

November 05, 2009

Pakistan Market**NML 1QFY10 detailed accounts review/'Buy'****MORNING BRIEFING**

KSE100 Index: Closing 9154.99 ↑ (+216.00)

Despite a 3% growth in topline, Nishat Mills Limited's (NML) reported earnings declined by 27%YoY to Rs513mn (diluted EPS Rs2.12). The depreciating rupee was the major factor behind the rise in net sales, however, rising input costs kept earnings under pressure. As expected the company did not announce any payouts with the result.

Gross margins shrunk to 18% from 23%

In 1QFY10, net sales of the company depicted an increase of 3%YoY only to be eroded by rising input costs. Higher cotton prices of local as well as the imported cotton were the main reason for increased cost of production in the period under review. The consumption rates for local and imported cotton stood at Rs89/kg (Rs87/kg in 1QFY09) and Rs120/kg (Rs105/kg in 1QFY09) respectively. Consequently, gross margins came down to 18% from 23% in the corresponding period last year. On the contrary, financial charges registered a decline as average 6-month KIBOR fell to 12.3% in 1QFY10 against 13.9% last year.

Other income continued to support the bottomline

Other income soared by 22%YoY to Rs186mn from Rs152mn in 1QFY09 providing a breather to the bottomline as it contributed 36% towards the earnings. The major share of other income comes from NML's strong equity portfolio which comprises of investments mainly in MCB Bank and DGKC. MCB Bank announced its dividend for the period at Rs2.5 per share contributing around 64% of NML's other income.

Garments amongst top performers

Garment segment registered growth of 210%YoY in terms of revenue. Total revenue from garments stood at Rs555mn against Rs179mn in 1QFY08. Successful launch of Operational Product Development Department to focus on clients through research and rising average selling rates to Rs497/unit (up 25%YoY) accredited the sales growth of the segment. Moreover, gradual recovery in western economies surely helped the company to acquire more orders.

Higher cotton prices to keep margins in check

As per the latest numbers released by the Pakistan Cotton and Ginners Association (PCGA), total cotton arrivals stand at 7.3mn bales compared to 5.2mn bales in the corresponding period last year, up a significant 40%YoY. The increase in cotton arrivals is mainly attributable to the use of new BT cotton seeds. According to experts, at current rate cotton arrivals are expected to exceed 14mn bales as against official target of 13mn bales. However, lackluster world cotton production is likely to keep the cotton prices on the rise during the year. Cotton prices currently stand at Rs3825 per maund.

In the wake of high cotton prices and stiff international competition, we expect gross margins of the company to remain under pressure.

Table: Financial Highlights

(Rs mn)	1QFY10	1QFY09	Δ%
Net Sales	6,396	6,205	3%
Cost of Goods Sold	5,214	4,753	10%
Gross Profit	1,182	1,451	-19%
Gross Margin	18%	23%	
Admin & Dist. exp	468	416	13%
Operating profit	713	1,036	-31%
	11%	17%	
Finance cost	259	330	-22%
Other operating income	186	152	22%
Other charges	47	89	-47%
Profit Before Taxation	593	768	-23%
Taxation	80	62	29%
Profit After Taxation	513	707	-27%
Diluted EPS	2.12	2.91	-27%

Source: Company accounts

Outlook: 'Buy' maintained

Global economic recovery along with the recent talks regarding the free trade agreement is likely to sure up company's topline in the future. Moreover, we believe the incentives given the maiden textile policy are likely to bode

well for the business. Further, the decent dividend income and addition of Nishat Power Limited (NPL) into its already strong portfolio will remain a major contributor to the bottomline of the company, in our view. At current levels, NML is trading at FY10E and FY11F PE of 7.2x and 6.3x respectively. We therefore maintain our 'Buy' stance on the stock.

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Also in focus**Rs5bn released for remaining R&D claims**

The ministry of finance has released the remaining Rs5bn to settle the outstanding 60% research and development support programme claims of the textile sector. In February this year, the ministry had released Rs4bn of such payments. This current payment has been released from the Rs42bn Export Development Fund created through the textile policy.

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