RATING REPORT

Nishat (Chunian) Limited

REPORT DATE:
July 05, 2024

RATING ANALYSTS:
M. Amin Hamdani
amin.hamdani@vis.com.pk

Mahekash Kumar
mahekash.kumar@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook/ Rating Watch	Stable		Stable	
Rating Action	Reaffirmed		Downgrade	
Rating Date	*July 05, 2024*		*June 08, 2023*	

COMPANY INFORMATION

Incorporated in 1990	**External Auditors:** Riaz Ahmed & Co. Chartered Accountants
Public Limited Company (Listed)	**Board Chairman:** Mr. Muhammad Azam Siddiqui
Key Shareholders (with stake 5% or more):	**CEO:** Mr. Shahzad Saleem
Mr. Shahzad Saleem ~22.9%	
Nishat Mills Limited ~13.6%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates:
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

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 Act 1913 (now Companies Act, 2017). The company is listed on Pakistan Stock Exchange.

Profile of Chairman

Muhammad Azam Siddiqui has 30 plus years' experience in the textile industry and is founder of TexWinka, a buying house. He holds an MBA degree from the Lahore University of Management Sciences (LUMS).

Profile of CEO

Mr. Shahzad Saleem has over 30 years of professional work experience in the relevant industry. He holds an MBA degree from Lahore University of Management Sciences (LUMS).

Profile of CFO

Ms. Faryal Riaz joined Nishat Group in 2023 as as Director Finance and is currently serving as Chief Financial Officer of NCL. She is an associate member of Institute of Chartered Accountants of Pakistan and also holds a bachelor's degree from Institute of Business Administration – Punjab University.

RATING RATIONALE

Corporate Profile

Nishat (Chunian) Limited (referred to as "NCL" or "the Company") commenced its operations in 1991 with a modest spinning setup, subsequently evolving into one of the foremost vertically integrated textile enterprises. NCL stands as one of Pakistan's major exporters. Its core activities encompass spinning, weaving, dyeing, printing, stitching, processing, and trading of yarn, fabrics, and made-ups derived from raw cotton and synthetic fibers. Moreover, the Company extends its operations into the retail sector through The Linen Company, which boasts eight retail outlets across four major cities in Pakistan, offering premium home-textile and bedding products. In total, NCL's workforce comprises over 7,000 dedicated employees.

On May 09, 2024 the board of directors of Nishat Mills Limited has approved the scheme of Arrangement for transfer of shareholding amongst two shareholders of NCL namely, Mr. Shahzad Saleem, and Nishat Mills Limited. NML shareholding in NCL will be transferred to, and vested in Mr. Shahzad saleem. In return, corresponding part of Shahzad Saleem's shareholding in Nishat Chunian Power Limited ("NCPL") will be transferred to, and vested in, NML.

Environment and Social Framework

Environmental initiatives include wastewater treatment and caustic recovery, while a coal power plant is equipped with emission monitoring systems. Social responsibility efforts include health and safety programs and free medical camps. The company also continuously explores energy conservation methods and has implemented power-efficient LED lights at manufacturing units to reduce energy consumption. Regular employee training sessions are conducted to promote awareness and encourage energy-saving practices.

Operating Performance

The Company is headquartered in Lahore, with its production facilities in districts Kasur and Raiwind. Overall, the Company's facilities including its operations and office is operational at a land size of approximately 256 acres. During FY23, the Company allocated investments totaling Rs. 6.2 billion, which were primarily directed towards the addition of 2,880 rotors and various maintenance and repair activities. Over all, the installed capacity in each segment has predominantly remained unchanged.

Moreover, the Company fulfills its power requirements through a 46-MW coal-fired power plant, supplemented by standby generators with a capacity exceeding 30MW, a 1.6MW solar power plant, and connectivity with the LESCO gridline.

Table: Capacity & Production Data

	FY21	FY22	FY23
Spinning			
Number of Spindles installed	223,668	219,528	223,428
Number of Spindles Worked	211,567	206,221	200,850
Number of rotors installed	-	-	2,880
Number of rotors worked	-	-	2,566
Capacity after conversion into 20s	80,813,152	80,008,821	81,049,638
Actual Production	79,449,352	78,893,713	79,851,861

Capacity Utilization	***98%***	***99%***	***99%***
Weaving			
Number of Looms Installed	379	379	379
Number of Looms Worked	379	379	365
Capacity After conversion into 50 picks-Sq.yards	345,597,351	345,597,351	345,597,351
Actual Production	300,663,935	256,118,920	216,850,138
Capacity Utilization	***87%***	***74%***	***63%***
Dyeing			
Number of Thermosol Dyeing Machines	1	1	1
Number of Stenter Machines	4	5	5
Capcity in meters	36,500,000	54,600,000	43,200,000
Actual Processing of Fabrics	36,256,326	48,532,979	26,205,932
Capacity Utilization	***99%***	***89%***	***61%***
Printing			
Number of Pronting Machines	1	1	1
Capcity in Meters	10,800,000	10,800,000	10,800,000
Actual Processing -in meters	9,711,359	7,991,733	6,249,256
Capacity Utilization	***90%***	***74%***	***58%***
Digital Printing			
Number of Printing Machines	5	5	5
Capacity in meters	9,125,000	9,125,000	9,125,000
Actual Processing of Fabrics	3,698,556	2,454,445	2,239,073
Capacity Utlziation	***41%***	***27%***	***25%***
Process Steam, and coal fired power generation plant (46 MW)			
Number of Engines Installed	17	19	19
Number of Engines Worked	17	19	19
Generation Capacity (KWh)	747,894,000	739,017,000	739,017,000
Actual Generation (KWh)	323,400,200	272,890,559	166,604,050
Capacity Utilization	***43%***	***37%***	***22.6%***
Solar			
Installed	-	-	1
Worked	-	-	1
Generation Capacity (KWh)	-	-	976,333
Actual Generation (KWh)	-	-	918,173
Capacity Utilization	-	-	***94%***

Sector Update

The business risk profile of the textile sector in Pakistan is characterized by a high level of exposure to economic cyclicality and intense competition. This sector's performance is significantly influenced by the broader economic conditions in the country, making it inherently vulnerable to fluctuations in demand driven by economic factors.

In FY23, the textile sector faced challenges due to various economic and environmental factors. These included damage to the cotton crop resulting from flooding in 1HFY23, escalating inflation, and import restrictions due to diminishing foreign exchange reserves.

During FY23, Pakistan's yarn production registered a substantial decline, primarily due to reduced availability of cotton, as a result of crop damage and import restrictions. The sector's profitability was constrained by factors such as higher production costs, increased raw material costs, and rising energy expenses, all of which constrained the sector's profit margin. The industry's performance is closely intertwined with the outlook of the cotton and textile industries, both of which were affected in FY23. Reduction in cotton supply, coupled with global economic slowdown and contractionary economic policies, led to a decrease in demand for textile products and, consequently, cotton yarn.

While the global outlook for cotton production is expected to rebound, local challenges persist. These challenges include high interest rates, increasing energy costs and inflationary pressures. Additionally, the sector's vulnerability to global market dynamics and the domestic economic landscape further contribute to its high business risk profile. However, there is optimism as an anticipated bigger cotton crop in FY24 is expected to alleviate some pressure on input costs and margins.

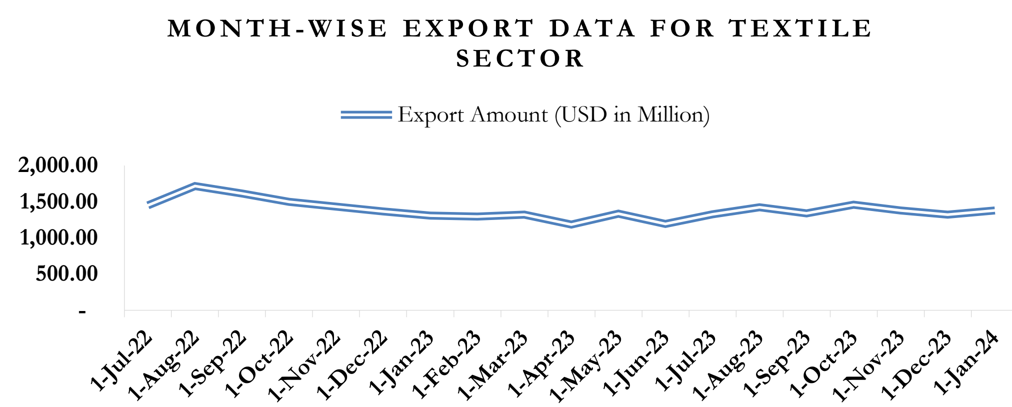

Figure 1: MoM Textile Exports (In USD' millions)
Source: SBP

Key Rating Drivers

Sales Maintain Upward Trend While Profitability Margins Fluctuate in FY23 and 9M'FY24

- Despite reduced product demand, Net Sales of the Company have shown a growth of 9.1%, amounting to Rs. 67.6 billion (FY22: Rs. 62.0 billion) mainly attributed to effective price increase due to rupee depreciation.
- In terms of sales during FY23, 72% of the revenue was generated from exports (FY22: 81%), with the remaining sales originating from the domestic market.
- Gross Profit Margins of the Company have dropped significantly from 21% in FY22 to 10% in FY23 mainly attributed to inventory losses in its spinning segment amid a sharp decline in yarn prices in the industry.
- During FY23, 61% of the sales were derived from spinning (FY22:60%), 26% of sales originated from processing and home textiles (FY22: 26%), while 13% stemmed from weaving (FY22:13%).
- In terms of geographic segmentation of sales during FY23, 58% of the Company's sales can be allocated to exporters in the local market in Pakistan (FY22: 55%), followed by 20% directed towards Asia, Africa, and Australia (FY22: 23%). Sales to the European market accounted for 15% of the Company's total sales (FY22: 14%).
- In FY23, NCL achieved an operating profit margin of 7% (down from 17% in FY22). however, NCL recorded a net margin of -1.5%, contrasting with a net margin of 12% in FY22. The negative bottom line was driven by reduced gross profit margins impacting the overall profitability, compounded by increased finance costs.

- In 9M'FY24, the Company's sales clocked in at Rs. 68.5 billion, 46% higher than sales of 9M'FY23.
- The Company has exhibited recovery in its gross margins during 9M'FY24, reaching 12% compared to 8% in 9M'FY23.
- During 9M'FY24, the Company reported an operating margin of 9%. However, the Company has recorded a net margin of -0.03%, reporting a loss of Rs. 23.6 Million. This loss is attributed to high finance cost to the Company.
- The Company projects to close FY24 with a positive net margin while margins are projected to remain thin.

Declining Cash Flow and Debt Coverage Trends during FY'23; 9M'FY24 shows Marginal Improvement

- Due to the Company's negative bottom line in FY23, NCL's FFO plummeted to its all-time low of Rs. 0.9 billion, compared to Rs. 9.0 billion in FY22.
- The Company's debt coverage metrics witnessed a decline, with FFO to total debt dropping to meagre 0.02x in Jun'23 from 0.31x in Jun'22, and FFO to long-term debt declining to 0.06x from 0.57x due to the negative bottom line for the same period.
- Furthermore, the Debt Service Coverage Ratio (DSCR) of the Company also experienced a downturn, dropping from healthy levels of 2.1x to 0.7x as of Jun'23 due to the decline in FFO.
- Despite maintaining an adequate current ratio of 1.3x as of Jun'23 (compared to 1.7x in Jun'22), the decrease can be attributed to a significant increase in accrued markup and higher short-term borrowings within the Company's current liabilities.
- In 9M'FY24, FFO increased to Rs. 1.4 billion from Rs. -0.9 billion in 9M'FY23, primarily due to the reduction in the Company's negative bottom line.
- Debt coverage metrics displayed recovery as of Mar'24, with FFO to total debt and FFO to long-term debt reaching 0.05x and 0.14x, respectively.
- Although the DSCR of the Company exhibited some improvement, it remains below the desired level at 0.89x as of Mar'24.
- Concerning liquidity, the Company's current ratio remained stable at 1.2x as of Mar'24.
- The Company maintains the highest inventory holding days in the industry compared to its peers.
- Improvement in DSCR and other coverage metrics are crucial from a ratings perspective.

Equity has noted deterioration during FY23 attributed to negative bottom line impact on retained earnings; while Company is taking measures to control its debt levels.

- As of June 2023, the Company experienced a decline in net equity by Rs. 3.8 billion, attributed to a decrease in appropriate profit resulting from negative profit after tax, leading to a net equity of Rs. 20.7 billion.
- Concurrently, the total debt of the Company surged by Rs. 13.8 billion to Rs. 42.6 billion, primarily due to heightened short-term borrowings during the as of Jun'23. Consequently, the gearing ratio of the Company escalated from 1.2x to 2.1x during the same period.
- As of Mar'24, the Company's total equity inched down, whereas, long-term loan repayments were timely made. This has resulted in minimal impact on gearing of the Company, reaching 2.0x.

- Debt profile of the Company as of Mar'24 demonstrates that, the Company has 33% of long-term debt and 67% of short-term debt on its books. Additionally, around 8% of NCL's financing relies on LIBOR, with 39% of its overall debt structured under SBP refinance schemes, and the remaining 53% of total debt being based on KIBOR.
- Leverage position of the Company also deteriorated reaching 2.45x as of Mar'24 (FY23: 2.37x, FY22:1.42x).

Corporate Governance

Notable changes have been made in the organizational structure of the Company to begin with re-arrangement of NCL. Firstly, the position of Chairman of the board has transitioned from Mr. Farrukh Ifzal to Mr. Muhammad Azam Siddiqui, while Mr. Farrukh Ifzal is no longer a board member, being replaced by Ms. Nadia Bilal. Additionally, an independent director, Mr. Ahmad Hasnain, has replaced Mr. Zahid Khan. Overall, the Company boasts a structured organizational setup with a board comprising seven members, including two independent directors and two female representatives. These members have transitioned to these positions from within the Group Companies.

The Company has two board-level committees: the Audit Committee and the HR & Remuneration Committee. Furthermore, a change in the Chief Financial Officer role has occurred, with Mr. Mustaqeem Talish being succeeded by Ms. Faryal Riaz.

Regarding IT infrastructure, the Company utilizes Oracle to manage its operations from production to reporting.

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY21**	**FY22**	**FY23**	**9M'FY24**
Fixed Assets	17,224.5	22,595.9	23,673.0	23,960.3
Long-term Investments	1,886.7	510.1	510.1	510.1
Stock-in-Trade	18,214.4	21,177.2	23,554.0	25,772.4
Trade Debts	6,782.4	7,741.0	11,409.8	12,394.3
Loans & Advances	3,270.0	1,869.3	4,070.4	2,649.4
Other Receivables	2,031.5	1,521.6	3,589.7	3,817.7
Cash and Bank Balance	272.6	209.0	279.0	196.6
Total Assets	**71,038.0**	**59,435.6**	**69,845.8**	**71,454.2**
Trade and Other Payables	4,093.6	4,554.0	4,222.9	6,352.4
Long-Term Borrowings *(Inc. current maturity)*	9,269.4	15,834.7	14,744.5	13,861.3
Short-Term Borrowings	18,897.9	12,944.0	27,881.7	28,117.8
Total Liabilities	**32,773.9**	**34,892.2**	**49,137.6**	**50,769.7**
Paid-up Capital	2,401.2	2,401.2	2,401.2	2,401.2
Total Equity	**18,996.1**	**24,543.4**	**20,708.1**	**20,684.5**
INCOME STATEMENT				
Net Sales	49,283.8	61,988.0	67,629.3	68,564.7
Gross Profit	8,969.1	12,974.2	6,589.1	8,416.3
Operating Profit	7,496.6	10,752.3	4,474.0	6,414.9
Profit Before Tax	**6,273.2**	**8,347.9**	**-86.9**	**801.4**
Profit After Tax	**5,598.9**	**7,468.2**	**-998.9**	**-23.6**
RATIO ANALYSIS				
Gross Margin (%)	18.2%	20.9%	9.7%	12.3%
Net Margin (%)	11.4%	12.0%	-1.5%	-0.03%
Current Ratio	1.25	1.67	1.27	1.20
FFO	6,587.0	9,001.8	918.8	1,442.0
FFO to Long-Term Debt (x)	0.23	0.32	0.06	0.14*
FFO to Total Debt (x)	0.72	0.58	0.02	0.05*
DSCR (x)	3.55	2.35	0.71	0.89*
Gearing (x)	1.48	1.17	2.06	2.03
Leverage (x)	1.73	1.42	2.37	2.45
Inventory + Receivable/Short-term Borrowings (x)	1.32	2.23	1.25	1.36
ROAA (%)	11.3%	13.4%	-1.5%	-0.04%*
ROAE (%)	34.3%	34.3%	-4.4%	-0.2%*

**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	see table below
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information.

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		Rating Type: Entity		
05-07-2024	A-	A-2	Stable	Reaffirmed
08-06-2023	A-	A-2	Stable	Downgrade
02-06-2022	A	A-2	Positive	Maintained
26-03-2021	A	A-2	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Ms. Faryal Riaz	Chief Financial Officer	June 25, 2024