



The Pakistan Credit Rating Agency Limited

Rating Report

Eastern Garments (Pvt.) Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
08-Aug-2019	BBB+	A2	Stable	Maintain	-
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 has recently expanded into woven denim garments. This has enabled it to diversify its sales while increasing revenues and margins which were further complimented by the currency devaluation. Margins recently showed improvement, led by a high value-added product mix, synergies achieved in denim operations and cost savings on the back of recent BMR. 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

Name of Rated Entity	Eastern Garments (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	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, 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 and 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 possesses 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 and lacks independent oversight.

Members' Profile Mr. Noor 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. He 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 & Co. is the external auditor 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 divided into various functional departments, headed by three Executive Directors. The Executive Directors in turn report to the Managing Director – Mr. Nizar – who reports to the CEO – Mr. Noor.

Management Team Mr. Nizar has been the Managing Director of Eastern Garments since 1997 and oversees the production and marketing aspects. He currently serves on the Board of Planet N Group. The executive directors also have extensive experience while 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. The production and marketing departmental heads meet with the Managing Director daily to discuss performance and issues.

MIS Eastern Garments has an in-house ERP system to aid the flow of information from all production units. Reports are regularly reviewed by the 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 In FY19, Pakistan's textile sector exports displayed negative YoY growth of ~1% in dollar terms. Even though leading textile categories including ready-made garments, knitwear and cotton cloth displayed double-digit volumetric growth, the hit to unit prices on account of exporters having to share the benefit of the currency depreciation with buyers, curbed overall growth. Meanwhile, cotton yarn exports fell by ~18% YoY, mainly driven by volumetric decline owing to the US-China trade war. Amidst rising interest rate environment, the recent removal of zero-rated status of the textile sector in the FY19-20 budget may pose a challenge to the liquidity of exporters if refunds are not timely disbursed by the government.

Relative Position Eastern Garments contributed ~1% to the Country's total export of ready-made garments and knitwear during 9MFY19. 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 Eastern Garments' sales mix equally comprises knitwear and woven garments to renowned international fashion apparel and active-wear brands. It's main market for knitwear exports is USA while woven garments are targeted towards Europe. While customer concentration is currently high, the Company is focusing on diversifying its customer base, particularly in Europe, on the back of an aggressive marketing strategy. During 9MFY19, the Company's revenue showed a significant increase of ~44% YoY, clocking in at ~PKR 4,472mln. This was driven by currency devaluation over the period, increased business with established customers as well as shifting towards higher value-added knitwear, which allowed it to benefit from higher prices, despite an overall downward trend in the Country's knitwear export prices.

Margins The Company's gross margin witnessed a sharp YoY improvement in 9MFY19, amounting to ~17% (9MFY18: ~11%). This was mainly due to overall higher product pricing, which was complimented by synergies achieved in established denim segment operations and cost savings on the back of BMR activities during recent years. This translated into an increase in operating margins as well (9MFY19: ~8%, 9MFY18: ~3%). Meanwhile, finance cost displayed a YoY increase of ~18% on the back of higher short-term borrowings to support increased working capital needs. The Company's net margin improved to ~6% (9MFY18: ~1%) while the bottomline for the period amounted to ~PKR 272mln (9MFY18: ~PKR 22mln).

Sustainability In recent years, the Company has utilized a mix of internal resources and long-term financing for capex focused towards energy efficiency, which has reflected in improved margins. Flexibility to adjust product mix in line with international trends remains a major advantage, as reflected in recent performance, and the same is likely to help sustain margins, going forward. The Company is also focusing on its marketing side and has hired a team in Italy to direct its marketing efforts in Europe, to help penetrate the woven denim garments segment.

Financial Risk

Working Capital Eastern Garments finances its working capital needs through internal cash flows as well as short term borrowings. During 9MFY19, the Company's net cash cycle decreased by ~29 days (9MFY19: 94 days, 9MFY18: 123 days) mainly owing to improved inventory management. The Company had significant finished inventory piled up to meet upcoming customer orders. With the conversion of booked orders into sales, the liquidity position is likely to improve further. Meanwhile, borrowing capacity at trade assets level is strong.

Coverages During 9MFY19, Eastern Garments' free cash flows tripled YoY on the back of significantly higher profitability. In line with this, the Company's coverages showed strong improvement, with interest coverage clocking in at 8.9x (9MFY18: 2.9x) while core coverage amounted to 5.7x (9MFY18: 2.1x). The Company's overall finance cost remains low, owing to predominant portion of borrowing being availed at the SBP's concessionary rates.

Capitalization Eastern Garments has a significantly leveraged capital structure with a leveraging ratio of ~54% (9MFY19: 57%), comprising mainly of short-term borrowing, which majorly comprises export refinance. Meanwhile, long-term financing wholly comprises the State Bank's LTFF facility. With no major upcoming capex planned, leveraging is expected to remain at largely the same level.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Eastern Garments (Private) Limited Textile Composite	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
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A BALANCE SHEET

1 Non-Current Assets	932	893	827	621
2 Investments	324	205	256	276
3 Related Party Exposure	-	-	-	-
4 Current Assets	3,202	2,538	2,294	2,048
<i>a Inventories</i>	1,892	1,616	1,607	1,463
<i>b Trade Receivables</i>	379	194	37	93
5 Total Assets	4,458	3,636	3,377	2,945
6 Current Liabilities	937	381	365	382
<i>a Trade Payables</i>	764	253	248	239
7 Borrowings	1,805	1,837	1,693	1,224
8 Related Party Exposure	109	83	10	45
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	1,607	1,335	1,309	1,294
11 Shareholders' Equity	1,607	1,335	1,309	1,294

B INCOME STATEMENT

1 Sales	4,472	4,021	3,133	3,829
<i>a Cost of Good Sold</i>	(3,733)	(3,573)	(2,740)	(3,406)
2 Gross Profit	738	448	394	423
<i>a Operating Expenses</i>	(365)	(335)	(311)	(299)
3 Operating Profit	373	113	83	123
<i>a Non Operating Income</i>	(6)	10	19	92
4 Profit or (Loss) before Interest and Tax	367	123	101	215
<i>a Total Finance Cost</i>	(51)	(57)	(58)	(58)
<i>b Taxation</i>	(44)	(40)	(28)	(37)
6 Net Income Or (Loss)	272	26	16	120

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	412	172	144	157
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	363	109	85	96
<i>c Changes in Working Capital</i>	(109)	(254)	(267)	88
1 Net Cash provided by Operating Activities	255	(144)	(182)	184
2 Net Cash (Used in) or Available From Investing Activities	(222)	(86)	(257)	(385)
3 Net Cash (Used in) or Available From Financing Activities	(6)	217	434	197
4 Net Cash generated or (Used) during the period	26	(13)	(5)	(4)

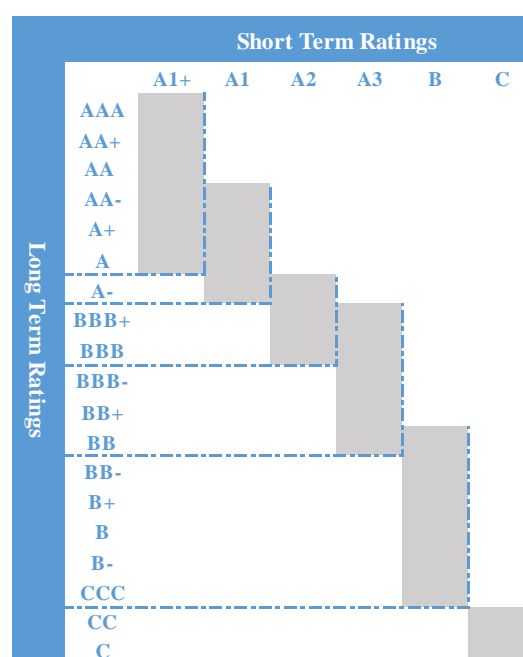
D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	48.3%	28.3%	-18.2%	6.5%
<i>b Gross Profit Margin</i>	16.5%	11.1%	12.6%	11.0%
<i>c Net Profit Margin</i>	6.1%	0.6%	0.5%	3.1%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	10.1%	5.2%	5.7%	7.2%
<i>e Return on Equity (ROE)</i>	24.6%	1.9%	1.2%	8.3%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	125	157	186	200
<i>b Net Working Capital (Average Days)</i>	94	134	158	168
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	3.4	6.7	6.3	5.4
3 Coverages				
<i>a EBITDA / Finance Cost</i>	9.7	3.6	3.5	5.7
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	5.7	1.9	2.2	3.2
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.5	2.2	2.0	0.4
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	54.4%	59.0%	56.5%	49.5%
<i>b Short-Term Borrowings / Total Borrowings</i>	87%	87%	89%	96%
<i>c Average Borrowing Rate</i>	3.2%	3.1%	3.4%	2.4%

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	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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.

Disclaimer: PACRA’s ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA’s opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

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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