



The Pakistan Credit Rating Agency Limited

Rating Report

Nishat Chunian Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
16-May-2019	A	A1	Stable	Maintain	-
16-Nov-2018	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Nishat Chunian Limited's (Nishat Chunian) established business profile emanating from strong presence in textile sector. The company's revenues have grown by ~9.7% in 9MFY19 mainly augmented by operational efficiency and currency devaluation as ~56% of its revenues comprises exports. The company has significant presence in spinning sector, as it's the largest contributor to its revenue base. Prudent procurement of cotton in FY18 led to inventory gains which supplemented profitability. The company has a highly leveraged structure with borrowing utilized for working capital and capex. Working capital cycle is stretched, though in line with peers; any improvement will bring efficiency. Recent hike in interest rate may stretch the coverages though remaining at adequate level. Ratings take comfort from Nishat Chunian's dividend stream from its subsidiary – Nishat Chunian Power Limited – an Independent Power Producer. Dividend stream supports company's cashflows, strengthening its overall financial profile. The dividend income is expected to remain low due to prevailing liquidity situation in power sector.

The ratings are dependent on the management's ability to sustain its margins while improving growth in revenue. Sustainability of non-core income and prudent management of the working capital are important. Maintaining coverages amidst rising interest rates would remain critical.

Disclosure

Name of Rated Entity	Nishat Chunian Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Textile(Oct-18)
Rating Analysts	Ateeb Riaz ateeb.riaz@pacra.com +92-42-35869504

Profile

Legal Structure Nishat Chunian Limited (Nishat Chunian) is a listed concern. It commenced operations in 1991. The Company is engaged in the business of spinning, weaving, dyeing and stitching.

Background Nishat Chunian is associated with Nishat Chunian Group since its inception.

Operations Nishat Chunian's current operational capacity comprises 222,708 Spindles, 363 Looms, 2 Digital Printing Machines, 1 Rotatory Printing Machine and 1 Thermosole Dyeing Machine. Overall, Nishat Chunian has 12 manufacturing units, each specializing in a specific product range. The Company has a generation capacity of 46 MW (NC Electric Company), from which 30MW is internally consumed. The Company has a LESCO connection as well.

Ownership

Ownership Structure Nishat Chunian is the flagship company of Nishat Chunian Group. Nishat Chunian is majorly own by Saleem Family (32%) and Nishat Group (~27.3%) through individuals and corporates. Rest is well spread among corporates, financial institutions and general public.

Stability The considerable positions in Nishat Chunian are held by Saleem Family. Moreover, the next generation has joined business at various capacities. Meanwhile, succession planning of transfer of ownership is yet to be seen.

Business Acumen Nishat Chunian has a considerable position in textile composite units of Pakistan. Saleem Family's expertise in textile value chain has led the Company from single spinning unit in 1991 to one of the largest textile ventures in Pakistan, over a time span of more than two decades.

Financial Strength Nishat Chunian Group has interests in power through its subsidiaries; Nishat Chunian Power Limited and NC Electric. The continuous dividend income provides ample financial support to the Company's cash flows.

Governance

Board Structure Nishat Chunian has an eight-member board including the Chairman – Mrs. Farhat Saleem - and Chief Executive Officer (CEO), Mr. Shahzad Saleem. The board has inducted a new independent director. The board now comprises five Non-Executive, one Executive and two independent Director. The board is compliant with the Code of Corporate Governance, 2017 after this change.

Members' Profile Board members have diversified experience and relatively long association with the Company. The Chairman of the board – Mrs Farhat Saleem – holds a graduate degree. She has been associated with the Company since its inception.

Board Effectiveness The board has formed two sub-committees, namely, i) Audit Committee, and ii) Human Resource & Remuneration, to assist the board in relevant matters and ensure proper oversight. Attendance of board members in meetings remains adequate and meeting minutes are properly documented.

Financial Transparency M/s. Riaz Ahmad & Company, Chartered Accountants, is the external auditor of the Company. The auditors are in Category A of the SBP panel of auditors. The auditors have expressed unqualified opinion on the financial reports for the year ended 30th June 2018.

Management

Organizational Structure Management control vests with Saleem Family, with well-defined reporting line to ensure smooth operations.

Management Team Mr. Shahzad Saleem – the CEO – holds MBA from LUMS. The management team has significant experience and has relatively long association with the Company.

Effectiveness The Company's management meetings are held on periodic basis to ensure efficiency and strategic planning. The management tier ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations.

MIS Nishat Chunian has in place Oracle based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting. Also, the production facilities are connected with corporate office through multiset (VPN), resulting in real-time reporting.

Control Environment The Company is compliant with multiple safety and quality assurance standards; including GOTS, Oeko-Tex, ISO 9001, GOTS and BCI certification.

Business Risk

Industry Dynamics Textile exports of the country grew by ~9% in FY18, backed by devaluation of the rupee, bailout package from the government and GSP Plus Scheme of the EU. During 9MFY19, however, exports stagnated. Even though major segments including cotton cloth, knitwear, garments and bedwear displayed volumetric growth, industry players needed to share the benefit of the currency depreciation with their buyers which resulted in a unit price dip across all major categories, curbing overall growth. This, coupled with cotton yarn displaying double-digit volumetric decline on account of the US-China trade war as well as strong domestic demand for yarn, resulted in overall increase in exports of only ~0.1% YoY. Going forward, the devalued currency, recently announced relief in electricity tariffs for textile players and expected payment of tax refunds is expected to boost exports.

Relative Position Nishat Chunian is one of the largest textile composite unit of Pakistan with considerable representation in spinning sector when compared to peers. Moreover, the Company is one of the leading exporters with ~1.2 % (FY18) share in country's total textile exports.

Revenues Sales mix of Nishat Chunian continued to be dominated by Spinning segment as the key revenue contributor (~59%), followed by Home Textile and Dyeing (~25%), and Weaving (~16%) segment. During 9MFY19, the Company's topline rose by ~13%, due to rupee devaluation.

Margins The Company's gross margins stood at 13% during 9MFY19 (9MFY18: 10.2%), due to prudent inventory procurement. The Company's operating profits improved (9MFY19: PKR 2,884mln, 9MFY18: PKR 1,795mln), portraying higher operating margins (9MFY19: ~9.9%, 9MFY18: ~7.0%). Interest expense increased (~50% YoY) on the back of increased short-term borrowings and hike in benchmark rate. Net profitability increased by ~103% YoY to report at PKR 2,441mln in 9MFY19 (9FY18: PKR 1,203mln), mainly due to significant foreign exchange gain during the period.

Sustainability Nishat Chunian maintains a substantial investment portfolio comprising strategic holdings (PKR 3,087mln) – ~21% of equity of Nishat Chunian at end-Mar19. Moreover, the Company has incurred a BMR of ~ PKR 5.3bln during last three years to ensure better capitalization of local as well as export market with improved efficiency.

Financial Risk

Working Capital The Company meets its working capital requirements through a mix of internal cash generation and short-term borrowings. The considerable increase in inventories due to stocking in peak season, lead to increase in working capital days (gross – 9MFY19: 200days, 9MFY18, 171days, net – 9MFY19: 189days, 9MFY18: 162days). The Company's short-term borrowings increased (9MFY19: PKR 23,519mln, 9MFY18: PKR 17,122mln) to finance the increased stock levels.

Coverages During 9MFY19, the Company's operating cash flows (FCFO) increased by ~44% (9MFY19: PKR 4,018mln, 9MFY18: PKR 2,793mln) – largely due to improved profitability and higher top line. However, interest coverages remained stable (9MFY19: 3.0x, 9MFY18: 3.0x), and the debt coverage improved slightly (9MFY19: 1.8x, 9MFY18: 1.3x). Moreover, the Company receives a continuous stream of dividend income from Chunian Power - subsidiary, supplementing its total cash flows (FY18: PKR 188mln). Going forward, recent hike in interest rates may stretch the coverages.

Capitalization Nishat Chunian has a significantly leveraged capital structure. It stood at ~ 66% during 9MFY19 (9MFY18; 65.5%), out of total leveraging, ~82.2% (9MFY18: ~72.0%) of debt comprises current debt.



Nishat Chunian Limited

Listed Public Limited

A BALANCE SHEET	Mar-19 9M	Jun-18 12M	Jun-17 12M	Jun-16 12M
1 Non-Current Assets	11,175	11,398	12,013	9,496
2 Investments	3,087	3,187	3,902	3,413
a Equity Instruments	3,087	3,187	3,902	3,413
b Debt Instruments	-	-	-	-
3 Current Assets	32,375	24,117	17,676	15,408
a Inventory	18,332	10,447	8,650	6,858
b Trade Receivables	5,817	8,125	5,173	5,199
c Others	8,226	5,545	3,852	3,351
4 Total Assets	47,698	39,394	34,622	28,884
5 Borrowings	28,605	23,195	20,888	15,781
a Short-Term	23,519	17,022	15,237	12,120
b Long-Term (Incl. CMLTB)	5,087	6,173	5,652	3,661
6 Other Short-Term Liabilities	4,123	2,488	1,726	2,116
7 Other Long-Term Liabilities	-	-	-	-
8 Shareholder's Equity	14,970	13,710	12,008	10,987
9 Total Liabilities & Equity	47,698	39,394	34,622	28,884

B INCOME STATEMENT

1 Sales	29,251	35,560	29,816	25,799
2 Gross Profit	3,801	4,271	2,900	2,455
3 Non Operating Income	1,437	1,003	923	1,094
4 Total Finance Cost	(1,517)	(1,383)	(1,095)	(1,030)
5 Net Income	2,441	2,363	1,621	1,329

C CASH FLOW STATEMENT

1 Free Cash Flow from Operations (FCFO)	4,018	4,641	2,481	1,872
2 Total Cashflows (TCF)	4,018	4,828	3,372	2,998
3 Net Cash changes in Working Capital	(6,767)	(5,563)	(2,087)	(1,293)
4 Net Cash from Operating Activities	(3,883)	(2,101)	241	646
5 Net Cash from Investing Activities	(624)	479	(4,756)	(1,500)
6 Net Cash from Financing Activities	4,459	1,654	4,511	(67)
7 Net Cash generated during the period	(48)	32	(4)	(921)

D RATIO ANALYSIS

1 Performance				
a Sales Growth (for the period)	10%	19%	16%	#DIV/0!
b Gross Profit Margin	13%	12%	10%	10%
c Net Profit Margin	8%	7%	5%	5%
d Return of Equity	23%	18%	14%	12%
2 Working Capital Management				
a Gross Working Capital (Inventory Days + Receivable Days)	199.9	166.3	158.4	161.7
b Net Working Capital (Inventory Days + Receivable Days - Payable Days)	189.3	159.1	149.3	147.9
3 Coverages				
a Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	1.8	1.7	1.1	0.7
b Interest Coverage (FCFO / Finance Cost)	3.0	3.8	2.5	2.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.4	1.8	3.8	3.9
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Capital Structure (Current Borrowings / Total Borrowings)	189	159	149	148
b Capital Structure (Total Borrowings / Total Borrowings+Equity)	66%	63%	63%	59%

May-19

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.

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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

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- (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.
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- (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)
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- (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)

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- (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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