RATING REPORT

Nishat (Chunian) Limited

REPORT DATE:
June 08, 2023

RATING ANALYSTS:
Muhammad Tabish
muhammad.tabish@vis.com.pk

Syed Ilyas Afridi
ilyas.afridi@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A	A-2
Rating Outlook	Stable		Positive	
Rating Action	Downgraded		Maintained	
Rating Date	*June 08, 2023*		*June 2, 2022*	

COMPANY INFORMATION	
Incorporated in 1990	**External Auditors:** Riaz Ahmed & Co. Chartered Accountants
Public Limited Company (Listed)	**Board Chairman:** Mr. Farrukh Ifzal
Key Shareholders (with stake 5% or more):	**CEO:** Mr. Shahzad Saleem
Mr. Shahzad Saleem ~22.8%	
Nishat Mills Limited ~13.6%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2023) *https://docs.vis.com.pk/docs/CorporateMethodology.pdf*

APPLICABLE RATING SCALE(S)
VIS Issue/Issuer Rating Scale: *https://docs.vis.com.pk/docs/VISRatingScales.pdf*

Nishat (Chunian) Limited

OVERVIEW OF THE INSTITUTION

Nishat (Chunian) Limited (NCL) is a public limited company incorporated in Pakistan under the Companies Ordinance 1984 (now Companies Act, 2017). The company is listed on Pakistan Stock Exchange. The company is primarily involved in spinning, weaving, processing and finishing fabric along with sale of textile madeups.

Profile of Chairman

Mr. Farrukh Ifzal joined Nishat Group in 1988 as financial controller of NCL and since then has been serving the group in various capacities. He is a fellow member of Institute of Chartered Accountants of Pakistan.

Profile of CEO

Mr. Shahzad Saleem has over 25 years of professional work experience in the relevant industry. He holds an MBA degree from Lahore University of Management Sciences (LUMS).

RATING RATIONALE

Corporate Profile

Nishat (Chunian) Limited (NCL) has grown from a small spinning setup in 1990 to become one of the leading vertically-integrated textile companies. NCL is a holding company engaged in the textile and power generation business (production and distribution of electricity and steam). Textile operations involve spinning, weaving, dyeing, printing, stitching, processing, and trading of yarn, fabric, and made-ups from cotton and synthetic fibers. The processes are integrated, and a captive power plant ensures an uninterrupted power supply to all units. In 2016, the group ventured into the local retail sector by launching The Linen Company, offering premium home-textile and bedding products through eight retail outlets in four major cities. The company holds multiple export standards and trade certifications and has a workforce of over 7,000 employees.

Strategic Investment Portfolio

Long-term investments decreased to Rs. 510m (FY21: 1.9b) in FY22 due to the transfer of the entire ownership of Rs. 1.9b in Nishat Chunian Power Limited (NCPL) to NCL's shareholders/members. Presently, the investment in subsidiaries comprises two entities i.e. Nishat Chunian USA Inc. & Nishat Chunian Properties (Private) Limited.

Operating Performance

Headquartered in Lahore, the company operates a total of 10 production units spanning three zones and a total of 255 acres of land located in District Kasur and Raiwand. Currently, zone 1 and 2 have an energy demand of 30MW and rely on a mix of gas generators, the national grid, and a coal power plant. Zone 3 has a lower energy demand of 6MW, which is fulfilled by the LESCO gridline, gas generators, and 1.6MW solar power plant.

As per company policy, major BMR activities are conducted every two to three years, involving replacements and upgrades. In FY22, total capital expenditure amounted to Rs. 6.9b, with ~46% allocated to new assets additions. Moreover, roughly 10,000 spindles were replaced by more efficient 2,880 rotors. Installed capacity in each segment remains largely unchanged. Despite the global demand slowdown, production levels across all divisions have remained consistent, as reflected in the utilization ratios.

Table: Capacity & Production Data (Units in millions)

	FY21	FY22	9M'FY23
Spinning			
Spindles Installed	223,668	219,528	215,731
Spindles Worked	211,567	206,221	198,733
Installed Capacity (kgs)	81	80	64
Actual Production (kgs)	79	79	63
Capacity Utilization	***98%***	***99%***	***99%***
Weaving			
Looms Installed	379	379	379
Looms Worked	379	379	330
Installed Capacity (sq. yards)	346	346	197
Actual Production (sq. yards)	301	256	177
Capacity Utilization	***87%***	***74%***	***90%***
Power Plant			

Engines Installed	17	19	19
Engines Worked	17	19	19
Generation Capacity (MWh)	747,894	739,017	554,263
Actual Generation (MWh)	323,400.2	272,890.6	112,306
Capacity Utilization	***43%***	***37%***	***20%***
Dyeing			
No. of Thermosol Dyeing Machines	1	1	1
No. of Stentor Machines	4	5	5
Installed Capacity (meters)	36	55	32
Actual Production (meters)	36	48	18
Capacity Utilization	***99%***	***89%***	***56%***
Printing			
No. of printing machines	1	1	1
Installed capacity (meters)	11	11	8
Actual Processing (meters)	10	8	4
Capacity Utilization	***90%***	***74%***	***55%***
Digital Printing			
No. of printing machines	5	5	5
Installed Capacity (meters)	9	9	7
Actual Processing (meters)	4	2	1
Capacity Utilization	***41%***	***27%***	***21%***

Key Rating Drivers

Business risk profile is constrained by current weak macroeconomic environment both globally and locally, demand slowdown, high interest rate situation, inflationary pressures and recent floods adversely affecting cotton crop while ongoing energy crisis in the country pose a challenge to margins sustainability and future growth.

Pakistan's export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally broke the threshold, coming in at USD 32.4b. Textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country's GDP, with an estimated market size of around Rs. 4.0tr. Barring seasonal and cyclical fluctuations, textiles sector has maintained an average share of about 60% in national exports.

Table: Pakistan Export Statistics (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
Pakistan Total Exports	22,536	25,639	32,450		23,706	21,088
Textile Exports	12,851	14,492	18,525		13,577	12,992
PKR/USD Average rate	158.0	160.0	177.5		171.5	235.5

Source: SBP

Export revenues from textile sector have noted sizeable growth over the years (FY22: $19.3b FY21: $15.4b; FY20: $12.5b; FY19: $13.6b). Knitwear, Readymade and Bed wear segments continue to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While the growth was primarily driven by volume (excluding knitwear and cotton yarn), higher prices also boosted exports.

Table: Textile Export Details (in USD millions)

	FY20	FY21	FY22		9M'FY22	9M'FY23
High Value-Added Segment	**9,669**	**12,427**	**15,605**		**11,482**	**10,318**
- Knitwear	2,794	3,815	5,121		3,730	3,390
- Readymade Garments	2,552	3,033	3,905		2,864	2,657
- Bed wear	2,151	2,772	3,293		2,449	2,032
- Towels	711	938	1,111		820	745
- Made-up Artides	591	756	849		627	535
- Art, Silk & Synthetic Textile	315	370	460		344	309
- Others	555	743	866		650	650
Low to medium Value-Added Segment	**2,858**	**2,972**	**3,717**		**2,760**	**2,158**
- Cotton Cloth	1,830	1,921	2,438		1,795	1,538
- Cotton Yarn	984	1,017	1,207		908	573
- Others	43	34	72		56	47
Total	**12,527**	**15,399**	**19,332**		**14,243**	**12,476**

Source: PBS

Cotton prices rose to a new 12-year high of ~Rs. 22,935/maund as of Sept'22, driven by the scarcity of cotton resulting from the recent floods that impacted the local cotton production. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.

Table: Cotton Prices Trend (In Rs.)

	FY19	FY20	FY21	FY22	9M'FY23
Per Maund	8,770	8,860	13,000	17,380	18,935
YoY % Change	26%	1%	32%	34%	*n/a*

Floods in Sindh and Southern Punjab during recent monsoon season have caused significant damage to the cotton crop. According to industry estimates, ~45% of the crop has been washed, worth more than $2.5b, resulting in significant price increases. The government has announced facilitation for raw materials imports to compensate for domestic shortages. Nonetheless, in addition to affecting profit margins, higher raw material pricing is expected to increase the working capital requirements, which is likely to have a negative impact on the liquidity profile of textile operators, particularly spinners, weavers and dying companies.

Global and domestic challenges, such as slowdown in export demand (primarily from North America and the EU, which has begun to materialize in Pakistan's monthly export proceeds) due to recessionary trend, industrial gas load shedding expected in the country, and rising production costs due to inflation, will weigh on the business risk profile going forward. These factors may result in competitive market pricing for exporters.

High cyclicality and competitiveness in the spinning sector translate into high business risk profile.

Movement in cotton prices and cotton crop levels drives performance of spinning players in Pakistan. Given sizeable deficit in local cotton production compared to demand in recent years, cotton prices remained high. However, availability of imported yarn kept yarn prices competitive in the current fiscal year and thus resulting in weakening of profitability profile for spinning players.

Rupee devaluation and strong volumetric uptick in yarn and grey cloth fueled revenue growth in FY22. However, global demand slowdown has impacted sales growth in the current year.

Net sales have posted strong double-digit annual growth for two consecutive years in a row, reaching nearly Rs. 62b in FY22. The YoY uptick of ~26% can be attributed primarily to rupee devaluation and healthy volumetric sales growth in yarn and grey cloth. However, the recent demand slowdown due to the economic downturn in major world economies has impacted the growth in the current fiscal year, with revenues sustaining to Rs. 47.1b in 9M'FY23. Despite waning volumes, management anticipates FY23 revenue to match the previous year due to consistent rupee devaluation.

Exports sales, including direct and indirect, contribute to over 80% of entire revenues on a timeline while the rest is derived from local sales. Spinning remains the core strength, constituting three-fifths of total revenues, followed by processing & home textile, weaving, and power generation segments. Product-wise, yarn and made-ups dominate the revenue stream, while the rest is shared by grey and processed cloth, wastages, and electricity sales. Exports span Europe, USA, Canada, Asia, Africa, and Australia, reflecting a well-balanced geographic sales distribution. In addition, yarn exports target prominent Asian markets like China, Hong Kong, and Bangladesh, while the home-textile segment focuses primarily on the US market.

Gross margin decline, higher operating overheads and significant jump in financial charges led to a negative bottom-line in the current fiscal year.

Following its peak in FY22, gross margins noted a sharp dip in the current fiscal year mainly due to sluggish sales and higher expenses for raw materials, salaries, and power. Margins were negatively impacted in the spinning and weaving segments, while power generation reported a gross loss. Inventory levels are adequately managed, with more than a 10-month buffer for cotton and a 2-3 month advance stock of yarn and fabric. Management stated procurement mix exhibits imported to the local raw material ratio of 30:70.

Distribution overheads grew sizably over the review period, driven by higher freight, export commission, and marketing expenses. Administrative costs increased in line with inflation, particularly impacting salaries and travel expenses. Moreover, financial charges also rose sharply in the current fiscal year due to higher benchmark rates and increased utilization of running finance. Combined with the impact of declining gross margins, these factors led to a negative bottom line.

Contrasting cash flow trend reflects profitability performance, while debt coverage metrics have significantly weakened. High inventory holding days have contributed to extended cash conversion cycle over time.

Improved earnings in the last two years significantly increased funds flow from operations (FFO) to Rs. 9.1b (FY21: Rs. 6.6b; FY20: Rs. 1.0b) at end-FY22. However, the contrasting cash flow trend in the current fiscal year, primarily due to the net loss reported, resulted in a notable deterioration of debt coverage metrics. The current ratio and coverage of short-term borrowings in relation to trade debts and inventory have also weakened but remain at comfortable levels, indicating a satisfactory liquidity profile. However, the extended cash conversion cycle over time is influenced by high inventory holding days and longer receivable periods. The aging profile of trade debts is sound as ~97% of receivables are settled within 30 days; no instances of bad debt were reported.

Capital buffers have noted deterioration; leverage ratios have trended upwards.
Net equity declined to Rs. 20.3b (FY22: Rs. 24.5b; FY21: Rs. 19.0b) at the end-9M'FY23 due to negative bottom-line, investment transfer from NCL to shareholders, and dividend payment. FY22 payout ratio increased to 23% (FY21: 21%) with a total dividend amounting to Rs. 1.7b (FY21: Rs. 1.2b). Debt profile comprises a mix of short-term and long-term debt, with total interest-bearing liabilities reaching Rs. 42.0b (FY22: Rs. 28.8b; FY21: Rs. 28.2b) at end-9M'FY23; ~64% constituted short-term debt. Aggregated running finance lines stand at nearly Rs.40b, with one-third allocated to concessionary schemes. Leverage ratios have exhibited an upward trend.

Nishat (Chunian) Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**9M'FY23**
Fixed Assets	16,569.3	17,224.5	22,595.9	23,580.1
Long-term Investments	1,886.7	1,886.7	510.1	510.1
Stock-in-Trade	19,317.4	18,214.4	21,177.2	27,358.8
Trade Debts	4,686.6	6,782.4	7,741.0	9,070.2
Loans & Advances	1,106.7	3,270.0	1,869.3	2,775.7
Other Receivables	2,305.8	2,031.5	1,521.6	3,492.7
Cash and Bank Balance	47.5	272.6	209.0	157.4
Total Assets	**47,750.6**	**51,770.0**	**59,435.6**	**69,812.7**
Trade and Other Payables	4,455.7	4,093.6	4,554.0	5,751.7
Long-Term Borrowings *(Inc. current maturity)*	6,589.3	9,269.4	15,834.7	15,091.8
Short-Term Borrowings	22,554.4	18,897.9	12,944.0	26,941.8
Total Liabilities	**34,113.2**	**32,773.9**	**34,892.2**	**49,553.0**
Paid-up Capital	2,401.2	2,401.2	2,401.2	2,401.2
Total Equity	**13,637.4**	**18,996.1**	**24,543.4**	**20,259.7**
INCOME STATEMENT				
Net Sales	35,666.9	49,283.8	61,988.0	47,079.9
Gross Profit	4,204.4	8,969.1	12,974.2	3,681.9
Operating Profit	3,011.1	7,496.6	10,752.3	2,141.1
Profit Before Tax	**709.2**	**6,273.2**	**8,347.9**	**(952.3)**
Profit After Tax	**265.4**	**5,598.9**	**7,468.2**	**(1,447.3)**
RATIO ANALYSIS				
Gross Margin (%)	11.8%	18.2%	20.9%	7.8%
Net Margin (%)	0.7%	11.4%	12.0%	-3.1%
Trade Debt/Sales (%)	13.1%	13.8%	12.5%	14.5%*
Current Ratio	1.04	1.25	1.76	1.27
FFO	1,013.7	6,587.0	9,101.9	(935.4)
FFO to Total Debt (x)	0.03	0.23	0.32	-0.03*
FFO to Long Term Debt (x)	0.15	0.71	0.57	-0.08*
DSCR (x)	0.98	3.54	2.35	0.46*
Gearing (x)	2.14	1.48	1.17	2.07
Debt Leverage (x)	2.50	1.73	1.42	2.45
Inventory + Receivable/Short-term Borrowings (x)	1.06	1.32	2.23	1.35
ROAA (%)	0.6%	11.3%	13.4%	-3.0%*
ROAE (%)	1.8%	34.3%	34.3%	-8.6%*

**Annualized*

REGULATORY DISCLOSURES	Appendix II				
Name of Rated Entity	Nishat (Chunian) Limited				
Sector	Textile				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	Rating Type: Entity				
	08-06-2023	A-	A-2	Stable	Downgraded
	02-06-2022	A	A-2	Positive	Maintained
	26-03-2021	A	A-2	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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Due Diligence Meeting Conducted	**Name**	**Designation**	**Date**		
	Mr. Mustaqeem Talish	Chief Financial Officer	March 17, 2023		