



The Pakistan Credit Rating Agency Limited

Rating Report

Nishat Chunian 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
15-Nov-2019	A	A1	Stable	Maintain	-
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' or 'The Company') established business profile emanating from strong presence in textile sector. As an export oriented unit, the Company posted growth of 10.6% in FY19 mainly augmented by operational efficiency and currency devaluation. The Company has significant presence in spinning sector, as it's the largest contributor to its revenue base. Prudent procurement of cotton in FY19 led to inventory gains and better margins, supplementing profitability. The Company has a highly leveraged structure with borrowing utilized for working capital and CAPEX. Working capital cycle remains stretched, though in line with peers; any improvement will bring efficiency. The Company has extended loans to group entities resulting in higher leveraging. The ratings take comfort from Nishat Chunian's dividend stream from its subsidiary – Nishat Chunian Power Limited – an Independent Power Producer. The dividend income is expected to remain low due to prevailing liquidity situation in the power sector.

The ratings are dependent on the management's ability to sustain growth in revenue while improving margins. 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-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Weaving(Sep-19)
Rating Analysts	Muhammad Hassan muhammad.hassan@pacra.com +92-42-35869504

Profile

Legal Structure Nishat Chunian Limited ('Nishat Chunian' or 'The Company') is a listed concern that commenced operations in 1991. It is a composite textile company engaged in the business of spinning, weaving, dyeing, stitching and power generation.

Background Nishat Chunian is the flagship company of 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 Dying 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. It is majorly owned by Shahzad Saleem Family (28.4%) and Nishat Group (27.6%) through individuals and group companies. Remaining shareholding is well spread among corporates, financial institutions and general public.

Stability The considerable positions in Nishat Chunian are held by Shahzad 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 strong position among textile composite units of Pakistan. Shahzad 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 interest in power sector through its subsidiary; Nishat Chunian Power Limited. The dividend from this ventures provided financial support to the Company's cash flows in the past.

Governance

Board Structure Nishat Chunian has an eight-member board including the Chairman, Mrs. Farhat Saleem, and the Chief Executive Officer (CEO), Mr. Shahzad Saleem. The board comprises of four Non-Executive, two Executive and two Independent Directors. The board is compliant with the Code of Corporate Governance.

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 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 2019.

Management

Organizational Structure Management control vests with Shahzad 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 management holds meetings on periodic basis to ensure efficiency and strategic planning. The management tier ensures effective delegation of functional responsibility across various departments, facilitating smooth flow of operations.

MIS Nishat Chunian has Oracle based Enterprise Resource Planning (ERP) system in place that provides comprehensive MIS reporting. 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 The export performance of Pakistan's textile industry remained stagnated during FY19, despite ~34% currency devaluation and incentives introduced by the government to promote exports. Meanwhile, cotton yarn exports witnessed a ~18% decline driven by US-China trade war. Cotton crop for the year is expected to be lower than last last year due to crop diseases and late rainfall. The revised target of cotton crop for FY20 is 10mln bales, down by 7% from FY19. This will result in the need to import 4-5mln bales, making for much costlier input, given the current duty structure on imported cotton. Meanwhile, higher interest rates along with withdrawal of zero-rating status is expected to put the overall liquidity of textile industry under pressure. These factors are likely to impact margins of textile companies, going forward.

Relative Position Nishat Chunian is one of the largest textile composite units in Pakistan with considerable representation in spinning sector, when compared to peers. Moreover, the Company is one of the leading exporters with ~1% (FY19) 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 (60%), followed by Home Textile and Dyeing (26%), and Weaving (14%). During FY19, the Company's top line rose by 10.6% to PKR 39,338mln (FY18: 35,560mln) due to expansion in local market share (mainly in spinning and home textile segments) and capitalization on currency devaluation. This growth trend continued in 1QFY20, with top line rising to PKR 9,549mln (1QFY18: PKR 9,227mln).

Margins The Company's gross margin slightly increased to 12.4% during FY19 (FY18: 12%) while its operating margin improved to 9.3% (FY18: 8.8%) due to prudent inventory procurement and better pricing. The net profit margin also increased to 8% (FY18: 6.6%) mainly due to significant foreign exchange gain during the period. The Company posted net income of PKR 3,168mln (FY18: PKR 2,363mln). During 1QFY20, the margins mostly remained stable with gross profit margin clocking in at 12.5% and operating profit margin at 9.3%. Net profit margin in 1QFY19 dropped to 1.8% (1QFY18: 9.2%) due to higher in finance cost by two folds and no dividend income as net income dropped significantly to PKR 172mln (1QFY19: PKR 852mln).

Sustainability Nishat Chunian maintains a substantial investment portfolio comprising strategic holdings (PKR 3,309mln) – ~21% of Nishat Chunian's equity at June 30th, 2019. Moreover, the Company has incurred a BMR of PKR 5.3bln during previous few years to optimize capacity and improve efficiency. The dividend inflow from subsidiary may slowdown. This coupled with higher finance cost, could impact the Company's performance.

Financial Risk

Working Capital The Company meets its working capital requirements through a mix of internal cash generation and short-term borrowings. During FY19, inventory increased considerably (by 50%) due to stocking in peak season, which led to increase in net working capital days to 180days (FY18: 159days). The Company's short-term borrowings during FY19 also increased to PKR 20,092mln (FY18: PKR 17,022mln) to procure higher amounts of inventory. During 1QFY20, net working capital cycle clocked in at 189days and short term borrowings stood at PKR 19,449mln.

Coverages During FY19, the Company's operating cash flows (FCFO) increased by 17% (FY19: PKR 5,429mln, FY18: PKR 4,641mln) – largely due to improved profitability and higher top line. However, interest coverage ratio dropped to 2.6x and debt coverage ratio to 1.7x, due to significant increase in finance cost. During 1QFY20, interest coverage ratio came down to 1.7x and debt coverage ratio at 1.2x due to lower FCFO.

Capitalization Nishat Chunian has a significantly leveraged capital structure. During FY19, leveraging stood at 62% (FY18: 63%). Out of total leveraging, 82% debt comprises short term borrowing (FY18: 73%). Share of debt from SBP's concessionary rates in total debt stood at 41% during FY19. Leveraging during 1QFY20 mostly remained the same and stood at 61%.



Nishat Chunian Limited Textile	Sep-19 3M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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A BALANCE SHEET

1 Non-Current Assets	11,084	11,155	11,398	12,013
2 Investments	-	-	-	-
3 Related Party Exposure	5,875	4,603	3,879	4,934
4 Current Assets	26,980	27,750	24,117	17,676
<i>a Inventories</i>	14,834	15,721	10,447	8,650
<i>b Trade Receivables</i>	5,116	6,426	8,125	5,173
5 Total Assets	43,939	43,508	39,394	34,622
6 Current Liabilities	4,628	3,326	2,488	1,726
<i>a Trade Payables</i>	1,500	1,073	882	518
7 Borrowings	23,800	24,843	23,195	20,888
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	15,512	15,338	13,710	12,008
11 Shareholders' Equity	15,512	15,338	13,710	12,008

B INCOME STATEMENT

1 Sales	9,549	39,338	35,560	29,816
<i>a Cost of Good Sold</i>	(8,353)	(34,450)	(31,289)	(26,916)
2 Gross Profit	1,196	4,888	4,271	2,900
<i>a Operating Expenses</i>	(305)	(1,222)	(1,131)	(949)
3 Operating Profit	891	3,665	3,141	1,951
<i>a Non Operating Income</i>	21	2,181	1,003	923
4 Profit or (Loss) before Interest and Tax	912	5,846	4,143	2,873
<i>a Total Finance Cost</i>	(619)	(2,178)	(1,383)	(1,095)
<i>b Taxation</i>	(120)	(501)	(397)	(157)
6 Net Income Or (Loss)	173	3,168	2,363	1,621

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	987	5,429	4,641	2,481
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	539	3,950	3,462	2,328
<i>c Changes in Working Capital</i>	2,855	(3,268)	(5,563)	(2,087)
1 Net Cash provided by Operating Activities	3,394	681	(2,101)	241
2 Net Cash (Used in) or Available From Investing Activities	(2,062)	(1,081)	479	(4,756)
3 Net Cash (Used in) or Available From Financing Activities	(1,043)	341	1,654	4,511
4 Net Cash generated or (Used) during the period	288	(59)	32	(4)

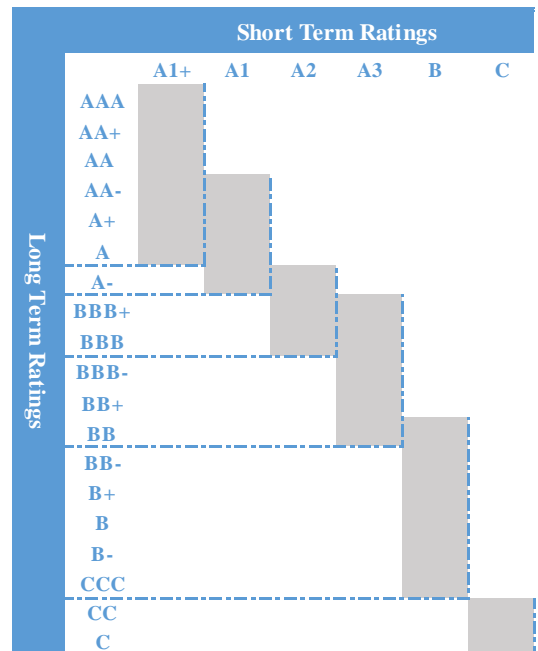
D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	-2.9%	10.6%	19.3%	15.6%
<i>b Gross Profit Margin</i>	12.5%	12.4%	12.0%	9.7%
<i>c Net Profit Margin</i>	1.8%	8.1%	6.6%	5.4%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	11.1%	14.7%	13.7%	9.7%
<i>e Return on Equity (ROE)</i>	4.5%	21.8%	18.4%	14.1%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	201	189	166	169
<i>b Net Working Capital (Average Days)</i>	189	180	159	160
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	5.8	8.3	9.7	10.2
3 Coverages				
<i>a EBITDA / Finance Cost</i>	1.8	2.8	4.0	2.9
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.2	1.7	1.7	1.1
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	2.7	1.4	1.8	3.8
4 Capital Structure (Total Debt/Total Debt+Equity)				
<i>a Total Borrowings / Total Borrowings+Equity</i>	60.5%	61.8%	62.9%	63.5%
<i>b Short-Term Borrowings / Total Borrowings</i>	0.8	0.8	0.7	0.7
<i>c Average Borrowing Rate</i>	9.6%	8.6%	5.6%	5.5%

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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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

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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.
- (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)

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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)

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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