

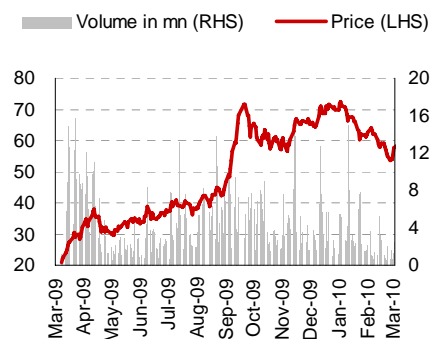
## In Focus

Textile

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### Price and Volume Graph



## NML: Reinitiating Coverage with a BUY stance

- We have reinitiated our coverage on Nishat Mills Limited (NML) with an EPS forecast of PKR9.29 for FY10E and a DCF-based fair value of PKR77/share; upside of 33% from current price levels
- NML manufactures various varieties of yarn, grey fabric, processed fabrics and ready-made garments. About 80% of the company's revenues are export-based while the rest is sold locally or used for in-house production
- Valuation from core operations stands at PKR34/share, whereas PKR43/share is contributed by the value of its portfolio, discounted at 50% of the market value. The scrip currently trades at FY10E PE and PBV of 6.2x and 0.7x respectively; Buy!

Nishat Mills Limited (NML) operates in the textile composite sector of Pakistan. It manufactures various varieties of yarn, grey fabric, processed fabrics and ready-made garments. About 80% of the company's revenues are export-based while the rest is sold locally or used for in-house production. We have reinitiated our coverage on the company with an EPS forecast of PKR9.29 for FY10E and a DCF-based fair value of PKR77/share; upside of 33% from current price levels.

### Nishat Mills Limited; Dynamics and Financials

PKR mn	FY08A	FY09A	FY10E	FY11E	FY12E	FY13E
Revenues	19,590	23,870	29,531	32,987	35,641	38,392
Gross Profit	2,812	4,352	5,059	6,232	7,081	8,022
Other Income	748	599	1,679	1,981	1,491	1,602
Financial Charges	951	1,447	1,759	1,723	1,482	1,175
PBT	6,119	1,562	2,690	3,899	4,277	5,372
PAT	5,858	1,268	2,254	3,347	3,677	4,668
CFO	(161)	2,138	93	1,720	2,725	3,660
Total Assets	40,277	31,513	41,108	41,987	42,919	43,863
Total Liabilities	13,785	12,182	17,390	15,408	13,148	10,030
Total Equity	26,492	19,331	23,718	26,580	29,771	33,833
EPS (PKR)	24.16	5.23	9.29	13.80	15.16	19.25
EPS growth	383.6%	-78.4%	77.7%	48.5%	9.9%	27.0%
PER (x)	2.40	11.10	6.24	4.20	3.83	3.01
ROA	15%	4%	5%	8%	9%	11%
ROE	22%	7%	10%	13%	12%	14%
Debt/Equity	43%	57%	66%	51%	37%	22%
Debt/Assets	26%	31%	34%	30%	23%	16%

Source: Company Reports, BMA Research

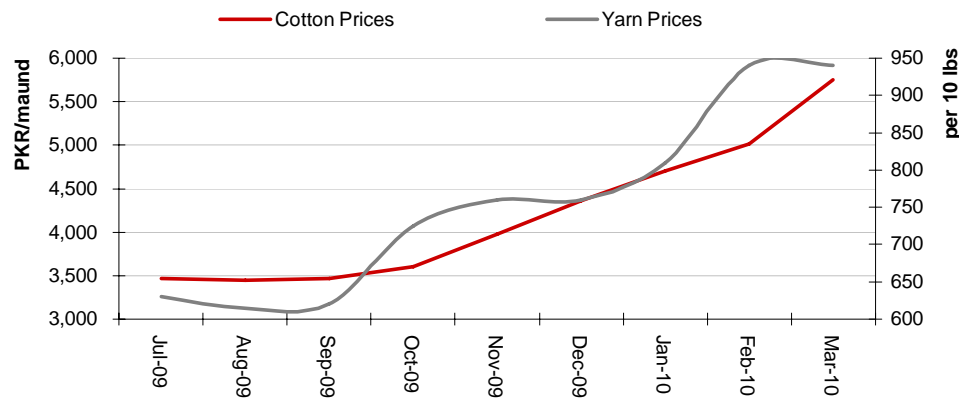
NML's sales have grown at a 3-yr CAGR of 13% till FY09 and has posted an average gross margin of 16%.

**In Focus**  
Textile

**Spinning contributes 29% to the topline**

NML derives 29% of its revenue from its spinning operations with most of its yarn exports going to Far East, USA, and Europe. The segment yielded 9% gross margin in 2QFY10, down from 14% in the 1Q. Reasons behind this decline include 26% increase in cotton prices in 1HFY10 and production losses resulting from power outages during the same period. However, yarn prices also followed a similar trend, increasing 20%, which coupled with a robust demand from international buyers enhanced NML's revenue by 14% QoQ to PKR2,890mn.

**Uptrend in Cotton and Yarn Prices FY10TD**



Source: KCA, Business Recorder, BMA Research

Currently cotton prices are hovering around PKR5,750/maund (37.32kg), up 66% from PKR3,462 in Jul09. Reduced cotton crop of China and increasing demand of cotton yarn particularly in the Far East has led to yarn prices also rising by 49% to PKR940/10lbs in Mar10 from PKR630/lbs in Jul09. Oct-Jan is usually the prime buying season for NML which suggests that the company would have procured most of its annual cotton requirements at around PKR4,500/maund and is expected to result in inventory gains for its spinning operations in 2HFY10.

**Weaving's share down to 24% of revenues**

Higher cotton and yarn prices have had a negative impact on the cost of weaving fabrics. Additionally, NML also witnessed a 3% QoQ decline in its sales of grey cloth in 2QFY10 reducing its share to the company's revenue to 24%, down from 28% in 1QFY10. However increased presence in the work wear and military uniform business, in addition to better sales of abrasive fabrics consumed by the auto industry, is expected to show some improvement in the segment's sales going forward. Furthermore, textile exhibitions in the ongoing quarter can be expected to result in NML receiving large orders from international buyers.

**Processing and Home Textile accounting for 35% of revenues**

Gradual recovery from recession in US and Europe in 1HFY10 has led to improved business for Pakistan's textile industry. In addition, NML also developed some new businesses in the Turkish and Spanish markets while adding new customers such as Angore, Next, Kohls, and HLL at the same time. In 2QFY10 NML saw a whopping

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## In Focus

### Textile

growth of 31% QoQ and 18% YoY in its sales of processed fabric and home textile products. The segment's sales currently account for 35% of NML's total revenue yielding a healthy gross margin of 20%, up from 17% in 1QFY10. Higher sales in addition to higher prices during 1HFY10 led to this improvement in profitability.

#### Garments, the growth segment

Gulf Nishat Apparel Limited was merged with NML during FY09 to form Nishat Apparel. Nishat Apparel is in the business of making pants of piece dyed and denim fabrics, providing a one window solution to customers of NML. The company sold over 2mn garments in 1HFY10, 84% higher than 1.2mn units sold in the same period of last year. Similarly, the segment's revenue more than doubled to PKR1,197mn accounting for 6% of company's total sales. Furthermore, it posted a gross margin of 15% in 1HFY10 with the entire segment turning profitable during the same period compared to 1HFY09 when it posted a net loss of PKR33mn.

#### Power Generation ensuring output

NML has installed power generation plants at all its sites in order to keep its units operational at all times. Not only this, but it also saves on its fuel costs leading to lower costs of production. The plants are based on natural gas-fired generators and provide surplus power produced to PEPCO distribution companies. This business, however, accounts for a very small proportion of the company's sales and profits.

#### Income from investment holdings

NML is a major stakeholder in some of the largest companies operating in the country including DG Khan Cement (DGKC) and MCB Bank in addition to 65% holding in Nishat Power (NPL) and 14% in Nishat Chunian Power (NCPL). Habib Bank Limited (HBL) and Adamjee Insurance (AICL) also form a small portion of the company's investments.

Subsequently, NML derives dividend income from these investments which form a major component of its earnings. For instance, in FY09 NML earned PKR511mn in dividend income which is expected to increase 3-fold to PKR1,613mn in FY10E on the back of additional income coming from AES Power. This is further expected to increase to PKR1,915mn in FY11E with dividends flowing in from NPL.

#### Investment stakes

Long-term Investments	No. of shares held	Equity Held	Short-term Investments	No. of shares held	Equity Held
<b>Subsidiary Companies</b>					
NPL	160,187,500	65.2%	NPL	9,812,498	65.2%
Nishat USA Inc.	200				
<b>Available for Sale – Associated Companies</b>					
DGKC	95,537,640	31.4%	Security general Insurance Co.	10,226,244	15.0%
MCB	47,810,242	6.9%			
Nishat paper products Co.Ltd	11,634,199	25.0%			
AICL	33,034	0.03%			
<b>Available for Sale - Others</b>					
HBL	132		NCL	1,256,661	13.6%
			NCL - Preference Shares	5,628,330	
			Pak Strategic Allocation Fund	500,000	

Source: Company Accounts FY09A, BMA Research

## In Focus Textile

### Potential upside of 33% to our SOTP based Fair Value of PKR77/share

According to FBS statistics for 7MFY10, Pakistan has recorded a YoY growth of 142% and 31% in its exports of raw cotton and cotton yarn respectively. This accounts for both the volumetric growth as well as PKR depreciation against USD during the year. NML's spinning segment operates at 91% capacity utilization level which is expected to continue going forward with a continuation of robust demand from importers and the indigenous value-added sector. However, weaving business may not do so well considering 20% YoY decline in aggregate cloth exports in 7MFY10.

#### Textile Exports

USD '000	7MFY10	7MFY09	% chg	Jan-10	Jan-09	% chg
Raw Cotton	174,081	71,913	142%	28,231	7,824	261%
Cotton Yarn	861,575	658,809	31%	127,854	79,127	62%
Cotton Cloth	996,689	1,246,020	-20%	154,120	135,341	14%
Cotton Carded Or Combed	4,186	11,228	-63%	118	435	-73%
Yarn Other Than Cotton Yarn	22,882	14,520	58%	3,443	914	277%
Knitwear	1,024,576	1,089,387	-6%	138,905	139,523	0%
Bed Wear	974,471	1,025,219	-5%	144,631	144,967	0%
Towels	377,794	382,485	-1%	63,170	51,757	22%
Tents, Canvas & Tarpulin	33,990	37,889	-10%	6,034	7,604	-21%
Readymade Garments	743,686	720,357	3%	132,894	102,852	29%
Art, Silk & Synthetic Textile	252,173	135,860	86%	45,363	18,414	146%
Madeup Articles	300,328	290,720	3%	51,740	42,149	23%
Other Textile Materials	179,423	129,633	38%	33,093	19,671	68%
<b>Total</b>	<b>5,945,854</b>	<b>5,814,040</b>	<b>2%</b>	<b>929,596</b>	<b>750,578</b>	<b>24%</b>

Source: Federal Bureau of Statistics, BMA Research

Furthermore, we believe cotton prices would continue its uptrend in the following years on the back of low world production and greater demand from the spinning mills which would continue to add pressure on margins. However, an increase in product prices to the same extent cannot be ruled out. Looking ahead, we believe textile industry is on its way to recovery with the implementation of Textile Policy 2009-14 and inclusion of Pakistan in the Generalized System of Preferences (GSP) plus scheme.

Using the FCFE methodology with a cost of equity (Ke) of 19% and terminal growth of 3%, our sum of the parts (SoTP) value for NML arrives at PKR77/share, 33% upside from its current price level. NML's valuation from core operations stands at PKR34/share, whereas PKR43/share is contributed by the value of its portfolio, discounted at 50% of the current market value. The scrip currently trades at FY10E PE and PBV of 6.2x and 0.7x respectively and we issue a Buy stance on the stock.