

February 12, 2010

Pakistan Market**NML: 1HFY10 EPS expected at Rs4.1, down 13%YoY** KSE100 Index: Closing 9802.80 ↑ (+69.44)**MORNING BRIEFING**

Nishat Mills Limited (NML) is scheduled to announce its 1HFY10 results on February 16, 2010. Despite higher revenues and lower financial costs, we expect the company to post earnings of Rs1.0bn, a decline of 13%YoY, mainly due to high raw material costs which kept the margins in check. We do not expect any pay out with the result.

Gross margins to shrink to 18%

Despite a growth of 8%YoY growth in revenues mainly owing to devalued rupee, we project the company's gross margins to shrink by 430bps to 18% from 23% in 1HFY09. High cotton prices locally (average price: Rs4,800/maund) as well as the imported cotton (68 cents/lbs) were the main reasons behind the increased cost of production in the period under review.

Div. income to support the bottom line

We project Other Income will jump by 10%YoY to Rs347mn and provide a breather to the bottom line as it contributes ~30% towards the earnings. MCB Bank announced a dividend of Rs2.5 per share in 1QFY10 which will contribute towards the Other Income. Moreover, financial charges are expected to decline to Rs527mn from Rs723mn in 1HFY09 (down 27%YoY) as average 6-month KIBOR fell by 213bps to 12.46% in the period under review.

Table: NML 1HFY10 earnings estimates

Rsmn	1HFY10	1HFY09	Δ%
Net Sales	13,111	12,132	8%
Cost of products sold	10,691	9,370	14%
Gross Profit	2,421	2,762	-12%
Gross margin	18%	23%	
Operating expenses	1,076	1,061	1%
Finance cost	527	723	-27%
Other operating income	347	316	10%
Profit before tax	1,164	1,293	-10%
Taxation	163	147	11%
Profit after tax	1,001	1,147	-13%
Earnings per share	4.1	4.7	-13%

Source: JS Research and company accounts

Cotton prices on the rise

Although, cotton arrivals are in line with our expectations and are well set to cross the government's set target of 12.5mn bales, cotton prices have lately reached new heights, crossing Rs5,000/maund in future contracts for the next season, while the current spot rate is Rs4,800/maund. The hike in cotton prices is due to shortage in world cotton production and strong demand for local cotton in the international market. This rise in cotton prices is likely to keep margins for the company in check for the coming year.

Outlook: 'Buy' maintained

With diversified product range and a strong customer base, NML looks set to bounce back from difficulties faced during the last year. Stringent competition in the international market has given NML reason to explore new markets to cater to and as per the management NML is likely to focus on work wear business, which is likely to enable the company to register consistent growth in its core business. Further, NML's strong portfolio (comprising of MCB Bank, DG Khan Cement and Nishat Power Limited) remains a major trigger for the company. Additionally, the possible acquisition of AES power projects will enhance earnings prospects in the coming years. The scrip currently trades at FY10E and FY11F PE of 6.8x and 5.4x respectively, and we reiterate our 'Buy' call on the scrip.

bilal.qamar@js.com

92 (21) 111-574-111 (ext. 3099)

Also in focus**Japan to resume the ODA programme**

According to local newspaper reports, Japan is likely to release its assistance of US\$500mn annually to Pakistan under the Official Development Assistance (ODA) programme. Earlier, Japan International Cooperation Agency had redirected the ODA funds to the FoDP account, after Japan's announcement of contributing US\$1bn to the pledges made by the FoDP. As a large number of development projects were suffering due to the delay in availability of these funds and with incremental FoDP pledges failing to materialize thus far, Pakistani officials have insisted Japan to release the ODA programme proceeds immediately. A note of exchange is expected to be signed by March 31, 2010 and Pakistan is likely to receive US\$400mn in this regard.

JS Global Capital Limited

6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi

Research:

Tel: +92 (21) 32799005

Fax: +92 (21) 32800163

js.research@js.com

Fixed Income Sales:

Tel: +92 (21) 32799541-44

Fax: +92 (21) 32800165

tariq.usman@js.com

Equity Sales:

Tel: +92 (21) 32799513

Fax: +92 (21) 32800166

junaid.iqbal@js.com

Corporate Finance:

Tel: +92 (21) 32799005

Fax: +92 (21) 22800163

azhar.iqbal@js.com

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