

RATING REPORT

Eastern Spinning Mills Limited (ESML)

REPORT DATE:

October 15, 2018

RATING ANALYSTS:

Maimoon Rasheed

maimoon@jcrvis.com.pk

Syed Fahim Haider Shah

fahim.haider@jcrvis.com.pk

RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A-	A-1
Rating Outlook	Stable	
Rating Action	Initial	
Rating Date	October 15 th , '18	

COMPANY INFORMATION

Incorporated in 1991	External auditors: Mushtaq & Co. Chartered Accountants
Public Limited – Unquoted	Chairman of the Board/CEO: Mr. Anjum Zafar
Key Shareholders (with stake 5% or more):	
Zakia Textile Mills (Pvt.) Limited – 99%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria: Industrial Corporates (May 2016)

<http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf>

Eastern Spinning Mills Limited

OVERVIEW OF THE INSTITUTION

Eastern Spinning Mills Limited (ESML) was incorporated in 1991 and started commercial production in 1994. The company is mainly involved in manufacturing and sale cotton yarn.

Profile of the Chairman/CEO

Mr. Anjum Zafar serves as the Chairman of the Board and Chief Executive Officer (CEO) of the company. He has over 40 years of experience in leather, textile, and dairy industries.

Financial Snapshot

Total Equity: end-FY18: Rs. 2.4b; end-FY17: Rs. 2.0b; end-FY16: Rs. 2.0b

Assets: end-FY18: Rs. 3.7b; end-FY17: Rs. 2.8b; end-FY16: Rs. 2.9b

Profit/(Loss) After Tax: FY18: Rs., 369m; FY17: Rs. 78m; FY16: Rs. (193)m

RATING RATIONALE

Rating Rationale

Eastern Spinning Mills Limited (ESML) is a medium-sized spinning unit which manufacture a range of cotton yarn. ESML is a part of Eastern Group, a conglomerate having business interest in leather, textile, and dairy industries. Shareholding of the company is vested with the sponsoring family through a holding company Zakia Textile Mills (Pvt.) Limited. The assigned ratings take into account moderate business risk profile of the company underpinned by extensive experience of sponsors and established relationships with the suppliers and customers. The ratings derive support from low gearing and leverage indicators and adequate debt service coverages. However, the ratings are constrained by the vulnerability of the spinning sector to raw material prices and high customer concentration. The ratings also factors in full capacity utilization of existing spinning units and lack of expansion plan. Corporate governance framework has room for improvement.

Performance lifted by exports

ESML is an export-oriented spinning unit which can spun up to 16.5m kgs of yarn per annum from locally procured cotton. The reported net sales increased to to Rs. 5.2b during FY18 mainly on account of a notable increase in yarn exports and favorable prices. The company was able accelerate export volumes to 15.0m kgs (FY17: 14.3m kgs; FY16: 14.8m kgs) with the average selling price of Rs. 303 per kg (FY17: Rs. 274 per kg; FY16: Rs. 235 per kg). Local yarn volume sales, however, declined by 21% to 1.8m kgs (FY17: 2.3m kgs; FY16: 2.0m kgs). The overall profit margins of the company improved owing to higher prices, availability of cheaper raw material, and lower operational costs. ESML reported Rs. 369m in profit after tax during FY18 (FY17: Rs. 78m). Going forward, sales are expected to remain steady as the company is already operating at 100% capacity and currently has no expansion plan.

Improved liquidity and sound debt service coverages

The company's uses a mix of short-term borrowings and internally generation cash flows to finance working capital requirements. With notable growth in profits and fairly stable finance charges, funds from operations improved to Rs. 391m during FY18 (FY17: Rs. 114m; FY16: Rs. -102m). The sizeable growth in FFO positively impacted the debt coverage ratios. FFO to total debt stood higher at 0.44x (FY17: 0.21x; FY16: -0.16x), while the debt service coverage ratio stood higher at 4.01x (FY17: 1.13x). The current ratio remained largely stable at 2.6x at end-FY18 (FY17: 2.6x; FY16: 2.2x).

A low leveraged spinning unit

Equity base strengthened to Rs. 2.4b by end-FY18 on account of accumulation of unappropriated profits. The debt profile comprises a mix of short and long-term debt. During FY18, ESML raised a new long-term debt of Rs. 198m to finance in plant & machinery. Short-term borrowings also stood higher at Rs. 634m (FY17: Rs. 505m; FY16: Rs. 522m) mainly on account of higher working capital needs. Gearing and debt leverage indicators were reported slightly higher at 0.37x and 0.54x, respectively, and are consider lower than the peer group average. The said indicators are expected to remain at current levels as the company has no plan to mobilize notable amount of debt any further.

Lagging corporate governance and IT infrastructure

The Board of Directors comprises four family members. Informal meetings are held on ad-hoc basis and there are no Board level committees. The senior management consists of well-experienced resources from the textile industry. The company is using in-house developed ERP system for the management reporting. However, the overall corporate governance framework have notable room for improvement.

Eastern Spinning Mills Limited
Appendix I

FINANCIAL SUMMARY <i>(amounts in PKR millions)</i>			
<u>BALANCE SHEET</u>	June 30, 2016	June 30, 2017	June 30, 2018
Non-Current Assets	1,108	1,071	1,134
Stores, Spares. And Loose Tools	91	91	97
Stock-in-Trade	722	766	783
Trade Debts	338	519	815
Loans and Advances	2	20	205
Cash & Bank Balances	564	292	564
Other Assets	54	67	102
Total Assets	2,879	2,826	3,700
Trade and Other Payables	179	138	328
Short Term Borrowings	522	505	634
Long-Term Borrowings <i>(Inc. current matur)</i>	117	52	248
Other Liabilities	77	85	87
Tier-1 Equity	1,984	2,046	2,403
Total Equity	1,984	2,046	2,403
<u>INCOME STATEMENT</u>			
	June 30, 2016	June 30, 2017	June 30, 2018
Net Sales	3,981	4,647	5,164
Gross Profit	33	331	614
Operating Profit	(82)	199	487
Profit After Tax	(193)	78	369
FFO	(102)	114	391
<u>RATIO ANALYSIS</u>			
	June 30, 2016	June 30, 2017	June 30, 2018
Gross Margin (%)	0.8%	7.1%	11.9%
Net Working Capital	982	1,070	1,566
FFO to Long-Term Debt	(0.87)	2.21	1.58
FFO to Total Debt	(0.16)	0.21	0.44
Debt Servicing Coverage Ratio (x)	(0.16)	1.13	4.01
ROAA (%)	-6.3%	2.7%	11.3%
ROAE (%)	-9.1%	3.8%	16.6%
Gearing (x)	0.32	0.27	0.37
Debt Leverage (x)	0.45	0.38	0.54

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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.

JCR-VIS Credit Rating Company Limited

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

REGULATORY DISCLOSURES		Appendix III			
Name of Rated Entity	Eastern Spinning Mills Limited				
Sector	Textile				
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				
	15/10/2018	A-	A-1	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	JCR-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.				
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