The Pakistan Credit Rating Agency Limited

Textile

Nishat Mills Limited (NML)

Ratings (December 2006)
Nishat Mills Limited

	New	Previous
Entity		
Long Term (L.T)	A+	A+
Short Term (S.T)	A1	A1

Financial Data
PKR (mln)

	30-Jun-06	30-Jun-05
Total Assets	31,179.3	21,917.6
Turnover	16,417.4	11,374.6
Net Income	1,632.9	1,867.4
Gross Margin %	16.54	18.77
ROE %	9.63	16.74
Net Debt/ Equity excluding revaluation surplus %	79.19	76.97

Analysts

Sumaira Fazal
+92 42 5869504
sumaira@pacra.com

Shahzad Saleem
+92 42 5869504
shahzad@pacra.com

Rating Rationale

Assessment

- NML's ratings reflect its strong risk absorption capacity emanating from a sound capital structure supported by substantial revaluation surplus on the company's equity investment portfolio. The management continues to pursue it strategy of diversification, both in terms of products and markets, while improving production efficiency and gradually increasing the proportion of value added products in the sales mix. This strategy helps NML in maintaining its strong competitive position and in turn, low level of business risk.
- Beginning January 2006, the industry focused on freer global trading regime. This provides both opportunities and challenges for the textile exporting countries. The textile industry in Pakistan responded by injecting substantial capital investment in upgradation and expansion during the period 1999-2006. While this helped in export expansion during FY06, the momentum could not be sustained in the current financial year with decline both in global market share and in absolute levels reflecting an erosion of Pakistan's competitive edge, particularly in higher value added products. Going forward, companies that are large and vertically integrated, alongwith focus on specialized products are better placed to withstand competitive pressures. NML with its constant move towards value addition and diversification is well placed in all these areas, thereby effectively managing the intensifying competition.
- During FY06, although NML's turnover value registered a reasonable upsurge, its gross profit margins declined. This could be attributed to higher raw material prices and rising energy cost. The company's management, while maintaining its stance towards diversification, will be focusing more on improving product efficiency. This strategy would help the company in maintaining its overall core performance, going forward.
- During FY06, the company changed its accounting policy regarding investments whereby investment in associated companies is reported under equity method. This has resulted in recognition of share of profit in associated companies in income statement - substantially augmenting the bottom line - and restatement of book value of these investments resulting in substantial revaluation surplus. However, the company's 'other income' remained lower compared to the previous year due to non-replication of one-off capital gains. Meanwhile, higher financial charges, due to combined effect of increase in interest rates and high debt levels, contributed towards decline in profitability. Given the recent downturn prevailing in the cement sector, in which NML holds major investments, its income stream from investment portfolio is likely to be affected.
- The company's cash flows remained somewhat stressed owing to lower profitability and increased working capital requirement. This, together with additional borrowings to finance capex, led to a temporary dip in coverages. However, with ongoing repayment of existing debt together with a largely stable revenue stream, the company's coverges are expected to remain adequate. The company's capital structure, given high profit retention despite further borrowings, remains strong, augmented by substantial revaluation reserve on investments.

Background

- Nishat Mills Limited (NML) is the single largest textile composite unit in Pakistan. The company is a leading exporter of textile products having extensive spinning, weaving, dyeing, printing, finishing and stitching facilities at Faisalabad, Sheikhupura, Ferozewatwan and Lahore. NML is the flagship company of Nishat Group – one of the largest conglomerates with interests in the textiles, cement and financial sector. The Nishat Group family members and associated concerns collectively hold around 47% of NML's equity.
- NML's product range is composed of various varieties of yarn, grey fabric, processed fabrics and made-ups. The proportion of processed fabrics and made-ups in the total sales mix is currently less than half, but this is steadily increasing. The bulk of its earnings are export-based.
- The company's management team comprises highly qualified professionals and remains stable over the years. The strong management team ensures effective deregulation of functional responsibility across various departments facilitating a smooth flow of operations.