The Pakistan Credit Rating Agency Limited

Rating Report

Nishat Mills Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
17-May-2019	AA	A1+	Stable	Maintain	-
15-Nov-2018	AA	A1+	Stable	Maintain	-
25-Apr-2018	AA	A1+	Stable	Maintain	-
30-Jun-2017	AA	A1+	Stable	Maintain	-
27-Sep-2016	AA	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect established position as a premier export-oriented composite unit which is supplemented by a sizable strategic portfolio and conservative capital structure. The Company enjoy's prominence in textile sector due to wide array of its products, extensive outreach and stable customer base. Recent currency devaluation, coupled with incentives for export-oriented units, has boded well for the core operations resulting in better margins. The diverse and sizable investment portfolio, emanating from the Company's implicit Holdco status within the Group, generates regular divided stream, supporting core income. The stock market has been on a downwards trend lately. This has impacted the investments and equity of the Company. Nishat Mills continues to maintain a low leveraged capital structure and strong coverages signifying its very strong financial profile. The Company's association with Nishat Group as its flagship entity, remains a key rating factor.

The ratings are dependent on the Company's ability to sustain its core margins and profitability. Preserving low leveraged capital structure and sound coverages remain important. Meanwhile, further strengthening the governance framework is considered positive for the ratings.

Disclosure	
Name of Rated Entity	Nishat Mills 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	Muhammad Hassan | muhammad.hassan@pacra.com | +92-42-35869504

Profile

Legal Structure Nishat Mills Limited (Nishat Mills), a listed concern, which commenced operations in 1951.

Background Nishat Mills is the flagship company of Nishat Group since its inception. Nishat Group is one of the renowned business conglomerates in Pakistan.

Operations Nishat Mills' current operational capacity comprises 238,032 Spindles, 794 Looms, 1200 rotors, 4 Rotary Printing Machines, 10 Digital Printing Machine, 5 Thermosole Dyeing and 4,239 Stitching Machines. Overall, Nishat Mills has 32 manufacturing units each specializing in a specific product range. The total energy requirement of the Company is ~50 MW, which is met through in-house generation. Meanwhile, the Company has WAPDA connections as alternative source.

Ownership

Ownership Structure Nishat Mills is the flagship company of Nishat Group. Mian Mansha’s family collectively owns majority (~51%) shares of the Company, directly through individuals (~42%) and group companies (~8%). Remaining (~49%) stake is spread among financial institutions, companies and general public.

Stability Mansha Family members hold prominent positions in Nishat Mills. Moreover, the next generation is already in business, serving at various capacities in Nishat Group. Roles are functionally divided among brothers.

Business Acumen Nishat Mills is among the pioneers of progressive textile manufacturers of Pakistan, with almost seven decades of presence in the textile industry. The sponsors have seen several economic cycles and kept growth trend intact to become the leading textile concern in the country.

Financial Strength Nishat Group is one of the most distinguished business groups in Pakistan. The Group maintains substantial presence in the country's financial sector and has strong foothold in textile, cement, power, dairy and hospitality sectors. Recently, the Group has entered Pakistan's automobile assembly industry through joint collaboration with Hyundai Motors.

Governance

Board Structure The board comprises seven members with two directors representing the sponsoring family – including the Chairman – Mr. Hassan Mansha and the CEO. The remaining directors include one independent member, one executive director, while all other members are non-executive directors working with Nishat Group entities. In March 2019, after the demise of Khalid Qadeer Qureshi, Mr. Mahmood Akhter has been appointed in his place on the board.

Members’ Profile Board members have diversified experience and relatively long association with the Company. The Chairman of the board – Mr. Hassan Mansha – carries with him over two decades of experience in textile value chain.

Board Effectiveness Appropriate board size and presence of independent oversight bodes well with the effective governance. The governance framework can be strengthened through induction of independent director or representation of other shareholders. Meanwhile, the Company’s board has two board committees, Audit and Human Resource & Remuneration Committee, to assist the board on relevant matters.

Financial Transparency M/s. Riaz Ahmad & Company, Chartered Accountants, are the external auditor of the Company. The auditors have expressed unqualified opinion on the financial reports for the periods ended 30th June 2018 and 31st Dec 2018.

Management

Organizational Structure Management control vests with Nishat Group, with well-defined reporting line to ensure smooth operations and efficiency.

Management Team Mr. Umer Mansha – the CEO – primarily manages the Company’s affairs and is supported by a team of seasoned professionals. Mr. Umer Mansha is associated with the Company since 1994. Recently, Mr. Muhammad Azam has replaced Mr. Badaral-ul-Hassan in the capacity of CFO. Previously, Mr. Muhamad Azam was serving as GM Finance in the Company.

Effectiveness The Company’s management meetings are held on periodic basis to ensure efficiency and formulate strategic plans. The top management tier ensures effective delegation of functional responsibility across various departments, facilitating smooth flow of operations. The Company’s monthly MIS comprises comprehensive segment and unit wise performance reports including, daily raw material consumption, production, inventory status and monthly pricing analysis, comparison of actual vs. budgeted performance, export vs. imports and plant efficiency reports.

MIS Nishat Mills deploys Oracle based Enterprise Resource Planning (ERP) system that provides comprehensive MIS reporting.

Control Environment The Company is accredited with International certifications for compliance. Nishat Mills has valid certificates for its products and facilities and is periodically audited by internationally recognized certification bodies.

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 shared the benefit of the currency depreciation with their buyers, which resulted in a unit price dip across almost all major categories, curbing overall growth. Going forward, the devalued currency, recently announced relief in electricity tariffs for textile players as well as expected payment of tax refunds is expected to boost exports.

Relative Position Nishat Mills is the largest composite textile unit in Pakistan with considerable representation, throughout textile value chain. The Company is leading exporter with ~2% (FY18) share in country’s total textile exports. Nishat Mills’ major competitors are Gul Ahmed and Kohinoor Textile.

Revenues During 9MFY19, the Company’s top-line clocked in at ~PKR 47,159mln, posting a growth of ~22%. This is largely attributable to better pricing in local market and better export market for value added products. Moreover, continuous BMR activities led to higher volumetric growth. The sales mix of Nishat Mills continued to be dominated by Processing & Home textile (P&HT) segment as the key revenue contributor (~46%), followed by weaving (~23%), spinning (~22%) and garment (~9%) segments.

Margins The Company’s gross margin has shown improvements (9MFY19: 12.8%, 9MFY18: 9.8%), owing to better pricing and cost efficiency through BMR. Additionally, the subsidized gas and electricity tariff have further lowered the conversion cost. Collectively, these factors have translated into higher gross margins. Despite higher distribution cost due to export oriented nature, operating margin has improved (9MFY19: 6.7%, 9MFY19: 3.1%). The Company received dividend income of ~PKR 1,717mln (9MFY18: PKR 2,448mln), though it has declined due to lower dividend from IPP's. Despite the increase in finance cost, the Company’s net margin has improved (9MFY19: 8.8%, 9MFY18: 7.2%) as it booked net profit of PKR 4,137mln (9MFY18: PKR 2,765mln).

Sustainability The Company is continuously in process of up gradation and expansion, as evident from BMR of ~PKR 11bln in last three years. This has ensured better quality production with higher efficiency. In 9MFY19, the Company has added 1 open end Spinning unit of 1,200 automatic rotors at a cost of PKR 541mln. The Company intends to double the rotors capacity and add a towel factory of 20 Tons capacity. Further 2 million meters monthly processing plant is being planned for Home Textile Division. Meanwhile, the management continues its focus on product quality, innovation and value addition to coup with fast changing dynamics of the global textile industry. Moreover, the Company maintains a hefty investment portfolio, constituting ~57% (9MFY19) of its equity base. The investment mainly comprises strategic holdings along with interest bearing debt to Group companies.

Financial Risk

Working Capital The Company meets its working capital requirements through a mix of internal generation and short-term borrowings (STBs). Though payables were stretched to an extent, higher receivables and inventory days led to increased net working capital days (9MFY19: 95days, 9MFY18: 78days).

Coverages During 9MFY19, Nishat Mills’ financial risk profile has improved on the back of better operating cashflows (FCFO) – 9MFY19: PKR 4,589mln, 9MFY18: PKR 2,593mln – as the Company enjoyed higher profitability. This, coupled with lower than proportionate increase in finance cost, led to improved interest (9MFY19: 5.2x, 9MFY18: 4.8x) and debt coverages (9MFY19: 2.1x, 9MFY18: 1.2x). At the same time, the dividend income from investment has provided additional comfort to the Company’s financial profile.

Capitalization Nishat Mills has a low leveraged capital structure ~31% (9MFY18: 21%). Although leveraging increased on account of higher borrowings and lower equity, it remains manageable. Out of total debt PKR 32,771mln, the current debt comprises ~83%.

PKR mln

Nishat Mills Limited
Listed Public Limited

		Mar-19	Jun-18	Jun-17	Jun-16
A	**BALANCE SHEET**	9M	12M	12M	12M
1	Non-Current Assets	**29,213**	**28,471**	**28,057**	**24,877**
2	Investments	**41,394**	**47,803**	**63,011**	**57,937**
a	Equity Instruments	40,933	47,339	62,544	57,464
b	Investment Property	461	465	467	473
c	Others (including loans and advances)	**5,284**	**3,833**	**5,355**	**3,738**
3	Current Assets	**37,185**	**22,629**	**21,107**	**20,048**
a	Inventory	20,594	12,244	12,723	9,934
b	Trade Receivables	6,669	4,030	2,246	2,253
c	Others	9,923	6,356	6,139	7,861
4	Total Assets	**113,076**	**102,736**	**117,530**	**106,599**
5	Borrowings	**32,771**	**19,843**	**22,036**	**17,086**
a	Short-Term	25,548	12,508	14,697	10,476
b	Long-Term (Incl. CMLTB)	7,223	7,336	7,339	6,610
6	Other Short-Term Liabilities	8,325	6,608	5,948	7,097
7	Other Long-Term Liabilities	219	572	783	262
8	Shareholder's Equity	**71,761**	**75,713**	**88,763**	**82,155**
9	Total Liabilities & Equity	**113,076**	**102,736**	**117,530**	**106,599**
B	**INCOME STATEMENT**				
1	Sales	**47,159**	**53,729**	**49,248**	**47,999**
2	Gross Profit	6,039	5,550	5,380	6,264
3	Operating Expense	(2,861)	(3,512)	(3,497)	(3,255)
4	Non Operating Income/Expense	2,698	3,914	3,940	3,611
5	Total Finance Cost	(1,189)	(994)	(915)	(1,046)
6	Taxation	(551)	(860)	(758)	(802)
7	Net Income	**4,137**	**4,098**	**4,151**	**4,772**
C	**CASH FLOW STATEMENT**				
1	Free Cash Flow from Operations (FCFO)	4,589	3,745	3,668	4,163
2	Total Cashflows (TCF)	6,541	7,316	7,203	7,976
3	Net Cash changes in Working Capital	(9,836)	(596)	(4,129)	1,696
4	Net Cash from Operating Activities	(4,398)	5,725	2,157	8,517
5	Net Cash from InvestingActivities	(6,843)	(1,719)	(7,428)	(3,077)
6	Net Cash from Financing Activities	11,270	(3,944)	3,201	(3,378)
7	Net Cash generated during the period	28	61	(2,071)	2,063
D	**RATIO ANALYSIS**				
1	Performance				
a	Sales Growth (for the period)	22%	9%	3%	-6%
b	Gross Profit Margin	13%	10%	11%	13%
c	Net Profit Margin	9%	8%	8%	10%
d	Return of Equity	7%	5%	5%	6%
2	Working Capital Management				
a	Gross Working Capital (Inventory Days + Receivable Days)	126.4	106.1	100.6	97.2
b	Net Working Capital (Inventory Days + Receivable Days - Payable Days)	95.1	75.7	70.8	71.4
3	Coverages				
a	Debt Service Coverage (FCFO / Finance Cost+CMLTB+Excess STB)	2.1	1.3	1.3	1.5
b	Interest Coverage (FCFO / Finance Cost)	5.2	5.1	5.4	5.2
c	Total Operating Coverage (TCF / Finance Cost+CMLTB+Excess STB)	3.0	2.5	2.6	2.9
d	Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.5	2.4	2.5	2.0
4	Capital Structure (Total Debt/Total Debt+Equity)				
a	Capital Structure (Current Borrowings / Total Borrowings)	83%	74%	76%	73%
b	Capital Structure (Total Borrowings / Total Borrowings+Equity)	31%	21%	20%	17%

Credit Rating Scale & Definitions

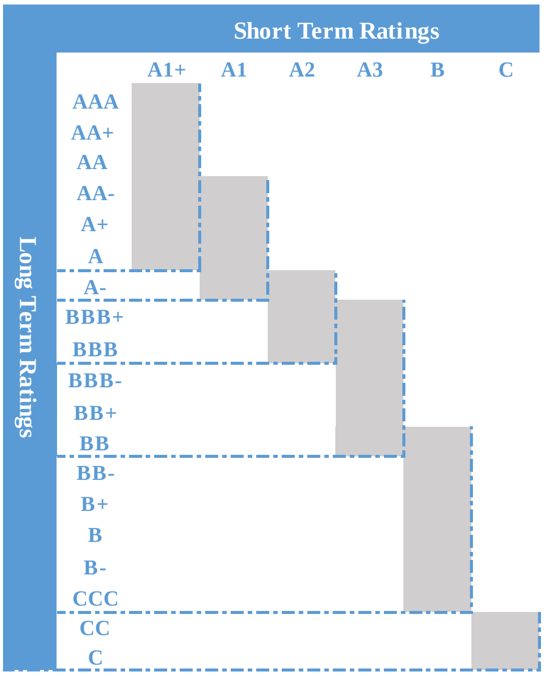
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

Rating	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 Ratings

Rating	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 conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

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.
(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 | 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)
Proprietary Information