JS Research

March 18, 2010

Pakistan Market

MORNING BRIEFING

NML: 1HFY10 detailed account review/'Buy'

KSE100 Index: Closing 9989.81 ↓ (-27.90)

Despite a 13%YoY growth in the top line, Nishat Mills Limited (NML) earnings declined by 11%YoY to Rs1.0bn (basic EPS: Rs4.17). Rising input prices became the major factor behind the fall in earnings as NML's gross margins slid by 473bps to 17.6% during the 1HFY10. Along with the result, the company announced a rights issue of 45% at Rs40 per share in order to fund its acquisition of the AES power projects (AES Lalpir and Pak Gen). As it generally happens, scrips tend to underperform with the announcement of the rights issue and so did NML. However, we believe the acquisition of AES power projects would certainly improve the scrip's valuation going forward. Now that the price has been adjusted for, we can see another round of appreciation in the stock price. With the ex right target price of Rs69 per share, we maintain our 'Buy' call on the scrip.

Rising input prices kept margins in check

Company's cost of raw materials increased by 18% to stand at Rs3.5bn which was the main reason for the declining margins during the period under review. Cotton prices in the 1HFY10 soared by more than 20% mainly due to lower imports and lower crop expectation from China and India during the current season. On the contrary, financial charges declined by 26% to Rs547mn (average 6-month KIBOR fell to 12.46% as compared to 14.59% in 1HFY09), which provided support to the bottom line.

Garments segment leads growth

Revenues from the garments segment led the way as it increase by 118% to Rs1.1bn. The company saw its average selling rate increase by 18% which accredited to the growth in this segment. Moreover, gradual recovery in the western economies helped the company to acquire more orders and sustain its current clientele through their Production Development Department which focuses specifically on client's requirements. Going forward, the management has plans to invest further in the segment to enhance its production capacity to 600k units per month from the current capacity of 500k units per month.

Other income remained stagnant

NML's strong equity portfolio (value as of March 17: Rs49 per share) comprising of MCB Bank and DG Khan Cement has always provided support to the bottom line as it contributes ~30% to the earnings of the company. Other operating income remained stagnant during the 1HFY10 which only rose to Rs336mn from Rs317mn in the same period last year.

(Rs mn)	1HFY10	1HFY09	Δ%
Net Sales	14,152	12,484	13%
Cost of Goods Sold	11,663	9,697	20%
Gross Profit	2,489	2,787	-11%
Gross Margin	*18%*	*22%*	
Adminstration & Distribution exp	1,005	901	11%
Operating profit	1,485	1,886	-21%
	10%	*15%*	
Finance cost	547	737	-26%
Other operating income	336	317	6%
Other charges	128	182	-30%
Profit Before Taxation	1,146	1,284	-11%
Taxation	136	147	-8%
Profit After Taxation	1,010	1,138	-11%
Basic Earning per share	4.17	4.69	-11%
Diluted Earning per share	2.87	3.24	-11%

Source: Company accounts

Positive cash flows from the power projects

With announcement of the rights issue, the management's plan to invest in the AES projects has become clearer. The 45% rights issue at Rs40 per share will generate Rs4.4bn in funds which will be available to invest in the projects. Based on the remaining project life of 18 years and indexation with the US CPI & Rupee/US$ parity (2.5% & 3% annually, respectively), the investment is expected to offer an attractive IRR of ~25%. The Present Value (PV) of the cumulative dividend stream from the two projects is expected to stand slightly above Rs6.4bn and contribute Rs9 per share to our target value for NML at Rs69 per share.

The scrip is currently, trading at post right FY11F PE of 6.4x, and we have a 'Buy' call on the scrip as it offers a 23% upside to our target price.

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Also in focus

IMF's US$1.2bn tranche delayed till March 31

The IMF board meeting with Pakistan officials for the approval of US$1.2bn tranche, originally scheduled on March 24 has been extended to March 31. This is due to the delay in signing of the Letter of Intent (LoI) because of the vacant position of the finance minister, left after the departure of Shaukat Tarin. Hafeez Sheikh, a former privatization minister, is set to be the new candidate for the post although an official confirmation is awaited. We believe, this delay is unlikely to have a major impact on Pakistan's economy as foreign reserves stand at a comfortable level of US$14.7bn.

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