



Nishat Mills Limited

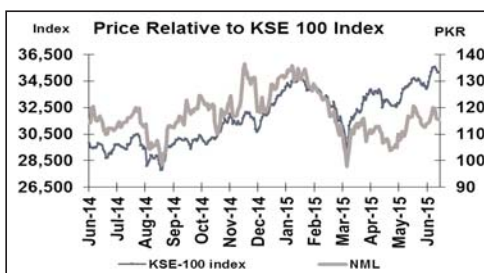
NML: Strong portfolio fetching investors' interest

We continue the coverage of Nishat Mills Limited (NML) with a June'16 Target Price of Rs 147/share, offers an upside potential of 21% including 3.3% dividend yield thus total return would jump to 24%. Our positive stance is based on; 1) Lower cotton prices supported lesser working capital, 2) Projects underway, 3) Dividend income to support bottom line, 4) 42-year record low 7% DR, financing costs benefited and 5) Strong Portfolio. The scrip is trading at attractive levels with a FY16E PER and FY17E PER of 8.5x and 8x The key risks to our valuations are; 1) China cotton policy, 2) Irregular gas supply, 3) PKR to USD parity, 4) Declined yarn export, 5) Gas tariff imposition.

KEY DATA

KATS Code	NML
Reuters Code	NISM.KA
Current Price (Rs)	121.45
Year High, Low (Rs)	137.49, 97
Market Cap (Rs' bn)	42.70
Market Cap (US\$ mn)	419
Shares Outstanding (mn)	351.60
Free Float (%)	50%

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

NML Financial Snapshot

	FY14A	FY15E	FY16F	FY17F
Net Sales (Rs mn)	54,444	50,096	55,270	58,102
Profit after Taxation (Rs mn)	5,513	3,575	5,009	5,331
EPS (Rs)	15.68	10.17	14.25	15.16
Book Value (Rs/share)	195.1	201.9	211.2	221.0
DPS (Rs)	4.00	4.00	5.00	5.00
P/E x	7.7	11.9	8.5	8.0
P/ BV (x)	0.6	0.6	0.6	0.5
Dividend Yield (%)	3.3	3.3	4.1	4.1
ROE (%)	8.0	5.0	6.7	6.9
ROA (%)	5.7	3.7	5.3	5.6

Source: Company Reports & WE Research



Valuation: BUY with a Target Price of Rs 147

We have used Sum of Parts Valuation Technique (SOTP) to calculate the Target Price of NML in which we separate valuation method for the core textile business and portfolio investment. For computing textile business, we have used Discounted Cash Flow Technique with assumption of 10% Risk free rate, 6% market premium and 3% growth rate, thus our SOTP Base June'15 Target Price for NML is Rs 147/share offers upside of 21%, including 3.3% FY15 dividend yield, stock offer total upside potential of 24%

Valuation Break-up

Rs in million	FY15E	FY16F	FY17F
Free Cash Flow to Firm	4,591	1,489	1,753
Discounted Free Cash Flow	4,591	1,386	1,413
Terminal Value		14,490	
PV Terminal Value		8,710	
(-) Debt		(11,653)	
Core Value		4,447	
(+) Portfolio value @ 25% discount		47,196	
Shares Outstanding		351.6	
Target Price June'16 - SOTP (Rs)		147	

Source: WE Research

Portfolio value

We assumed 25% discount rate to calculate portfolio value per share (quoted), which is calculated at Rs 134.20/share of total NML Target Price of Rs 147/share. Trading at FY16E PER of 8.5x, with estimated 3-year earnings CAGR of 22%, company provide potential of 24%. 'BUY'.

Rs in million	Shares Held	Price	Value
NPL	180.6	59.9	10,820
DGKC	137.6	154.1	21,200
LP	109.4	33.75	3,692
PKGP	102.5	32.5	3,332
MCB	80.79	279.9	22,617
NCL	27.24	40.49	1,103
Others			165
Total Portfolio Value			62,928
Shares Outstanding			351.6
Portfolio Value per Share			179
Portfolio value @ 25% discount			134.2



We are foreseeing FY16 to be a turnaround with expected Profit after tax of Rs 5,009 million (EPS: Rs 14.25/share) due to healthy contributions from its subsidiaries and associated companies.

During FY15, the prices of cotton bales remained in the range of Rs 4,750 - 5,500/maund that helped the company to generate earnings while utilizing lesser working capital. We expect gross profit to surge by 13% to reach Rs 6,701 million by fiscal year end 2016

Earning expected to incline in FY16 after dip in FY15

Although the period FY15 did not turn out to be impressive for Nishat Mills, owing to rising energy cost, sharp appreciation of PKR, lower sales, hike in financing cost and decline in other income; resulting in decline in earnings growth by 35% to Rs 3.6 billion (EPS: Rs 10.17/share). We are foreseeing FY16 to be a turnaround with expected Profit after tax of Rs 5,009 million (EPS: Rs 14.25/share) due to healthy contributions from its subsidiaries and associated companies.

Lower cotton prices supported lesser working capital

During FY15, the prices of cotton bales remained in the range of Rs 4,750 - 5,500/maund that helped the company to generate earnings while utilizing lesser working capital. The impact of it will bear fruits in FY16 in value added segments comprising of weaving, processing and home textile of NML. We expect gross profit to surge by 13% to reach Rs 6,701 million by fiscal year end 2016.

Addition of machinery in NML's different divisions

NML recently added a new unit of 28,800 spindles in its Spinning division at Feroze Watwan. In the Garments division, the construction work took place for its enhancement. In the Processing and Home Textile division, narrow width processing capacity has been increased by adding a new Digital Machine, a Mercerizing Machine, a Rotary Printing Machine, a Stenter Machine and Ager. Furthermore, an investment in 660 MW Coal Fired Power Plant at Rahim Yar Khan is also on the plate.

GSP+ status, company triggered to export

NML did not able to benefit much during FY15 due to increased cost of production and lack of electricity & gas supply. The company managed to overcome these issues via its own electricity plant. FY16 is expected to be better where international demand is anticipated to be catered well.



We expect MCB Bank to contribute the most with dividend income of Rs 1.3 billion; followed by NPL with Rs 1 billion; DGKC with Rs 550 million; Lalpir Power with Rs 252 million; and Pakgen Power with Rs 221 million in FY16 respectively.

NML is heavily indebted to meet its requirements ranging from cotton procurement needs to lending to its subsidiaries. 42-year lowest interest rate of 7% by State Bank of Pakistan helped the company to reduce its financial charges.

Dividend income to support bottom line

NML has invested heavily in diversified portfolio from which healthy dividend earnings are expected to support the earnings of the company. We expect MCB Bank to contribute the most with dividend income of Rs 1.3 billion; followed by NPL with Rs 1 billion; DGKC with Rs 550 million; Lalpir Power with Rs 252 million; and Pakgen Power with Rs 221 million in FY16 respectively.

42-year record low 7% DR, financing costs benefited

NML is heavily indebted to meet its requirements ranging from cotton procurement needs to lending to its subsidiaries. 42-year lowest interest rate of 7% by State Bank of Pakistan helped the company to reduce its financial charges. The more time SBP maintain this rate due to lower inflation, the more beneficial it will be for the company.

Nishat Power Limited - An Overview

Nishat Power Limited (NPL) is a subsidiary of NML that is playing pivotal role in electricity production area. During current year 2014-15, the plant operated with average capacity factor of 85% producing and supplying more than 1,100 GWh to National Transmission & Dispatch Company Limited (NTDCL). We expect Nishat Power Limited to contribute the dividend income of Rs 1 billion during FY16.

Lalpir Power Limited - An Overview

Lalpir Power Limited is an associated company of Nishat Mills Limited that performed at a capacity factor of 72%, dispatching 542 GWh of electricity to WAPDA during current year 2015. As on March 2015, WAPDA had an accrual of Rs 8.32 billion. We expect Lalpir Power Limited to contribute the dividend income of Rs 252 million during FY16.

Pakgen Power Limited - An Overview

Another associated company of Nishat Mills Limited is Pakgen Power Limited. The company managed to dispatch 245 GWh of electricity to WAPDA during current year 2015. As a result, the capacity factor turned out to be 32.6% as compared to 68% the corresponding period last year. The core reason behind shortfall was complex tripping on the failure of main station transformer that was sent to WAPDA's workshop for repair. The timeline and cost are yet awaited once WAPDA completes its inspection. We expect Pakgen to contribute the dividend income of Rs 221 million during FY16.



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Nishat Dairy (Private) Limited contains an overall capacity of 4,500 milking animals. The Dairy is spread over an area of 165 acres. It is growing with a total herd size of 6,200 animals plus followers.

DGKC is amongst the top operational capacity plants having Clinker capacity of 4.02M tons/annum and Cement capacity of 4.22M tons/annum. D. G. Khan Cement is undergoing a 2.5 million tons plant expansion in Balochistan that is expected to be completed by 2018.

Nishat Paper Products Limited - An Overview

Nishat Paper Products Limited (NPPL) is into paper sack production business and has vertical integration with D. G. Khan Cement Limited (DGKC). The company comprises of an annual production capacity of 120 million bags. Being situated in Northern territory, it also provide cement bags to other nearby cement producers as well including Lafarge Pakistan, Maple Leaf, Fauji Cement, Pioneer cement etc. The company announced a huge jump of 469% in its Profit after Tax to reach Rs 157 million during nine months ended March 2015 as compared to Rs 28 million the same corresponding period last year. Sack industry is highly sensitive to the price of Kraft paper that is imported from international market.

Nishat Dairy (Private) Limited - An Overview

Nishat Dairy (Private) Limited contains an overall capacity of 4,500 milking animals. The Dairy is spread over an area of 165 acres. It is growing with a total herd size of 6,200 animals plus followers. The cows of Pure Holstein Friesian breed were initially imported from Netherland and Australia that are later homebred. The company is optimistic to produce 150 thousand liters of milk on daily basis this year. In addition to it, the company also own 1 Mega Watt of solar plant that is not only saving fuel cost but also providing clean energy to the farm. The company announced a profit after tax of Rs 283 million for nine months ended March 2015 in comparison to a loss after tax of Rs 458 million for nine months ended March 2014.

D.G. Khan Cement Company Limited

D.G. Khan Cement is amongst the top operational capacity plants having Clinker capacity of 4.02M tons/annum and Cement capacity of 4.22M tons/annum. D. G. Khan Cement is undergoing a 2.5 million tons plant expansion in Balochistan that is expected to be completed by 2018. In this regard, a contract of 40MW electricity supply has also been inked with K-Electric. Further, the company itself is also implementing a 30MW coal based captive power plant.. We expect D.G. Khan Cement to contribute the dividend income of Rs 550 million during FY16

MCB Bank Limited

MCB Bank Limited (MCB) has shown multifold growth during recent years. The CASA ratio of MCB is standing at 91.36%; whereas Return on Assets and Return on Equity are at 3.25% and 29.13% respectively with the strong coverage ratio of 85.4%. We expect MCB Bank to contribute the dividend income of Rs 1,313 million during CY16.



Key Risks

China cotton policy remains skeptical

The import of cotton in largest importer China has dropped around 40% in March 2015 as compared to March 2014 due to strikes at U.S. West Coast ports and as Beijing issues less import permits to mills. NML being a major exporter to China is dependent towards China cotton policy. China might reverse or phase out its cotton policy by next season as its domestic mills are lobbying for direct subsidy to farmers rather than setting a floor price. If such thing happened, negative implications would spur for cotton prices and yarn margins internationally.

Inconsistent gas supply

Erratic gas supply towards industry is bringing question marks towards business going concern. Ultimately, companies are being forced to rely on alternatives such as Furnace Oil (FO), diesel, WAPDA etc. that would result in increased cost of production.

Squeezed yarn export

Yarn export volumes have been constantly facing decline during past two years mainly due to amended policy by China in its cotton procurement. Increased power tariff has further curbed margins of spinners. Although cotton prices might ease, 1) weak yarn prices, 2) slower off-takes and 3) high energy prices would continue to drag earnings for spinners in FY16.

Company Introduction

Nishat Mills Limited ("the Company") is the most modern and largest vertically integrated textile Company in Pakistan. The Company commenced its business as a partnership firm in 1951 and was incorporated as a private limited Company in 1959. Later it was listed on the Karachi, Lahore and Islamabad Stock Exchanges on 27 November, 1961, 11 March, 1989 and 10 August, 1992 respectively. The Company's production facilities comprise of spinning, weaving, processing, stitching, apparel and power generation.

Subsidiaries: Nishat Power Limited; Nishat Linen (Private) Limited; Nishat Spining (Private) Limited; Nishat Hospitality (Private) Limited; Nishat Linen Trading LLC; Nishat International FZE; Nishat Global China Company Limited; Nishat USA., Inc.; Nishat Commodities (Pvt.) Ltd.

Associated Companies: D. G. Khan Cement Company Limited; Nishat Paper Products Company Limited; Nishat Dairy (Private) Limited; Lalpir Power Limited; Pakgen Power Limited; MCB Bank Limited.



NML - Financial Highlights

Valuation

	FY14A	FY15E	FY16F	FY17F
EPS (Rs)	15.68	10.17	14.25	15.16
Book Value (Rs/share)	195.08	201.92	211.18	221.03
DPS (Rs)	4.00	3.00	3.00	4.00
P/E x	7.7	11.9	8.5	8.0
P/ BV (x)	0.6	0.6	0.6	0.5
Dividend Yield (%)	3.3	3.3	4.1	4.1
Payout (%)	26	39.3	35.1	33.0

Source: Company Reports & WE Research

Key Ratio Analysis

	FY14A	FY15E	FY16F	FY17F
Current Ratio (x)	1.34	1.40	1.57	1.75
ROE (%)	8.0	5.0	6.7	6.9
ROA (%)	5.7	3.7	5.3	5.6
Gross Margin (%)	14.4	13.4	13.7	13.0
Net Margin (%)	10.1	7.1	9.1	9.2
Sales Growth (%)	4	-8.0	10.3	5.1
PAT Growth (%)	-6	-35.1	40.1	6.4

Source: Company Reports & WE Research

Income Statement

Rs in million	FY14A	FY15E	FY16F	FY17F
Sales	54,444	50,096	55,270	58,102
Cost of Sales	46,580	43,395	47,685	50,544
Gross Profit	7,864	6,701	7,586	7,559
Admin. Expenses	3,587	3,847	4,283	4,695
Operating Profit	4,277	2,853	3,303	2,864
Finance Cost	1,610	1,973	1,686	1,410
Other Income	3,653	3,581	4,243	4,727
Other Charges	345	258	298	269
Profit before Taxation	5,976	4,202	5,561	5,912
Taxation	463	627	553	581
Profit after Taxation	5,513	3,575	5,009	5,331

Source: Company Reports & WE Research



Balance Sheet

Rs in million	FY14A	FY15E	FY16F	FY17F
Share Capital	3,516	3,516	3,516	3,516
Shareholder Equity	68,589	70,995	74,251	77,716
Non Current Liabilities	6,906	4,803	2,935	1,474
Current Liabilities	21,553	20,513	17,602	16,791
Total Liabilities	28,459	25,316	20,537	18,264
Non Current Assets	68,274	67,622	67,068	66,630
Current Assets	28,775	28,688	27,719	29,350
Total Assets	97,049	96,311	94,788	95,980

Source: Company Reports & WE Research

Rs in million	FY14A	FY15E	FY16F	FY17F
Cash from Operations	6,383	7,232	5,113	6,188
Cash from Investing activities	(7,922)	849	(179)	(135)
Cash from financing	3,213	(6,019)	(8,028)	(5,586)
Net change in cash	1,673	2,062	(3,095)	467
Beginning Cash balance	1,129	2,802	4,864	1,769
Ending Cash balance	2,802	4,864	1,769	2,236

Source: Company Reports & WE Research



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