The Pakistan Credit Rating Agency Limited

Rating Report

Eastern Garments (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
16-Feb-2024	A-	A2	Stable	Maintain	-
02-Mar-2023	A-	A2	Stable	Upgrade	-
05-Aug-2022	BBB+	A2	Positive	Maintain	-
06-Aug-2021	BBB+	A2	Stable	Maintain	-
07-Aug-2020	BBB+	A2	Stable	Maintain	-
08-Aug-2019	BBB+	A2	Stable	Maintain	-
06-Feb-2019	BBB+	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the strong business profile of Eastern Garments (Pvt.) Limited, an export-oriented knitwear unit, the product range includes knitted tops and bottoms, fleece tops, blankets, super/power stretches, workwear, and sportswear. The export destinations include the U.S., Europe, and Australia, out of which the U.S. holds the major portion of exports. However, the business risk remains high owing to the global knitwear industry's reliance on a few key players. During FY23, the revenue base increased by 29% to stand at PKR 16.6bln (FY22: PKR 12.9bln). Subsequently, the margins reflected an improving trend. The net profitability inclined to PKR 4.5bln (FY22: PKR 2.3bln). During 1QFY24, the top line of the company recorded at PKR 2.1bln (1QFY23: PKR 5.5bln) mainly due to demand pressure in export destinations. The financial matrix indicates a stable profile through good working capital management, strong coverages, and low leveraging. On a standalone basis, the Company's customer concentration remains high. However, comfort is drawn given its relationships with established international brands. Further, the professional management team as well as the sponsors' ability to provide support when required in the past is noted. Meanwhile, the corporate governance framework has room for improvement. Furthermore, the management is eyeing more penetration in the export markets to strengthen its customer base by establishing its own marketing department there. During FY23, textile exports were valued at $16.5 billion as against $19.33 billion, reflecting a 15% year-on-year decline – a downward trend seen since the beginning of FY23. Exports declined due to higher energy prices, cotton shortages, and uncertainty in foreign exchange rates. Taming the demand represented by export routes was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments saw an annual decline of 13 percent. Basic textiles, including raw cotton, cotton yarn, and cotton fabrics, declined by 21 percent year-on-year. During the month of June 2023, cotton yarn exports increased by 7% MoM. Value-added exports reported volume growth of 16 percent on a month-on-month basis.

The ratings are dependent upon the management's ability to capitalize on growth opportunities in a competitive landscape, operate at optimal levels, and intact margins. Moving forward, formal succession planning and improvement in the governance framework remain of vital importance.

Disclosure

Name of Rated Entity	Eastern Garments (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Composite and Garments(Dec-23)
Rating Analysts	Uswa Sikandar | uswa.sikandar@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. 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 generator.

Ownership

Ownership Structure The entire shareholding of the Company rests with the family members. The Company's shareholding is directly held equally by Mr. Noor Mohammed and his son, 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 a 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 has a two-member family dominated board. The Board is chaired by Mr. Noor Mohammed who is also the CEO while the other member is Mr. Nizar Noor (Managing Director). Both individuals participate in the operations of the Company.

Members' Profile Mr. Mohammed is an entrepreneur based in Karachi. With previous experience in the banking sector. Mr. Noor began trading in waste from 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 There is room for improvement in the governance framework as there are no formal board meetings and no management committees in place to assist the board. The Induction of independent directors and formal documentation of meeting minutes would improve the governance structure.

Financial Transparency The company has joint External Auditors; Faruq Ali & Co. Chartered Accountants and Muniff Ziauddin & Co. Chartered Accountants. The Joint auditors expressed an unqualified opinion on the company's financial statements for FY23. The company has an internal audit function in place. However, the Head of Internal Audit 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 During FY23 the country's textile exports decreased to $16.5bln, reflecting a 15% YoY decline. This decline was attributed to factors such as high energy costs, cotton shortages, and foreign exchange rate uncertainties. Value-added products like knitwear, bedwear, towels, and readymade garments witnessed a 13% YoY decline, while basic textiles, including raw cotton, cotton yarn, and cotton cloth, experienced a 21% YoY decrease. Notably, in June 2023, there was a 7% MoM increase in cotton yarn exports, and value-added exports depicted a volumetric increase of 16% on an MoM basis. Knitwear and readymade garments witnessed an 18% and 19% increase, respectively.

Relative Position Eastern Garments contributes a major portion to the country's total export of ready-made garments. The company faces competition from peers in textile finishing and garment makers including Sapphire Finishing Mills, and Style Textiles (Pvt.) Limited and Shahkam Industries (Pvt.) Limited, which are also export-oriented units focusing on value-added products, particularly garments.

Revenues Eastern Garments showed an increasing trend in revenue over the past years. During FY23, the revenue exhibited an increase of 29% YoY to stand at PKR 16,660mln (FY22: PKR 12,952mln). Eastern Garments is involved in the export of knitted and woven garments. In the past, the company's sales mix was significantly tilted toward knitted garments. The company's customer base mainly comprises fashion apparel and sportswear brands. Going forward, however, the company is focusing on diversifying its customer base. During 1QFY24, the topline of the company recorded at PKR 2,187mln (1QFY23: PKR 5,524mln).

Margins During FY23, the gross margin of the company increased to 38.5% (FY22: 25.3%). This translated into an inclined operating margin of 29% (FY22: 20.3%). The finance cost of the company increased to PKR 284mln (FY22: PKR 131mln). However, the net income inclined to PKR 4,558mln (FY22: PKR 2,399mln). Consequently, the net margin inclined to 27.4% (FY22: 18.5%). During 1QFY24, the gross margin declined to 29.2% (1QFY23: 39.9%). The finance cost increased to PKR 75mln (1QFY23: PKR 29mln). The bottom line declined to PKR 584mln (1QFY23: PKR 1,824mln). Consequently, the net margin declined to 26.7% (1QFY23: 33%).

Sustainability In recent years, the Company has utilized a mix of internal resources and long-term financing for capex focused on energy efficiency. Moreover, the management is eyeing more penetration in the export markets to strengthen its customer base by establishing its own marketing department there.

Financial Risk

Working Capital At end-Sept23, the net working capital cycle increased to 96 days (end-Jun23: 67 days) on account of increased inventory days at 95 days (end-Jun23: 75 days). The trade assets inched down to PKR 3,753mln (end-Jun23: PKR 3,775mln). ST trade leverage strengthened to 60% (end-Jun23: 44%) due to decreased ST borrowings clocking in at PKR 1,020mln (end-Jun23: PKR 1,560mln).

Coverages During FY23, the free cash flows inclined to PKR 5,379mln (FY22: PKR 2,919mln) owing to increased profitability. The finance cost paid inclined to PKR 234mln (FY22: PKR 106mln). Consequently, the interest coverage of the company declined to 25x (FY22: 37x). The debt coverage inclined to 11.2x (FY22: 8.4x). Furthermore, the debt repayment period of the company declined to 2 months (FY22: 4 months). During 1QFY24, the FCFOs decreased to PKR 914mln (1QFY23: PKR 1,922mln). The interest coverage declined to 14.2x (1QFY23: 83.1x).

Capitalization At end-Sept23, leveraging of the company decreased to 15% (end-Jun23: 20.2%) owing to an increase in the equity base clocking in at PKR 10,436mln (end-Jun23: PKR 9,576mln) attributable to enhanced profits. The total borrowings declined to PKR 1,842mln (end-Jun23: PKR 2,427mln) out of which ST borrowing constitutes 55.4%.

PKR mln

Eastern Garments (Pvt.) Limited Textile | Composite & Garments	Sep-23 3M	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	3,829	3,680	2,854	1,237
2 Investments	3,099	3,288	451	421
3 Related Party Exposure	-	-	-	-
4 Current Assets	6,927	7,238	8,097	5,745
a Inventories	*2,257*	*2,317*	*4,537*	*2,261*
b Trade Receivables	*545*	*505*	*1,001*	*525*
5 Total Assets	13,854	14,205	11,402	7,403
6 Current Liabilities	1,577	2,202	2,638	1,802
a Trade Payables	*489*	*547*	*1,679*	*1,100*
7 Borrowings	1,842	2,427	3,386	2,515
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	10,436	9,576	5,378	3,087
11 Shareholders' Equity	10,436	9,576	5,378	3,087
B INCOME STATEMENT				
1 Sales	2,187	16,660	12,952	8,541
a Cost of Good Sold	*(1,548)*	*(10,252)*	*(9,671)*	*(6,363)*
2 Gross Profit	639	6,408	3,281	2,179
a Operating Expenses	(188)	(1,574)	(657)	(510)
3 Operating Profit	450	4,834	2,623	1,669
a Non Operating Income or (Expense)	*317*	*479*	*81*	*(123)*
4 Profit or (Loss) before Interest and Tax	767	5,313	2,704	1,546
a Total Finance Cost	*(75)*	*(284)*	*(131)*	*(70)*
b Taxation	*(108)*	*(471)*	*(174)*	*(110)*
6 Net Income Or (Loss)	584	4,558	2,399	1,367
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*914*	*5,379*	*2,919*	*1,711*
b Net Cash from Operating Activities before Working Capital Changes	*822*	*5,145*	*2,813*	*1,643*
c Changes in Working Capital	*(279)*	*1,882*	*(2,293)*	*(139)*
1 Net Cash provided by Operating Activities	543	7,028	520	1,504
2 Net Cash (Used in) or Available From Investing Activities	(1)	(3,904)	(1,500)	(169)
3 Net Cash (Used in) or Available From Financing Activities	(616)	(1,331)	388	(138)
4 Net Cash generated or (Used) during the period	(74)	1,793	(592)	1,197
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-47.5%	28.6%	51.6%	30.3%
b Gross Profit Margin	29.2%	38.5%	25.3%	25.5%
c Net Profit Margin	26.7%	27.4%	18.5%	16.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	29.0%	43.6%	4.8%	18.4%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]*	23.3%	61.0%	56.7%	54.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	117	92	117	134
b Net Working Capital (Average Days)	96	67	78	93
c Current Ratio (Current Assets / Current Liabilities)	4.4	3.3	3.1	3.2
3 Coverages				
a EBITDA / Finance Cost	15.1	27.4	39.2	35.2
b FCFO / Finance Cost+CMLTB+Excess STB	9.5	11.2	8.4	7.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.2	0.2	0.4	0.3
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	15.0%	20.2%	38.6%	44.9%
b Interest or Markup Payable (Days)	45.7	89.9	107.2	138.5
c Entity Average Borrowing Rate	10.1%	7.5%	2.8%	2.1%

Credit Rating

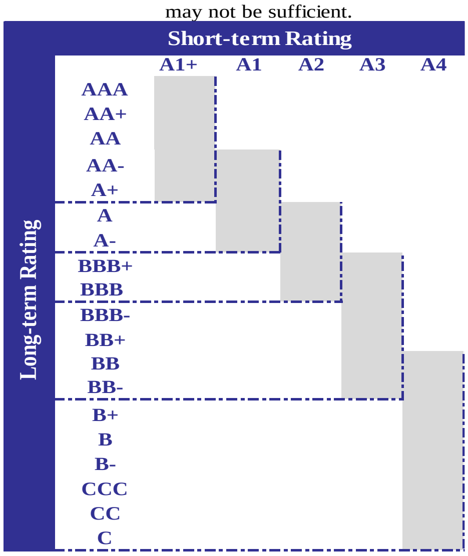
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
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.
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.
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+ 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.
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.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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 | Clause 11-(A)(p).
(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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information