Textile Sector of Pakistan

Personal Goods

GSP+ Status rejuvenates Textile's Growth Potential!

Textile Sector; Main stay of the economy!

The textile sector has remained at the forefront of Pakistan's economy for years although it accounted for only 9.5% of the GDP in FY13; the sector contributed a massive 58% (in FY13) to the total country's exports. Total textile exports from Pakistan clocked in at USD 13.0bn in FY13 (~2% of global textile exports), from only USD 9.5bn in FY09 depicting at CAGR growth of 8%, which has helped the country bring in precious foreign reserves in the last few years.

On account favorable development on the recently awarded GSP+ Status by the EU Parliament to Pakistan, we have reviewed our case on the sector and our likeness towards coverage companies Nishat Chunian Limited (NCL) and Nishat Mills Limited (NML).

For Pakistan's textile sector in general, and the spinning business in particular, FY13 has been a year of blessings. The key factors contributing towards the well being of Pakistan's textile sector includes yarn demand from China and exports to European and US markets. Given the current scenario, the outlook for demand from these markets seems encouraging and, thus, the textile sector's charm is expected to continue for FY14 as well. Factors to affect sector profitability the most include Cotton prices, fluctuation in local currency and interest rates.

Nishat Chunian Limited: Skewed towards massive outperformance!

We reiterate 'BUY' on NCL with a Jun-14 Sum of The Parts (SoTP) based price target of PKR 77.4/share for Jun'14 offering an upside of 33%. Our likeness towards the scrip is based on projected earnings upside with a decent CAGR of 11% in the next 4 years.

The company has already experienced a turnaround in its profitability where earnings have grown by a CAGR of an astonishing 35% in the past three years. Capacity expansion of additional spindles, lower leveraging and power projects in the pipeline in reducing massive fuel & power costs will further unlock the potential of NCL going further.

Nishat Mills Limited: It's never too late!

Using our Sum of the Parts-based methodology, we work out NML to have a Jun-14 target price of PKR 159/share (upside 27%) recommending a 'BUY' at these levels. We expect NML to post 4-year earnings CAGR of a straight 19.6% with significant improvements in net margins going forward, from 11% in FY13, to forecasted net margins of 16% in FY15.

With significant out-reach in European Markets to be further un-locked through granting of the GSP+ Status to Pakistan, coal & other alternative fuel mixes achieving fuel cost efficiencies and significant support of dividends incomes from associate companies, the scrip remains a textile favorite.

Textile Universe Forward (FY14) Estimates

Scrip	PE	PB	DY	ROE	Target	Upside	Recommendation
NCL	4.06	1.45	7%	32%	77.4	33%	BUY
NML	5.29	0.75	4%	12%	159.0	27%	BUY

Source: Company Accounts & AHL Research

Overweight

Nishat Mills Ltd	
Target Price	159
Last Closing	125.1
Upside	27.1%
KSE Code	NML
Bloomberg Code	NML PA

NML (major share holders)

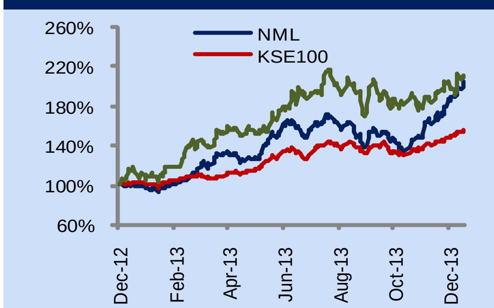
Share holders	% age Holding
DGKC	9%
AICL	0.4%
Banks & FIs.	10%
Directors	25%
Others	56%

Nishat Chunian	
Target Price	77.4
Last Closing	58.0
Upside	33.4%
KSE Code	NCL

NCL (major share holders)

Share holders	% age Holding
NML	14%
DGKC	3%
ABL	10%
NBP	5%
Others	68%

Stock Performance



Source: KSE

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Note: All stock prices are of 20-December-2013

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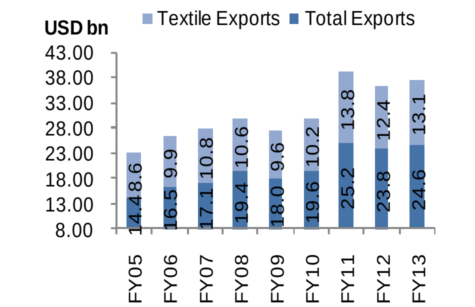
Sector Outlook

Textile: Main stay of the economy!

The textile sector has remained at the forefront of Pakistan's economy for years although it accounted for only 9.5% of the GDP in FY13; the sector contributed a massive 58% (in FY13) to the total country's exports. Total textile exports from Pakistan clocked in at USD 13.0bn in FY13 (~2% of global textile exports), from only USD 9.5bn in FY09 depicting at CAGR growth of 8%, which has helped the country bring in precious foreign reserves in the last few years. The gov't is also eying to double total country's exports in the next 5 years.

For Pakistan's textile sector in general, and the spinning business in particular, FY13 has been a year of blessings. The key factors contributing towards the well being of Pakistan's textile sector include yarn demand from China and exports to European and US markets. Given the current scenario, the outlook for demand from these markets seems encouraging and, thus, the textile sector's charm is expected to continue for FY14 as well.

Total v/s Textile Exports



Source: PBS, AHL Research

Key Investment Considerations

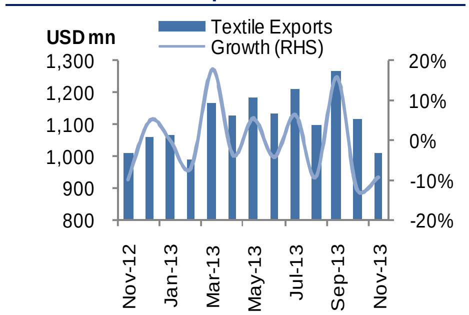
Pakistan granted GSP+ Status by the EU

EU Parliament in its historic verdict voted in favor (53%) of granting (406 votes out of a total 766) GSP+ status to 10 countries, including Pakistan, till 2017 by which it will be next reviewed further on the basis of 27 conventions; mainly on human rights and environmental issues.

Pakistan's grant for the GSP+ Status for exports to the European Union (EU) is set to come into effect from Jan'14 onwards, which will be valid till further review in 2017. Under the scheme, Pakistan's textile products will have a duty waiver in 28 European countries. Preliminary estimates suggest additional annual boost of USD 1.0–1.5bn in textile exports alone.

In FY13, Pakistan exported USD 13.1bn worth of textiles goods of which 35% or USD 4.6bn (+6% YoY growth) were directed towards EU. Henceforth, we estimate a 9% annualized increase in textile goods to EU in FY14, and subsequently 12% on average for the next two years, thereby adding solid growth to domestic textile sector.

Textile Exports Growth



Source: PBS, AHL Research

GSP+ Status in Brief

Background for Pakistan

Pakistan had previously been granted the GSP+ Status in the era of Musharraf (Oct'99 – Mar'08) for a period of three years. To recall, Pakistan did enjoy the GSP+ Status before in Musharraf's era for a period of three years, while Pakistan was enjoying only the GSP Status, which was only the standard scheme offering specifically substantial tariff reductions meaning partial or entire removal of tariffs on two-third of all product categories.

GSP+ Status brief overview

The Generalized Scheme of Preferences Plus or otherwise known as GSP+ Status will apply to 70 product categories out of which 64 categories are of textile orientated. These categories collectively combine to approximately 3,400 textile items in total where most of the products have full tariffs removal. On a regional front, this will now also provide a level playing field in EU exports for Pakistan in competing with it peers Sri Lanka and Bangladesh who are already benefitting from the GSP+ status scheme.

Policy review

The GSP+ Status will be valid till 2017, which will then be further reviewed for an extension by the EU Parliament. It is done through a scorecard evaluation system in which 27 conventions mainly human rights and environmental issues are analyzed.

Though challenges on the macro-level remain on the forefront for the government in ensuring gas supplies, law and order, lack of infrastructure, etc, which we believe need to be addressed for the sector to fully make use of the advantages of the GSP+ Status scheme.

Pakistan to compete on a level field with regional players now

Pakistan will now be able to compete on level playing field with other regional players in the region. In particular, Sri Lanka and Bangladesh that previously had been enjoying the benefits of GSP+ Status.

Value-added products the key in improving margins

We believe, those textile companies will significantly benefit who will be successful in penetrating the EU markets with their high margin value-added products (home textiles and weaving segments in particular). Due to increased demand of this segment, a likewise surge of by products, yarn in particular, cannot be ruled out.

PKR/USD parity effects

In addition to normal business revenues, the textile sector is also exposed to currency risk as exports (with its high concentration) are denominated in USD. Due to being a major exporter, Textile sector receives blessings with depreciation in PKR/USD parity alongside other factors (though product pricing and international demand scenario also play vital parts), and any un-hedged position can provide translation gains in such a depreciating environment, and vise versa.

In FY13 alone, PKR depreciated 8.3% YoY in FY13 and 6.7% from Jul'13 to YTD (FY14YTD), which is a significant factor towards improved profitability for the textiles. Going forward, we have incorporated an 11% YoY PKR depreciation against the USD for FY14 and 6% in subsequent years to incorporate depreciating PKR in the long term.

PKR Depreciation

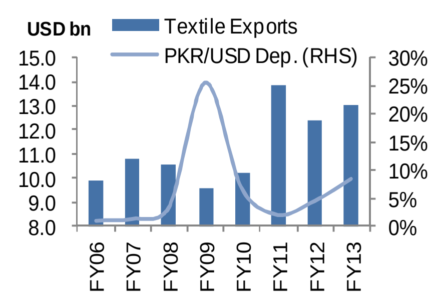
Period	CY13		CY12
	CY13	At Peak	
CY- to date	9.5%	11.8%	8.7%
Jul- to date	6.7%	9.0%	3.3%
Oct- to date	0.3%	2.4%	2.9%

Source: Bloomberg, AHL Research

Cotton & Yarn production and outlook

Moreover, FY13 also came with favorable cotton prices as depicted in the graph on the next page. Going further, the hike in cotton prices (+8% YoY forecasted for FY14) will result in higher yarn and other product pricing, which will further improve the gross margins (spinning remained the most profitable segment). Given the estimated supply (Pakistan) of approximately 13mn bales, cotton prices for FY14 seems reasonably manageable for the spinners and, in our opinion, do not pose any significant threat.

Textile Exports v/s PKR Dep.

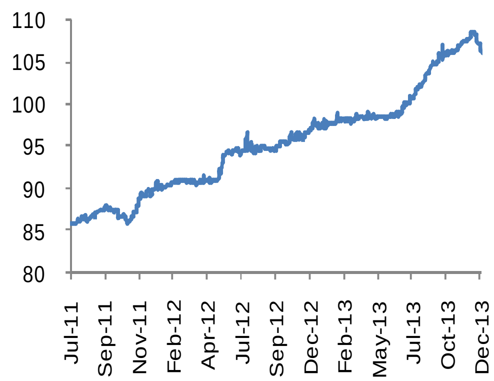


Source: PBS, AHL Research

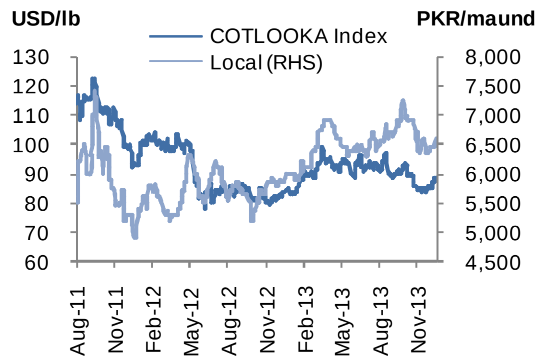
The outlook from China (a major player in global textile market with 35% market share) looks stable (with cotton reserves to reach 11.4mn tons in cotton in the year FY14, an increase of 2mn tons over previous year). Recently, there also have been reports regarding the Chinese gov't further increasing cotton support price (currently USD

1.48/lb) and raising the cotton import quota levels, which would be another positive sign for our local industry in increasing their yarn exports, going forward.

PKR to USD Trend



International & Local Cotton Prices Trend



Source: Bloomberg, AHL Research

Key Risks

Energy crisis the biggest threat

The most threatening factor towards textile sector is their abnormally high energy cost. As the country is experiencing worst ever energy crisis, textile sector has been the most hit sector of the economy. These companies usually rely upon expensive alternatives due to energy shortfall and any steps taken to provide them cheap energy can lead to improved bottomlines as well. This will also boost up economic activity across the country and we remain optimistic and foresee improvement in this regard. Also with the event of granting of GSP+ status, the Gov't has assured textile industry of gas supply on a regular basis, diverting gas supply from Compressed Natural Gas (CNG) available for motor vehicles.

Higher Cotton prices

Following the energy crisis is the issue of high input cost (high raw cotton cost). As discussed earlier in the outlook part, we foresee the cotton prices to remain amicable for spinners and therefore, this risk seems minimal.

High interest rates and changes in domestic currency

The sector is highly leveraged with an average debt-equity of 2.0x, therefore any upward revision in the interest rate will negatively impact the bottomline of vast majority of textile companies. Our companies in coverage are relatively lower leveraged as compared to the industry average, with a NML and NCL having a debt-equity of 0.4x and 1.3x.

Furthermore, while rapid PKR depreciation against the greenback provides significant support to profitability, recent appreciation in the local currency should offset some of the gains recorded so far by the textiles companies in the year FY14. Thus, changes in local currency cascade major impacts on textile sector profitability. We expect PKR to depreciate at a certain rate in the years ahead that should provide net benefits to the textiles sector in terms of both volumes and value.

Deterioration in law & order

Transporters' demands (mainly relating to compensation due to losses from riots) have yet to be fulfilled by the government; therefore chances of a strike by them remain high. Delivery of export orders on a timely basis could be impacted, whilst raising the risk of cancelation of orders from aboard especially during high demand seasons may impact the review on the GSP+ Status recently granted to Pakistan.

Nishat Chunian Limited (NCL) — Personal Goods

Skewed towards Massive Outperformance!

NCL: Outperformer of FY13 with more still to come!

We reiterate 'BUY' on NCL with a Jun-14 Sum of The Parts based price target of PKR 77.4/share for Jun'14 offering an upside of 33%. Our likeness towards NCL is based on a decent 11% CAGR earnings growth in the next 4 years. The company has already experienced a turnaround in its profitability where earnings have grown by a CAGR of an astonishing 35% in the past three years.

GSP+ Status impact: What's in store for NCL?

With newly awarded GSP+ Status to Pakistan, NCL has the potential to increase its exposure to EU market, which contributes around 11% of the company's topline. Timely capacity expansion by 22,000 spindles coupled with acquisition of Taj Textile (38,000 spindles), puts the company in great position to cater this increasing demand. On account of the GSP+ Status, FY14 is expected see a relatively subdued impact, we believe, while incremental bottom-line impacts from additional exports to EU would be in full swing from FY15 onwards. We foresee a positive annualized bottom-line impact of PKR 1.00/share and PKR 1.05/share for FY15 and FY16, respectively.

Spinning division dominating the 'swing' in profitability

The spinning business has proved a fortune-changer for NCL, whose gross margins from spinning division improved massively to 20% in FY13, from 13% in FY12; mainly due to increase in yarn prices (7.5% YoY) and substantial PKR-USD depreciation. We believe sustained demand of textile products from local and international markets will continue to put NCL on the track of rising profitability, which is the core basis of our expectations of growing earnings ahead.

Dividend income from NCPL proves to be the icing on the cake!

Every PKR 1/share DPS from 51%-owned subsidiary, Nishat Chunian Power Limited (NCPL), translates into positive bottom-line impact of PKR 0.85/share for NCL. For FY14, other income of the company is expected to improve by 36% YoY to PKR 1,038mn (PKR 5.5/share) mainly on account of special dividend from NCPL. With improving dynamics of power sector, we remain upbeat about the future payout aspects of the NCPL.

Power projects to bring energy efficiency

NCL's construction of 14MW grid station has been completed and expected to be available by the end of 2QFY14, which should help the company bring down its abnormally increasing fuel costs (PKR 2.7bn as per FY13) by annualized amount of PKR 400mn, which is a PKR 2.05/share positive bottom-line impact.

Financial Highlights

PKR mn	FY12A	FY13A	FY14E	FY15F	FY16F
Sales	18,617	21,213	22,997	24,902	26,483
Net Profit	699	2,276	2,862	2,953	3,197
EPS Adjusted (PKR)	3.49	11.37	14.30	14.75	15.97
DPS (PKR)	2.00	2.00	4.00	4.60	5.20
PE (x)	16.66	5.12	4.07	3.95	3.64
PBv (x)	36.72	44.07	51.27	61.42	72.19
ROE	11.9%	32.3%	31.3%	26.2%	23.9%
ROA	4.1%	11.5%	12.7%	12.5%	12.9%

Sources; Company Accounts, AHL Research

Buy

Target Price	77
Last Closing	58
Upside	33%
KSE Code	NCL
Bloomberg Code	NCL PA

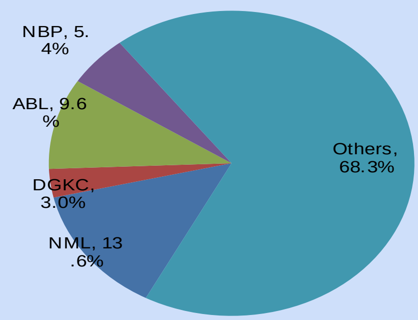
The Company

Nishat (Chunian) limited was established in 1990 as a public limited company. The company runs the businesses of spinning, weaving, printing, dyeing, processing, sizing, stitching, doubling, buying and selling of products fabricated from raw cotton. The company is also in the business of electricity generation and distribution. The company is listed on KSE and LSE.

Shares

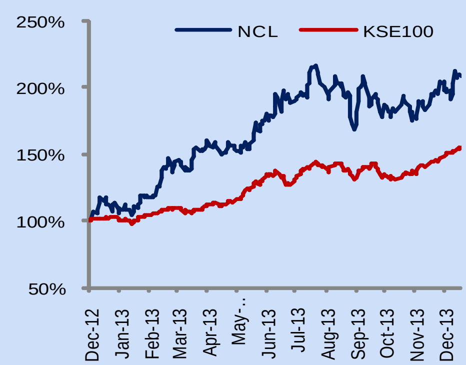
Market Cap (US$ m)	106.2
Outstanding Shares (m)	200.2
Free Float	45%
12M Avg. Daily Turnover (m)	2.7
12M High/Low (PKR)	60.40/28.88

Shareholding



Source: Company Financials

Stock Performance



Source: Bloomberg

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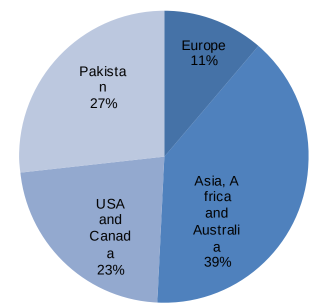
NCL to increase penetration into EU markets with GSP+ Status

Currently, Asia and USA are two major regions for NCL products, but with EU's GSP+ Status coming in effect from Jan'14, we believe it will help NCL penetrate in European markets further, which is currently 11% of the total topline as per FY13 accounts. To further break down export activity, 80% of the export is shipped to Chinese markets while the rest towards Europe. While in the exports, value-addition segment (Processing and Home Textiles) contributes 80%-85% to the USA's retail markets with the rest to European markets.

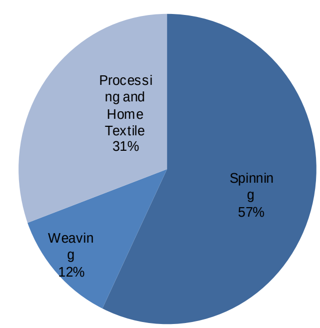
Moreover, export-oriented activities will not only help NCL reach wide categories of end users but also provide opportunity to take advantage of depreciation in the PKR/USD parity (though PKR has taken downward trend now for short-term amid USD inflows). An uptake in domestic yarn prices in GSP+ era cannot be ruled out, as demand of both yarn itself and value-addition goods could cause this price surge. This we believe would be a major gross-margin lifter for NCL.

Revenue % by Geographical as per FY13



Source: AHL Research

Revenue Segments as per FY13



Source: AHL Research

Timely capacity expansion of Spindles division

Moreover, NCL has increased its number of spindles by 22,000 to 171,948 spindles. This expansion has led to increase in company's yarn production capacity by an additional 7.05mn kgs to take the total to 55.06mn kgs, assuming new spindles produce 320 kgs of yarn per spindle. This will not only aid in catering to the increased demand from the Chinese markets, but will also help in catering to increased exports volumes in a post GSP+ scenario.

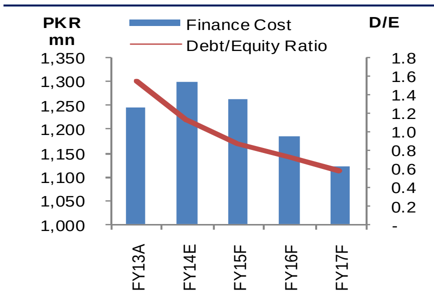
This project has been in addition to the recently acquired spinning assets (38,000 spindles) of Taj Textile Mills. As per recent discussion with the company management, the additional spindles are expected to come online by Feb-Mar'14, with renovation work (overhauling) currently taking place of the spindles.

Our initial estimates suggest annualized bottomline impact of PKR 0.60-0.50/share with addition of Taj Textile's spindles. A capex of PKR 600-700mn in the overhauling of the mills has already been incurred by NCL in this regard.

Future power projects also under consideration

The company is also considering investing (an outlay of PKR 4-5bn) in a 30MW to 40MW coal-based captive power plant in facilitating its own industrial power demand (requirement of approximately 45MW to 50MW currently) by FY15. The project though is in its initial phases and has yet to be finalized by the board of directors. We however believe the company may have to go for external borrowing to fund the project in the future.

Finance Cost & D/E



Source: AHL Research

Rising interest rate to inch up finance cost

Any upward reversal in interest rates going forward, however, is expected to swell NCL's finance cost as the company is significantly leveraged with debt-equity standing at 1.33x as of FY13.

It is worth mentioning here that the textile industry benefits from relatively lower interest-bearing loans through SBP's refinance facilities in the short-term borrowing schemes. Though with significant cash generations, especially from their spinning division, finance costs and leverage levels appear to be in control as the estimated FY14's interest cover ratio tunes in to be 2.6x.

Outlook and risks

Given the current textile scenario, NCL seems to have a smooth sail up ahead; uncertainties regarding demand from China pose a threat though. The company has significant exposure to exports (contributing approximately 73% of the total sales) and demand from international market will be the factor in the driving seat.

Main risks to evaluation include an abrupt change in cotton prices, change in value of PKR and increase in interest rates.

Following is provided NCL's earnings sensitivity with each of the above mentioned factors:

NCL- Sensitivity			
Increase in Interest Rate by 100 bps	**FY14E**	**FY15F**	**FY16F**
EPS without change	14.30	14.75	15.97
EPS with Change	14.14	14.60	15.88
Net Change in EPS	-1.1%	-1.0%	-0.6%
Cotton Price Increase by 1%	**FY14E**	**FY15F**	**FY16F**
EPS without change	14.30	14.75	15.97
EPS with Change	14.19	14.52	15.60
Net Change in EPS	-0.8%	-1.6%	-2.3%
PKR Depreciation by 1%	**FY14E**	**FY15F**	**FY16F**
EPS without change	14.30	14.75	15.97
EPS with Change	14.44	14.77	16.00
Net Change in EPS	1.0%	0.1%	0.2%

Source: AHL Research

Valuation and Recommendation

	Jun-14	Jun-15	Jun-16	Jun-17
Net income	2,862	2,953	3,197	3,430
Plus Depreciation and Amortization	523	547	567	578
Plus interest (1-tax rate)	1,004	1,081	943	803
Minus Fixed capital investment	(556)	(437)	(259)	(264)
Minus Changes in Working Capital	(153)	(904)	(748)	(703)
FCFF	3,680	3,241	3,701	3,844
Minus NCPL Dividend Income	(946)	(857)	(858)	(911)
FCFF	**2,734**	**2,384**	**2,843**	**2,933**

Valuation	PKR mn
Discounted FCFF	13,129
Terminal Value	23,322
Discounted Terminal Value	10,197
Firm value	23,326
Less: Debt	12,315
Add: Cash and Cash Equivalents	259
Equity Value	11,270
Nos of shares in Mn	200
FCFF - Target Price	56
NCPL Price	21
Sum of the Parts based Target Price	**77.4**

Recommendation

We reiterate BUY for NCL with a Jun-14 Sum of The Parts (SoTP) based target price of PKR 77.4/share in which we have based our valuation on risk free rate of 13.5% (10-year PIB) and a 3-year adjusted beta, we have taken a 35% discount to current market value of NCPL to absorb any market shock, any deep decline in prices can still affect our target value for NCL as it contributes approximately 27% to our target price. NCL is currently trading at attractive FY14E and FY15F PE of 4.1x and 3.9x.

Currently, the stock is offering a handsome upside potential of 33% from current levels, which should not be missed. Capacity expansion of additional spindles, lower leveraging and power projects in the pipeline in reducing massive fuel & power costs will further unlock the potential of NCL going further.

Summary Financials, Forecasts and Key Ratios

Income Statement (PKR mn)	FY13A	FY14E	FY15F	FY16F	FY17F
Net Sales	21,213	22,997	24,902	26,483	27,992
Cost of Goods Sold	17,618	19,166	20,541	21,951	23,358
Gross Profit	3,596	3,831	4,361	4,532	4,633
Other Income	1,000	1,371	1,120	1,129	1,195
Financial Charges	1,243	1,181	1,279	1,134	987
Net Profit Before Taxation	2,531	3,138	3,252	3,515	3,766
Net Profit after taxation	2,276	2,862	2,953	3,197	3,430
EPS (PKR) - Adjusted	11.37	14.30	14.75	15.97	17.14
DPS (PKR)	2.00	4.00	4.60	5.20	5.80
Balance Sheet (PKR mn)	**FY13A**	**FY14E**	**FY15F**	**FY16F**	**FY17F**
SHARE CAPITAL & RESERVE					
Unapproriated Profit	4,571	6,633	8,664	10,821	13,090
Shareholders Equity	**8,020**	**10,264**	**12,295**	**14,452**	**16,721**
NON CURRENT LIABILITIES					
Non Current Liabilities	**4,201**	**2,550**	**884**	**-**	**-**
CURRENT LIABILITIES					
Current maturity of Long term Liabili	1,620	1,651	1,666	1,401	1,061
Short term finance	6,494	7,040	7,499	7,445	7,169
Current Liabilities	**9,703**	**10,416**	**11,007**	**10,790**	**10,280**
TOTAL LIABILITIES & EQUITY	**21,925**	**23,229**	**24,187**	**25,242**	**27,001**
NON CURRENT ASSETS					
Operating Fixed Assets	7,636	6,026	5,923	5,622	5,316
Investment in subsidiaries	1,887	1,876	1,876	1,876	1,876
Non-current Assets	**9,528**	**9,556**	**9,453**	**9,152**	**8,846**
CURRENT ASSETS					
Stock-in-trade	5,640	5,749	6,225	6,621	6,998
Trade debts	3,904	3,987	4,317	4,591	4,852
Cash & Bank Balances	259	1,247	1,286	1,793	3,049
Current Assets	**12,397**	**13,673**	**14,734**	**16,089**	**18,155**
TOTAL ASSETS	**21,925**	**23,229**	**24,187**	**25,242**	**27,001**
Ratio Analysis	**FY13A**	**FY14E**	**FY15F**	**FY16F**	**FY17F**
Liquidity Ratios					
Current Ratio	1.28	1.31	1.34	1.49	1.77
Quick Ratio	0.70	0.76	0.77	0.88	1.09
Profitability Ratios					
Return on assets	11%	13%	12%	13%	13%
Return on equity	32%	31%	26%	24%	22%
Return on Capital	25%	26%	25%	25%	23%
Profit Margins					
Gross Margin	16.9%	16.7%	17.5%	17.1%	16.6%
Gross Margin - exclud. Depreciation	19.4%	18.9%	19.7%	19.2%	18.6%
EBITDA Margin	20.3%	21.1%	20.4%	19.7%	19.0%
Net Profit Margin	10.7%	12.4%	11.9%	12.1%	12.3%
Book value per share (PKR)	44.07	51.27	61.42	72.19	83.53
EPS	11.37	14.30	14.75	15.97	17.14
DPS	2.00	4.00	4.60	5.20	5.80
Payout Ratio	18%	28%	31%	33%	34%

Source: Company Accounts & AHL Research

About the company

Nishat Chunian Limited was founded in 1990. It is a public limited company with total paid up capital of PKR 2.0bn and is located at Bhai Pheru, Tehsil Chunian. It carries out the processes of spinning, weaving, dyeing, printing, stitching, processing, doubling and sizing. It also trades in yarn, fabrics and made-ups manufactured from raw cotton, synthetic fiber cloth and also accumulate, distribute, supply and distribute electricity. Close to a million cotton bales is total procurement requirement of NCL for the entire year, while most procurement of cotton occurs in the Rabi season from Sept onwards, where cotton prices are lower from the rest of the year. 70% - 75 % cotton is locally procured while the remaining is imported alongside yarn too from India.

Production and capacity

NCL has 171,948 spindles installed, along with 293 looms, a state of the art dyeing and finishing plant with a capacity of 101,370 meters per day and captive power plants capable of producing up to 29MW of electricity. In FY13, 73% of sales of Nishat Chunian Limited comprised of exports, whereas in FY12, exports contributed 69% towards the revenue.

NCPL: NCL's power arm

Nishat Chunian Power Limited (NCPL), a 200MW power plant established in 2007 is NCL's subsidiary. Currently, Nishat Chunian Limited possesses 51.07% shares of NCPL. The company, which commenced its production in July 2010, has a gross capacity of 200MW. Its primary function is to build, own, operate and maintain a fuel powered power station. It operates as an independent power producer and has a 25 year term of the Power Purchase Agreement (PPA) with National Transmission and Dispatch Company Limited. The main fuel for electricity generation is Residual Furnace Oil (RFO).

Nishat Mills Limited (NML) — Personal Goods

It's Never too Late!

NML: It's never too late!

Using our Sum of the Parts-based methodology, we work out NML to have a Jun-14 target price of PKR 159/share (upside 23%) recommending a 'BUY' at these levels. We expect NML to post 4-year earnings CAGR of a shining 19.6% with significant improvements in net margins going forward, from 11% in FY13, to forecasted net margins of 16% in FY15.

GSP+ Status to result in increased market share

With major out-reach into European markets, currently with 2.6% market share in country's textile exports to EU markets (especially through value-added segment), GSP+ will further unlock NML's value ahead, we believe. In this regard, a positive bottomline impact of PKR 2.36/share from additional exports to EU is expected in FY14. We foresee a further positive annualized bottomline impact of PKR 5.05/share and PKR 3.25/share for FY15 and FY16, respectively. On the basis of estimated additional textile industry exports of USD 1.0-1.5bn per annum from the mid of FY14, we expect NML's additional exports to EU to pick by 9% (incremental increase of ~PKR 1.06bn for the company).

Procurement of cotton at lower rates with financial leverage dropping

The company also benefited from lower cotton prices in early FY13 and later increase in cotton prices did not hurt the cost. The gross profit margins, therefore, improved by almost 200 bps to 17%. With relatively stable outlook on cotton prices, we remain optimistic that gross margins will further improve from 17% in FY13, to 21% in FY15. We expect NML to reduce its financial charges by an average of 24% in the next four years, which will bring the debt-equity of the company from 0.37x currently, to 0.13x by FY17. It has already reduced its finance cost by 8% in FY13 to PKR 1.6bn on account of debt repayments.

Coal & alternative means help NML achieve fuel & power cost efficiencies

NML also has the advantage of achieving lower fuel cost & higher power efficiencies through coal (30%) and alternative means (70%) to run their captive power plants, which should keep benefiting company's bottomline amid rising power tariffs.

Dividend income from Group companies further bolstering bottomline

Dividend income from investment in subsidiaries and associate companies accounted for around ~42% of NML's bottomline in FY13. The next page depicts a table of the bottomline impact for FY14 on NML from dividend from group companies. We foresee stable payouts from group companies going forward; though a 40% annualized contribution is expected to be diluted as core earnings will further pick up on account of GSP+ for incremental EU export sales and strong margins.

Financial Highlights

PKR mn	FY12A	FY13A	FY14E	FY15F	FY16F
Sales	44,924	52,426	57,795	64,228	67,209
Net Profit	3,529	5,847	8,319	10,408	10,635
EPS Adjusted (PKR)	10.04	16.63	23.66	29.60	30.25
DPS (PKR)	3.50	4.00	5.00	6.00	7.00
PE (x)	12.47	7.52	5.29	4.23	4.14
PBv (x)	0.96	0.75	0.67	0.59	0.54
ROE	8.7%	12.1%	13.3%	14.9%	13.6%
ROA	6.4%	8.5%	10.1%	12.0%	11.5%

Sources; Company Accounts, AHL Research

Buy

Target Price	159
Last Closing	125
Upside	27%
KSE Code	NML
Bloomberg Code	NML PA

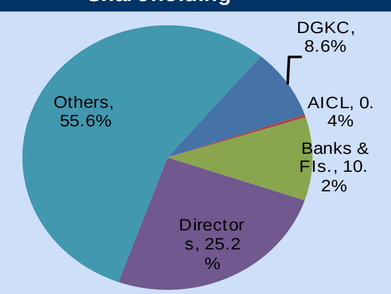
The Company

Nishat Mills limited w as established in 1951 as a public limited company, currently listed on all stock exchanges of Pakistan. The company runs the businesses of spinning, w eaving, processing, stitching and pow er generation. The company is one of the largest vertically integrated company of Pakistan.

Shares

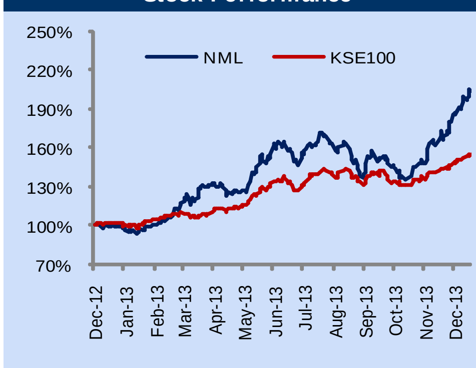
Market Cap (US$ m)	414.2
Outstanding Shares (m)	351.6
Free Float	50%
12M Avg. Daily Turnover (m)	3.1
12M High/Low (PKR)	125.85/57.18

Shareholding



Source: Company Financials

Stock Performance



Source: Bloomberg

www.arifhabibltd.com

Nishat Mills Limited - Long Term Investments in Listed Companies PKR Mn	Ticker	% Holding	No. of Shares	DPS Exp. for FY/CY14	Bottomline Impact on NML
Subsidiary Companies					
Nishat Power Limited	NPL	51.01%	180.63	3.50	1.85
Available for Sale					
Associated Companies (With Significant Influence)					
D.G. Khan Cement Company Limited	DGKC	31.40%	137.57	3.00	1.06
MCB Bank Limited	MCB	7.24%	73.27	14.00	2.44
Lalpir Power Limited	LPL	32.00%	110.50	2.00	0.57
Pakgen Power	PKPG	27.55%	102.52	2.00	0.52
Associated Company (other)					
Adamjee Insurance Company Limited	AICL	0.03%	0.67	2.50	Not Significant
Short Term Investments					
Nishat Chunian Limited	NCL	13.61%	24.76	4.00	0.13

Source: AHL Research and Company Accounts

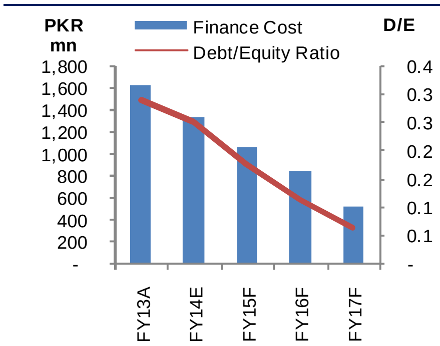
Power efficiencies through coal and alternative energy projects

NML has the advantage of its switching fuel mix to coal-based power generation as an alternative to gas at their power plants in Faisalabad, Bhikki, Lahore and Feroze Watwan. Currently, NML is using a combination of fuel mix of coal (30%) and other solid fuels (70%) with steam generating boilers, rice husk, wood chips, and corn cobs as alternative fuels. Further support will also be provided by its gas (SNGP-network) plant that is nearing completion, which will use LPG as means to run the plant ahead.

Leveraging on the low

The finance cost in FY13 shrank 8% YoY to PKR 1,618mn. It is worth mentioning here that, NML has less reliance upon debt than its peers i.e. Nishat Chunian Limited (NCL). Long term debt stands as low as PKR 3.1bn (debt-equity 0.37x currently) while short-term borrowings are the only significant contributor towards leveraging the balance sheet. For this reason, the 300bps cut by the SBP in its policy rate (from Jun'12 to Aug'13) provided marginal bottomline benefits to NML. Going forward, we expect NML to reduce its financial charges further (especially when interest rates are on the rise again) by an average of 24% in the next four years, which will bring the debt-equity of NML to 0.13x by FY17.

Finance Cost & D/E

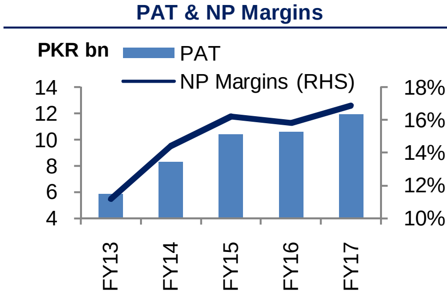


Source: AHL Research

New potential power venture

Along with the FY13 results, the company's BoD also announced its intention to participate in the bidding of 590MW Mahal Hydropower project, which has been initiated by the Private Power & Infrastructure Board Gov't of Pakistan. NML already owns 51% in Nishat Power Ltd (NPL, 200MW), 32% in Lalpir Power Ltd (LPL, 362MW) and 28% in Pakgen Power Ltd (PKGP, 365MW). Since NML's dividend income is on the rise, given its spreading footprints in the power sector (dollar-based tariffs and better cash recoveries recently), the new venture would add significantly to the bottomline should NML become successful in the bid. With NML having a balance sheet size of over PKR 80bn and a vast chain of other companies funding for further support, we believe Nishat Group should not face any financing troubles in funding the bid for the project.

PAT & NP Margins

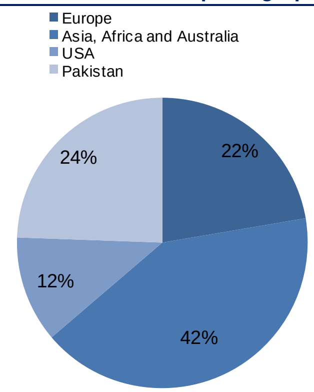


Source: AHL Research

Considerable financial support to subsidiaries for long term benefits

The BoD also announced PKR 400mn as equity injection to NML's wholly-owned subsidiary, Nishat Hospitality (Pvt) Ltd that is building a 4-star hotel (for cost overruns and project modifications). Another investment chunk of PKR 2.0bn has also been allocated to Nishat Linen (Pvt) Ltd to support the working capital requirements of the subsidiary. We believe cash outflows on part of these injections would eventually be well-compensated ahead through better returns and dividends from the same.

FY13 Revenue Break up Geographical



Source: AHL Research

Outlook and risks

Just like the textile sector in general, outlook for NML stands bright, especially for being the sector giant. Strong demand for products, in particular the value-added segment, hints at rising profitability for NML for the years ahead. We expect NML's earnings to grow at a CAGR of 19.6% for the next four years. The key risk to our valuation and earnings estimate includes any unexpected uptick in cotton prices with low level of inventory that could prove damaging for NML. On account of topline growth going forward, we expect it to be mainly driven by EU export demand, which we expect to grow by a CAGR of 8% in next four years.

Main risks to evaluation include an abrupt change in cotton prices, change in value of PKR and increase in interest rates.

Following is provided NML's earnings sensitivity with each of the above mentioned factors:

NML- Sensitivity			
Increase in Interest Rate by 100 bps	**FY14E**	**FY15F**	**FY16F**
EPS without change	23.66	29.60	30.25
EPS with Change	23.63	29.57	30.23
Net Change in EPS	-0.1%	-0.1%	-0.05%
Cotton Price Increase by 1%	**FY14E**	**FY15F**	**FY16F**
EPS without change	23.66	29.60	30.25
EPS with Change	23.43	28.04	26.85
Net Change in EPS	-1.0%	-5.3%	-11.2%
PKR Depreciation by 1%	**FY14E**	**FY15F**	**FY16F**
EPS without change	23.66	29.60	30.25
EPS with Change	24.19	30.40	31.16
Net Change in EPS	2.2%	2.7%	3.0%

Source: AHL Research

Investment portfolio risk

Other significant risk to our valuation is the portfolio value of NML. Though we have taken a 35% discount to current market values of respective companies, which are sufficient to absorb any market shock, any deep decline in prices can still affect our target value for NML as portfolio contributes approximately 50% to our target price.

Valuation and Recommendation

	Jun-14	Jun-15	Jun-16	Jun-17
Net income	8,319	10,408	10,635	11,957
Plus Depreciation and Amortization	1,398	1,461	1,499	1,537
Plus interest (1-tax rate)	1,261	1,028	788	486
Minus Fixed capital investment	(1,714)	(671)	(689)	(707)
Minus Changes in Working Capital	(747)	316	2,331	1,469
FCFF	**8,517**	**12,542**	**14,563**	**14,743**
Minus Dividend Income	(2,709)	(3,176)	(3,816)	(4,370)
FCFF	**5,808**	**9,366**	**10,748**	**10,373**

Valuation	PKR mn
Discounted FCFF	28,867
Terminal Value	16,651
Discounted Terminal Value	9,604
Firm value	38,471
Less: Debt	16,400
Nos of shares in Mn	352
FCFF - Target Price	78
Portfolio Value (35% Discount)	80
Sum of the Parts based Target Price	**159**

Recommendation

Using our Sum of the Parts-based financial model, basing our valuation on risk free rate of 13.5% (10-year PIB) and 3-year adjusted beta, we work out NML to have a Jun-14 target price of PKR 159/share. We expect NML to post 4-year earnings CAGR of 19.6%. NML is currently trading at FY14E and FY15F PE of 5.3x and 4.2x.

We recommend 'BUY' on NML at these levels. With significant out-reach in European markets to be further unlocked through granting of the GSP+ Status to Pakistan and significant support of dividends incomes from associate companies, the scrip remains a textile favorite.

Summary Financials, Forecasts and Key Ratios

Income Statement (PKR mn)	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17
Net Sales	52,426	57,795	64,228	67,209	70,932
Cost of Goods Sold	43,382	45,583	50,466	54,079	57,065
Gross Profit	9,044	12,212	13,762	13,130	13,867
Other Income	2,739	2,913	3,356	4,040	4,617
Financial Charges	1,618	1,360	1,095	839	516
Net Profit Before Taxation	6,357	8,942	11,050	11,308	12,667
Net Profit After Taxation	5,847	8,319	10,408	10,635	11,957
EPS (PKR)	16.63	23.66	29.60	30.25	34.01
DPS (PKR)	4.00	5.00	6.00	7.00	8.00

Balance Sheet (PKR mn)	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17
SHARE CAPITAL & RESERVE					
Unappropriated Profit	55,401	62,261	70,665	78,663	87,738
Shareholders Equity	**58,917**	**65,777**	**74,181**	**82,179**	**91,254**
NON CURRENT LIABILITIES					
Non Current Liabilities	3,649	1,654	943	657	672
CURRENT LIABILITIES					
Current maturity of Long term Liabilities	1,311	1,036	755	333	36
Short term finance	11,939	9,435	7,907	5,629	3,417
Current Liabilities	**18,068**	**15,963**	**14,367**	**11,997**	**9,795**
TOTAL LIABILITIES & EQUITY	**80,635**	**83,394**	**89,491**	**94,833**	**101,721**
NON CURRENT ASSETS					
Operating Fixed Assets	15,530	15,846	15,056	14,246	13,416
Investment in subsidiaries	37,378	36,448	36,448	36,448	36,448
Non-current Assets	**53,430**	**52,809**	**52,018**	**51,208**	**50,378**
CURRENT ASSETS					
Stock-in-trade	10,945	11,781	10,531	8,648	7,579
Trade debts	6,244	5,707	5,801	5,262	4,787
Current Assets	**27,205**	**30,585**	**37,473**	**43,625**	**51,343**
TOTAL ASSETS	**80,635**	**83,394**	**89,491**	**94,833**	**101,721**

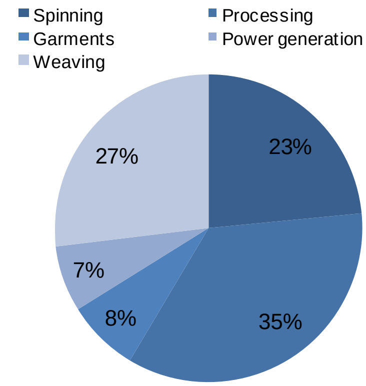
Ratio Analysis	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17
Liquidity Ratios					
Current Ratio	1.51	1.92	2.61	3.64	5.24
Quick Ratio	0.83	1.18	1.88	2.92	4.47
Profitability Ratios					
Return on assets	9%	10%	12%	12%	12%
Return on equity	12%	13%	15%	14%	14%
Return on Capital	15%	13%	15%	13%	14%
Profit Margins					
Gross Margin	17%	21%	21%	20%	20%
EBITDA Margin	20%	20%	21%	20%	21%
Net Profit Margin	11%	14%	16%	16%	17%
Book value per share (PKR)	167.57	187.08	210.98	233.73	259.54
EPS	16.63	23.66	29.60	30.25	34.01
DPS	4.00	5.00	6.00	7.00	8.00
Payout Ratio	24%	21%	20%	23%	24%

Source: Company Accounts, AHL Research

About the company

Nishat Mills limited was established in 1951 as a public limited company under the Companies Act 1913. The company operates in the lines of textile manufacturing and spinning, combing, weaving, bleaching, dyeing, printing, stitching, buying and selling of products fabricated from raw cotton. The company is also in the business of electricity generation and selling. NML is a leading exporter with 3% (FY12) share in country's total textile exports. Overall, NML has 28 manufacturing units each specializing in a specific product range located at Faisalabad, Sheikhupura, Feroze Watwan and Lahore.

Revenue Breakup as of FY13



Source: AHL Research

Revenue mix

To have an overview of top-line mix of NML, contribution of Processing & Home Textile is 44%, Spinning segment is 24%, and Weaving is 21% whereas Garments adds 10% in the total sales of the company. The Spinning segment is the most profitable segment with a profit margin of 16.7%; whereas segment profit margin of Garments is 13.77%, Weaving 8.12% and Processing & Home Textile 7.48%.

Nishat Group's portfolio

Nishat group of companies is a leading business group of Pakistan, having presence in major business segments present in the country, including textile, cement, banking, hotel, insurance, agriculture, dairy and paper products. The listed companies associated with Nishat Group includes: DG Khan Cement (DGKC), MCB Bank Limited (MCB), Adamjee Insurance Limited (AICL), Nishat Power Limited (NPL), Pakgen Power Limited (PKGP), Nishat Chunian Limited (NCL) and Lalpir Power Limited (LPL).

Insight on different business divisions of NML

NML has five reportable business segments including Spinning, Weaving, Processing & Home Textile, Garments and Power Generation. In spinning, yarn is manufactured using natural and artificial fibers. In weaving, yarn is converted into greige fabric and then, variety of home textile articles and printed fabrics are produced from greige fabric under processing & home textile.

Processed fabrics are used to manufacture garments in garments segment. In power generation, electricity is produced and distributes using gas, oil, steam, coal and biomass. Transactions between these segments are recorded at cost and intersegment sales are not included in total numbers.

List of Textile Companies on Favorable Multiples – Under Soft Coverage

Though not in our formal coverage (soft coverage), below is a list of textile companies trading on favorable multiples in addition to our sample textile companies.

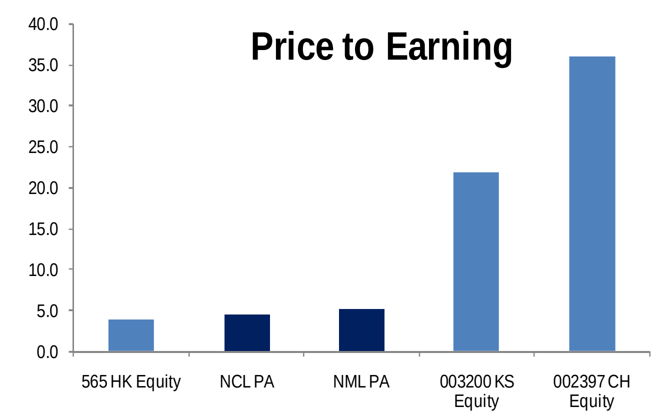
Code	Company	Shares (mn)	Freefloat (%)	Market Cap (USD mn)	Current Price	Adjusted EPS			PE Multiple*
						FY12A	FY13A	1QFY14A	
THAS	Taha Spinning Mills Ltd.	4.05	20.9%	0.78	20.4	(4.2)	(7.4)	18.3	0.3
DKTM	Dewan Khalid Textile Mills Ltd.	5.68	30.0%	0.51	9.5	(0.3)	0.2	3.4	0.7
JDMT	Janana-de-Malucho Textile Mills Ltd.	4.78	21.0%	4.12	91.4	30.2	49.0	31.7	0.7
DMTM	Dewan Mushtaq Textile Mills Ltd.	3.43	25.0%	0.47	14.5	5.3	(4.0)	4.3	0.8
BCML	Babri Cotton Mills Ltd.	3.65	23.2%	2.68	78.0	24.1	59.0	16.3	1.2
SANE	Salman Noman Enterprises Ltd.	4.47	32.4%	0.22	5.3	(27.7)	(3.3)	1.0	1.3
SHDT	Shadab Textile Mills Ltd.	3.00	15.0%	1.57	55.5	6.9	37.4	9.8	1.4
TATM	Tata Textile Mills Ltd.	17.32	30.0%	9.14	56.0	2.4	19.0	8.7	1.6
SLYT	Sally Textile Mills Ltd.	8.78	23.1%	2.74	33.1	4.1	15.6	4.1	2.0
SALT	Salfi Textile Mills Ltd.	3.34	10.0%	5.88	186.9	46.9	107.7	23.1	2.0
FASM	Faisal Sinning Mills Ltd.	10.00	10.0%	14.13	150.0	29.9	79.8	17.3	2.2
REWM	Reliance Weaving Mills Ltd.	30.81	20.0%	12.99	44.8	8.4	18.5	5.1	2.2
IDSM	Ideal Spinning Mills Ltd.	9.92	20.0%	1.63	17.5	2.9	3.1	1.9	2.3
BHAT	Bhanero Textile Mills Ltd.	3.00	5.0%	13.84	490.0	102.2	195.7	50.3	2.4
ILTM	Island Textile Mills Ltd.	0.50	35.0%	5.65	1,200.0	355.1	734.7	118.4	2.5
PRET	Premium Textile Mills Ltd.	6.16	70.0%	9.75	168.0	31.5	80.0	16.2	2.6
BTL	Bleesed Textile Mills Ltd.	6.43	18.6%	10.30	170.0	44.0	61.4	15.3	2.8
SUTM	Sunrays Tetile Mills Ltd.	6.90	10.0%	16.25	250.0	64.1	77.0	19.6	3.2
QUET	Quetta Textile Mills Ltd.	13.00	65.0%	6.72	54.9	2.8	12.3	3.9	3.5
AWTX	Allawasaya Tex. & Weaving Mills Ltd.	0.80	0.3%	2.03	270.0	52.0	109.0	19.2	3.5
SAIF	Saif Textile Mills Ltd.	26.41	25.0%	8.59	34.5	8.1	16.4	2.4	3.6
STML	Shams Textile Mills Ltd.	8.64	30.0%	4.90	60.3	4.9	32.9	4.1	3.7
FZTM	Fazal Textile Mills Ltd.	6.19	10.0%	22.61	388.1	21.3	70.5	24.4	4.0
GADT	Gadoon Textile Mills Ltd.	23.44	20.0%	46.84	212.2	27.7	48.4	13.0	4.1
ISTM	Ishaq Textile Mills Ltd.	9.66	15.0%	2.07	22.8	1.1	7.5	1.4	4.1
BNWM	Bannu Woollen Mills Ltd.	9.51	36.0%	6.01	67.2	14.4	15.2	4.0	4.2
CRTM	Crescent Textile Mills Ltd.	49.21	55.0%	9.01	19.4	(2.4)	2.3	1.0	4.6
BROT	Brothers Textile Mills Ltd.	9.80	37.4%	0.41	4.4	0.4	0.6	0.2	4.7
ARUJ	Aruj Garment Accessories Ltd.	6.15	9.0%	0.85	14.6	2.1	3.5	0.7	4.9
ADMM	Artistic Denim Mills Ltd.	84.00	30.0%	62.45	78.9	5.2	9.0	3.9	5.1
DMTX	D. M. Textile Mills Ltd.	3.05	25.0%	0.40	14.0	(23.2)	(11.0)	0.7	5.3
STJT	Shahtaj Textile Mills Ltd.	9.66	35.0%	4.44	48.8	9.0	11.7	2.2	5.7
SNAI	Sana Industries Ltd.	8.59	40.0%	5.48	67.7	6.5	7.3	2.8	6.1
ALQT	AL-Qadir Textile Mills Ltd.	7.56	4.7%	1.67	23.5	0.5	5.9	0.8	7.7
LATM	Latif Jute Mills Ltd.	3.56	33.5%	0.21	6.4	(0.0)	0.6	0.2	8.5
KTML	Kohinoor Textile Mills Ltd.	245.53	75.0%	66.43	28.7	0.5	2.0	0.8	9.3
ELCM	Elahi Cotton Mills Ltd.	1.30	25.0%	0.83	67.5	0.8	2.2	1.7	9.8
GATM	Gul Ahmed Textile Mills Ltd.	182.82	25.0%	64.26	37.3	(1.3)	3.8	0.9	11.0
CML	Colony Mills Ltd.	244.18	30.0%	12.14	5.3	(1.3)	1.2	0.1	12.3
APOT	Apollo Textile Mills Ltd.	8.28	1.5%	1.05	13.4	1.1	4.2	0.3	12.7
INKL	International Knitwear Ltd.	3.23	30.0%	0.29	9.5	2.1	(4.3)	0.1	16.5
SFAT	Safa Textile Ltd.	4.00	30.0%	0.56	14.9	0.4	0.3	0.1	67.2
NSRM	National Silk and Rayon Mills Ltd.	1.11	1.1%	0.18	17.0	3.8	7.0	na	na
FTHM	Fateh Textile Mills Ltd.	1.25	70.0%	na	NT	3.3	na	na	na

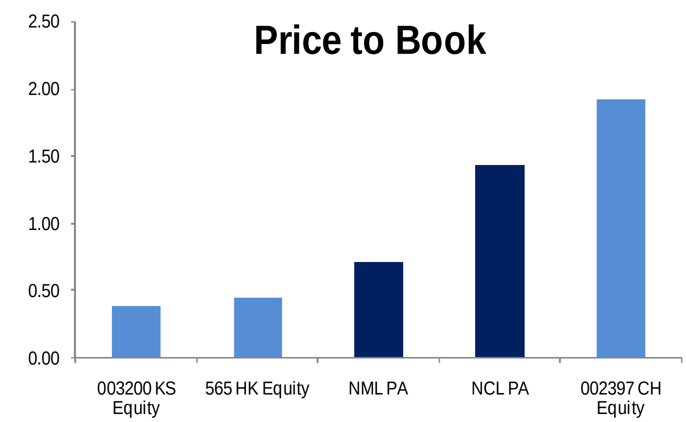
Source: Company Financials, AHL Research, *On extrapolated forward earnings

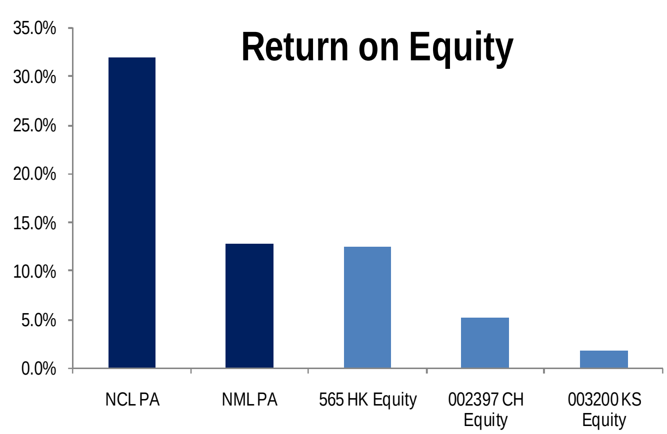
Regional Charm

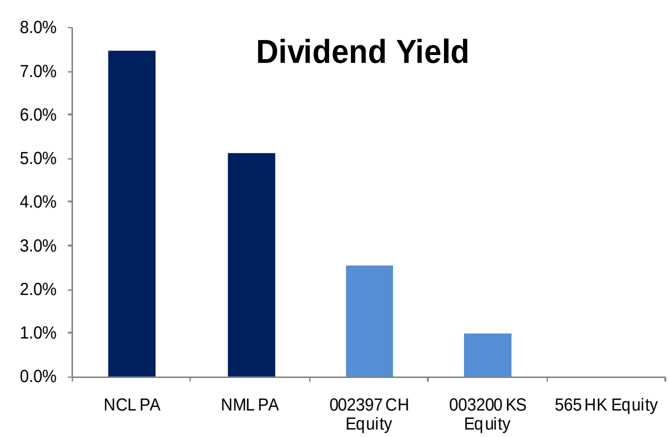
Companies	Origin	Mkt Cap (USD)	P/E (x)	P/B (x)	P/FCF	P/Sales	Gross Margins	EBITDA Margins	Net Margins	Div Yield	D/E	ROA	ROE
JIANGSU LIANFA TEXTILE CO-A	China	554.03	10.9	1.1	103.4	0.9	20.0%	17.5%	8.5%	0.0%	47.0%	7.1%	10.6%
VICTORY CITY INTL HLDGS LTD	Hong Kong	259.67	7.8	0.4	128.3	0.4	18.4%	13.9%	5.0%	0.0%	56.9%	2.6%	4.5%
VARDHMAN TEXTILES LTD	India	382.60	4.6	0.7	na	0.3	0.0%	20.1%	7.2%	2.8%	110.9%	5.6%	15.1%
FUJIBO HOLDINGS INC	Japan	233.18	9.1	1.5	8.7	0.7	36.4%	16.0%	7.7%	2.4%	26.1%	7.4%	18.0%
NISHAT MILLS LTD	Pakistan	414.20	5.1	1.4	4.1	0.4	21.0%	16.0%	15.0%	4.0%	37.0%	11.0%	12.0%
NISHAT CHUNIAN LTD	Pakistan	99.40	6.1	0.7	1.7	0.2	17.0%	21.0%	12.0%	7.0%	133.0%	12.0%	12.0%
ILSHIN SPINNING CO LTD	S. Korea	280.25	16.8	0.3	4.3	0.4	14.7%	-1.8%	2.4%	0.0%	3.6%	1.4%	1.8%
SHINKONG TEXTILE CO LTD	Taiwan	393.67	68.3	2.1	66.5	12.9	28.3%	8.6%	18.8%	0.0%	38.7%	2.0%	3.2%
SAHA-UNION CORP PCL	Thailand	326.65	9.4	0.7	9.2	1.2	10.2%	9.5%	13.2%	0.0%	17.4%	5.4%	7.8%

Source: Bloomberg, AHL Research









Annexure

Pakistan is also the 8th largest exporter of textile products in Asia and supplies 3% of United States demand of clothing & other textiles products. This sector provides employment to around 15mn people or ~30% of the 49mn workforce of the country. Pakistan is the 4th largest producer of cotton with the third largest spinning capacity in Asia after China and India, and contributes 5% to the global spinning capacity. Presently, there are roughly 1,221 ginning units, 442 spinning units, 124 large spinning units and 425 small units which produce textile related products.

Pakistan Textile Export Growth Trend

Textile Export Categories (USD mn)	FY09	FY10	FY11	FY12	FY13	CAGR 5Y
Raw Cotton	88	196	360	462	154	11.8%
Cotton Yarn	1,106	1,417	2,185	1,795	2,244	15.2%
Cotton Cloth	1,929	1,819	2,562	2,455	2,691	6.9%
Cotton Carded or Combed	16	16	31	12	6	-17.8%
Yarn other than cotton yarn	26	46	53	42	39	8.8%
Knitwear	1,724	1,761	2,311	1,974	2,033	3.3%
Bed Wear	1,710	1,724	2,085	1,748	1,784	0.9%
Towels	628	676	765	684	776	4.3%
Tents, Canvas, & Tarpulin	58	62	49	99	126	17.0%
Readymade Garments	1,247	1,283	1,774	1,635	1,815	7.8%
Art, Silk & Synthetic Textile	319	447	671	542	406	4.9%
Madeup Articles	489	540	627	585	592	3.9%
Other Textile materials	224	258	334	325	399	12.2%
Total	**9,564**	**10,244**	**13,805**	**12,357**	**13,064**	**6%**

Gul Ahmed Textiles (GATM): Conference call takeaways

In the backdrop of recent spree of currency depreciation across the emerging Asia region against the greenback, especially the INR (Indian rupee) depreciation and its relative impacts on Pakistan's Textiles sector, rising energy costs and the GSP-plus status update, we have had a conference call with the management of one of the key Textile giant, Gul Ahmed Textile Mills, to have an industry view on the same. Following are key takeaways of our call:

- Recent increase in electricity and gas prices to have a negative bottom line impact of around 18%-20% across the board for textile companies
- With Indian Rupee (INR) losing its vigor by massively against USD, Indian Textile sector stands to benefit textile companies who import yarn from India, which tends to be of better quality (in terms of harvesting in achieving better staple strength) and lesser costly from local yarn
- Granting MFN status to India will further boost Lawn Exports where India's textile products tend to have a higher percent of polyester mix from our make
- Pakistan has an edge over India Lawn Printing and Denim products, major textile exports across the border, this along with other value addition products such as home textiles, towels, etc stands to benefit from in exports to EU markets as GSP+ and ATP+ status is granted

- Pakistan has benefited from export orders which have been diverted from Bangladesh (after incident there) and China recently

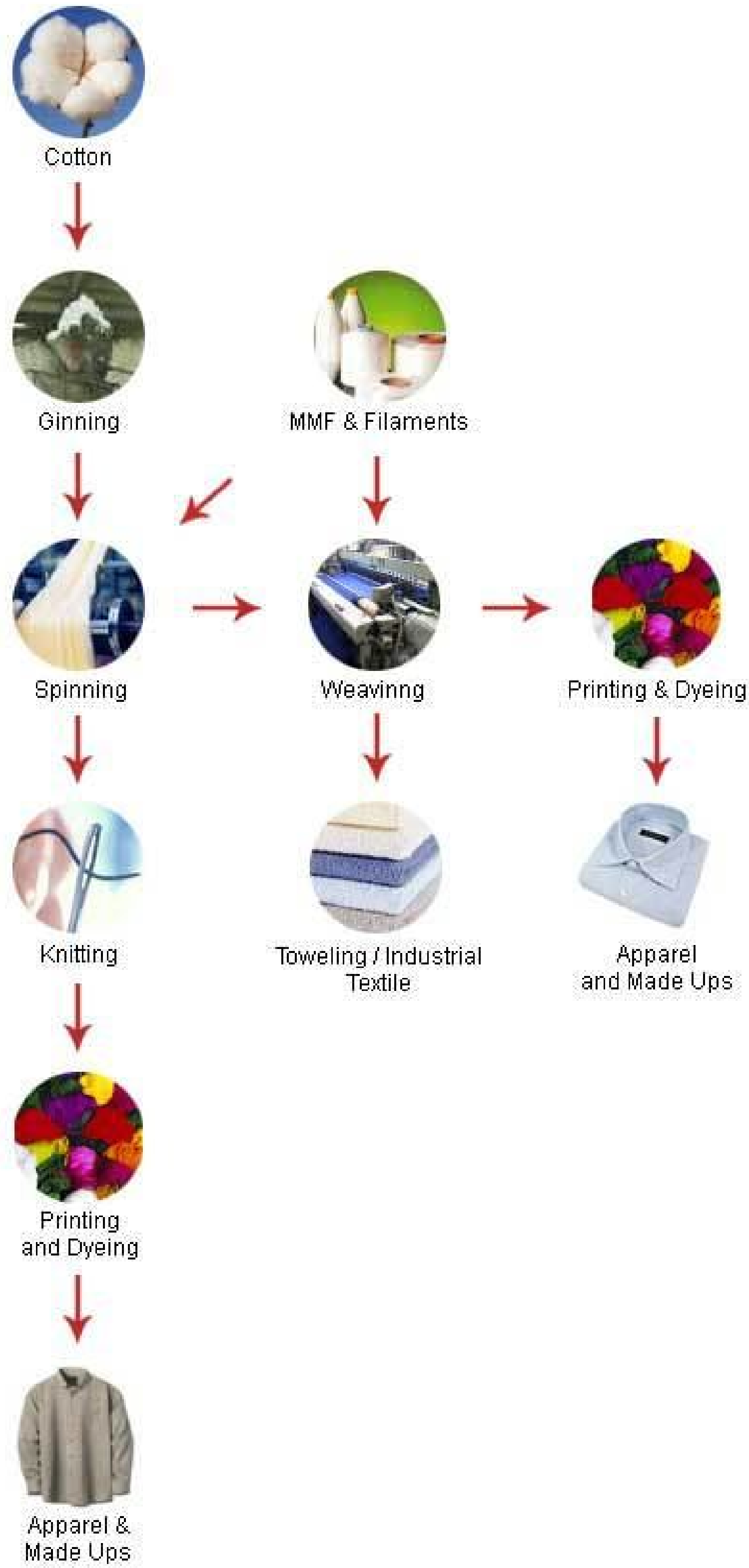
Nishat Chunian Limited (NCL): Conference call takeaways

We have also held a conference call with the management of one of the key Textile giants, Nishat Chunian Limited (NCL), to have an industry as well as the company view on the same. Following are the key takeaways from our call:

- NCL regressively procures its cotton without any major stoppage; NCL's average cost of cotton procurement is one of the lowest in the industry
- 70% - 75% of cotton procured is local while the remaining is imported
- Close to a million cotton bales is total procurement requirement for NCL in the entire year, with majority procurement taking place in September onwards when cotton prices are relatively lower from the rest of the year
- 80% of the yarn produced by the spinning division of NCL is exported to China while the remaining towards European markets
- NCL's management is against the view of a major trend shift in yarn exports post GSP-Plus scenario, from China to the EU
- Though foresees an uptake in yarn prices post GSP-Plus era, as demand of value adding goods will increase, the management sees this as a major gross margins lifter for NCL, going forward
- USA retail markets contribute almost 80%-85% of the total value addition (Processing and Home Textiles) exports of NCL while the remaining mostly to EU markets
- Adding to continuing PKR depreciation against the USD, NCL's forecast for FY14 end stands at PKR 115
- With the addition of the 6th spinning unit (22,000 spindles), major Capex of the expansion has already occurred (PKR ~1.0-2.0bn), this will not only aid in catering to the increasing demand from the Chinese markets, but will also help in containing increased demand from the EU in the post GSP-Plus era
- The recently acquired assets of Taj Textile Mills (38,000 spindles) is expected to come online by Feb-Mar'14 next year, with major renovation (detailed over-hauling of the spindles) taking place currently. A Capex of PKR 600-700mn in its over-hauling has to a great extent already been incurred by NCL
- Round about PKR 100-150mn (on a relatively higher side) is the only major capex mostly in the repairs and maintenance side to be incurred by NCL during FY14
- Finance and leverage levels remain in control of the management, as it has already been witnessed with debt to equity levels having been reduced from 1.6x to 1.3x, from FY12 to FY13, respectively
- 14MW grid station by NCL is nearing its completion and is expected to become operational by the end of this current financial quarter (issues with the ministry have mainly contributed to the continuous delays on the commencement of the project since many quarters)

- The management is considering setting up a 30-40MW coal-based captive power plant (capital outlay expected to be PKR 4-5bn) going forward in the next financial year (FY15), the project currently is in its initial stages and yet to be finalized by the board of directors
- Currently, and going forward, energy requirements of NCL stand at 45-50MW
- This major potential project going forward will help reduce the fuel & power expenditure for NCL, in particular its costly furnace oil & gas reliance
- NCL management foresees higher profitability and dividend payouts from the subsidiary, Nishat Chunian Power Ltd (NCPL) going forward, while dividends and earnings growth of the company itself, for FY14, is expected to remain maintained on YoY basis, being slightly on the higher side from the prevailing fiscal

Textile Value Chain



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Abbreviations

ABL	Allied Bank Limited
bps	Basis points
bn	Billion
COGS	Cost of goods sold
DGKC	D. G. Khan Cement Company
DPS	Dividend per share
DY	Dividend yield
EBITDA	Earning before interest, tax, depreciation and amortization
EPS	Earning per share
FCFF	Free Cashflow to the Firm
FY	Fiscal year
Gov't	Government of Pakistan
GSP	Generalised System of Preferences
GST	General Sales Tax
LESCO	Lahore Electric Supply Company
mn	Million
MoM	Month on Month
MW	Megawatt
NBP	National Bank of Pakistan
NCL	Nishat Chunian Limited
NCPL	Nishat Chunian Power Limited
NML	Nishat Mills Limited
PE	Price earning ratio
PKGP	Pakgen Power Limited
PKR	Pakistani Rupee
PPA	Power Purchase Agreement
pps	percentage points
RFO	Residual Furnace Oil
SBP	State Bank of Pakistan
SoTP	Sum of The Parts
USD	US Dollar
YoY	Year to year

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