The Pakistan Credit Rating Agency Limited

Rating Report

Nishat Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
15-Nov-2019	AA	A1+	Stable	Maintain	-
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	-
28-Oct-2015	AA	A1+	Stable	Maintain	-
10-Jan-2015	AA	A1+	Stable	Upgrade	-
10-Jan-2014	AA-	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect established position of Nishat Mills as the a premier export-oriented composite unit, with 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. Meanwhile, the Company's revenues are consistently on growing trajectory, a factor of continuous BMR activities, which has helped the Company in maintaining its leading position. Currency devaluation in FY19, coupled with incentives for export-oriented units, boded well for the core operations resulting in better margins and profitability during FY19. 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 volatility in stock market has impacted the investments and equity of the Company in recent times. 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 imperative. Meanwhile, further strengthening the governance framework, in line with best practices is considered important.

Disclosure	
Name of Rated Entity	Nishat Mills 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 Mills Limited ("Nishat Mills" or the "Company") is a listed concern, which commenced operations in 1951.

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

Operations Nishat Mills' current operational capacity comprises 238,032 Spindles, 794 Looms, 1,200 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 LESCO & FESCO connections as alternative sources.

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 three brothers.

Business Acumen Nishat Mills is among the pioneers of progressive textile manufacturers of Pakistan, with approximately seven decades of presence in the textile value chain. 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 and the CEO. The remaining directors include one independent member, one executive director, while all other members are non-executive directors working with other Nishat Group entities.

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 the textile value chain.

Board Effectiveness Appropriate board size and presence of independent oversight bodes well for effective governance. The governance framework can be strengthened through induction of more independent directors in line with requirements of SECP. 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, listed on panel of SBP, are the external auditor of the Company. The auditors have expressed unqualified opinion on the financial statements for the period ending FY19.

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.

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 to ensure compliance.

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 Mills is the largest composite textile unit in Pakistan with considerable representation, throughout textile value chain. The Company is leading exporter with ~2.3% (FY19) share in the country's total textile exports. Nishat Mills' major competitors are Gul Ahmed, Kohinoor Textile and Sapphire.

Revenues During FY19, the Company's top-line clocked in at ~PKR 63,499mln, posting a growth of ~18%. The growth is driven by i) better pricing in local market, ii) higher exports proceeds of value added products and iii) continuous BMR activities leading to higher volumetric growth. The sales mix of Nishat Mills continued to be dominated by exports ~76% (FY18: 75%). The Company's revenues grew YoY by ~11% in 1QFY20 and reported at PKR 16,933mln.

Margins The Company's gross margin has shown improvement (FY19: 13.5%, FY18: 12.6%), owing to better pricing and cost efficiency through BMR. Additionally, the subsidized gas and electricity tariff have further lowered the conversion cost. Despite higher distribution cost due to export oriented nature, operating margin has improved (FY19: 7%, FY18: 6.3%). The Company received dividend income of ~PKR 3,030mln (FY18: PKR 3,391mln) which declined due to lower dividend from D. G. Khan Cement. Despite higher finance cost, notable exchange gain (FY19: PKR1,438mln) led to better net margin (FY19: 9.2%, FY18: 7.6%) as the Company posted net profit of PKR 5,859mln (FY18: PKR 4,098mln). In 1QFY20, the Company's margins further improved (gross: 13.5%, operating: 7.0%) due to better performance of value added segments mitigating restrained performance of spinning and weaving segment. Exchange loss and higher finance cost had limited the Company's net profits (1QFY20: PKR 924mln, 1QFY19: 995mln) despite considerable revenue growth.

Sustainability The Company is continuously in the process of up gradation and expansion, as evident from BMR of ~PKR 13bln in last three years. This has ensured better quality production with higher efficiency. 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. The Company maintains a hefty investment portfolio, constituting ~65% (FY19) of its equity base. The investments mainly comprise 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 stagnated inventory days led to marginal increase in net working capital days (FY19: 78days, FY18: 76days). Whereas in 1QFY20, inventory days were higher (YoY basis) due to seasonal cotton procurement. resulting in slight increase in net working capital days.

Coverages During FY19, Nishat Mills' financial risk profile improved on the back of better operating cashflows (FCFO) – FY19: PKR 5,413mln, FY18: PKR 3,745mln – as the Company enjoyed higher profitability. Significant increase in finance cost led to declined interest coverage (FY19: 3.9x, FY18: 5.1x). On the contrary, debt coverages improved (FY19: 1.7x, FY18: 1.3x) because of lower CMLTD along with higher quantum of FCFO. The Company receives a continuous stream of dividends and interest income from associated companies, which supplements its total cash flows. In 1QFY20 the Company's coverages improved (Interest Coverage: 6.3x and Debt Coverage: 2.3x) on account of higher FCFO generation.

Capitalization Nishat Mills has a low leveraged capital structure ~27.3% (FY18: 20.8%). Although leveraging increased on YoY basis but still remains a relatively low leveraged company. Out of total debt PKR 25,027mln, STB comprises ~72%. Leveraging largely stagnated in 1QFY20.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Nishat Mills Limited	Sep-19	Jun-19	Jun-18	Jun-17
Composite	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	29,849	29,358	28,471	28,057
2 Investments	702	1,020	3,035	2,992
3 Related Party Exposure	40,903	41,641	48,601	65,375
4 Current Assets	28,835	28,527	22,629	21,107
a Inventories	*14,617*	*17,008*	*12,244*	*12,723*
b Trade Receivables	*4,232*	*4,711*	*4,030*	*2,246*
5 Total Assets	100,288	100,545	102,736	117,530
6 Current Liabilities	9,221	8,688	6,608	5,948
a Trade Payables	*6,718*	*6,239*	*4,768*	*4,185*
7 Borrowings	25,349	25,027	19,843	22,036
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	215	215	572	783
10 Net Assets	65,503	66,615	75,713	88,763
11 Shareholders' Equity	65,503	66,615	75,713	88,763
B INCOME STATEMENT				
1 Sales	15,933	63,499	53,729	49,248
a Cost of Good Sold	*(13,776)*	*(55,842)*	*(48,179)*	*(43,868)*
2 Gross Profit	2,157	7,657	5,550	5,380
a Operating Expenses	(1,045)	(3,889)	(3,512)	(3,497)
3 Operating Profit	1,112	3,768	2,038	1,883
a Non Operating Income	*382*	*4,797*	*3,914*	*4,052*
4 Profit or (Loss) before Interest and Tax	1,494	8,565	5,952	5,935
a Total Finance Cost	*(324)*	*(1,668)*	*(994)*	*(915)*
b Taxation	*(246)*	*(1,038)*	*(860)*	*(758)*
6 Net Income Or (Loss)	924	5,859	4,098	4,262
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,688*	*5,413*	*3,745*	*3,668*
b Net Cash from Operating Activities before Working Capital Changes	*1,711*	*7,245*	*6,320*	*6,286*
c Changes in Working Capital	*2,554*	*(2,966)*	*(596)*	*(4,129)*
1 Net Cash provided by Operating Activities	4,264	4,279	5,725	2,157
2 Net Cash (Used in) or Available From Investing Activities	(1,248)	(7,332)	(1,719)	(7,428)
3 Net Cash (Used in) or Available From Financing Activities	321	3,524	(3,944)	3,201
4 Net Cash generated or (Used) during the period	3,338	472	61	(2,071)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	11.4%	18.2%	9.1%	2.6%
b Gross Profit Margin	13.5%	12.1%	10.3%	10.9%
c Net Profit Margin	5.8%	9.2%	7.6%	8.7%
d Cash Conversion Efficiency (EBITDA/Sales)	11.7%	10.0%	8.5%	8.6%
e Return on Equity (ROE)	5.6%	8.2%	5.0%	5.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	116	109	106	101
b Net Working Capital (Average Days)	79	78	76	71
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.1	3.3	3.4	3.5
3 Coverages				
a EBITDA / Finance Cost	6.9	4.6	6.2	6.3
b FCFO / Finance Cost+CMLTB+Excess STB	2.3	1.7	1.3	1.3
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.3	1.8	2.4	2.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	27.9%	27.3%	20.8%	19.9%
b Short-Term Borrowings / Total Borrowings	0.7	0.7	0.6	0.7
c Average Borrowing Rate	4.3%	6.2%	3.5%	3.4%

Credit Rating Scale & Definitions

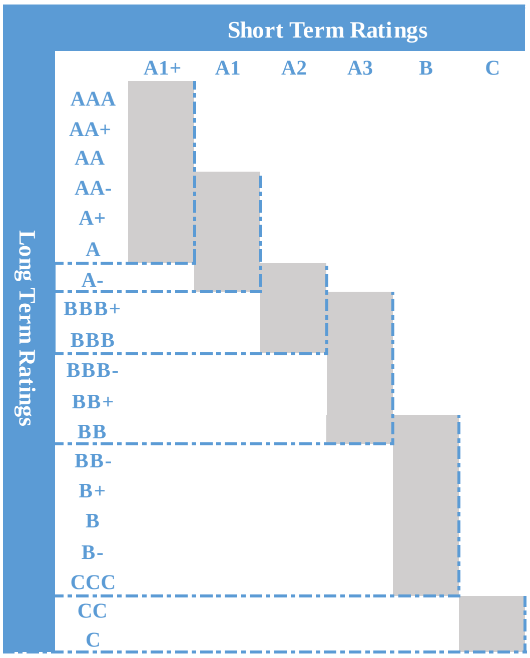
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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

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