</b>	<b>4,021</b>	<b>3,133</b>	<b>3,829</b>
Gross Profit	483	448	394	423
Net Other Income	(6)	10	20	92
Financial Charges	(34)	(57)	(58)	(58)
<b>Net Income</b>	<b>210</b>	<b>26</b>	<b>15</b>	<b>120</b>

**Cashflow Statement**

Free Cash Flow from Operations (FCFO)	332	172	144	157
Net Cash changes in Working Capital	(154)	(254)	(267)	88
Net Cash from Operating Activities	154	(138)	(179)	184
Net Cash from Investing Activities	(104)	(93)	(260)	(385)
Net Cash from Financing Activities	(25)	217	434	197

**Ratio Analysis**

<b>Performance</b>				
Turnover Growth (vs. SPLY)	42%	28%	-18%	6%
Gross Margin	15%	11%	13%	11%
Net Margin	6%	1%	0%	3%
<b>Coverages</b>				
Interest Coverage (FCFO/Gross Interest)	9.9	3.0	2.5	2.7
Core: (FCFO) / (Gross Interest+CMLTD+Uncovered Total STB)	6.6	1.9	2.0	2.7
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	6.6	1.9	2.0	2.7
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO- Gross Interest)	0.2	1.5	2.1	0.0
<b>Liquidity</b>				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	85	134	158	126
<b>Capital Structure (Total Debt/Total Debt+Equity)</b>				
	55%	59%	57%	50%

**Eastern Garments (Pvt.) Limited**

February 2019

## Credit Rating Scale & Definitions

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 Ratings		Short Term Ratings	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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.	<b>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	Obligations are currently in default.		



**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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

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