

August 25, 2009

Pakistan Market**Textile Policy? NML has got more to offer****MORNING BRIEFING**

KSE100 Index: Closing 8287.00 ↑ (+179.06)

Our liking for Nishat Mills Limited (NML) could not have come at a better time than this. The first ever Textile Policy of Pakistan was finally approved by the Cabinet on August 12, 2009. Secondly, Nishat Power Limited (NPL) a subsidiary of NML is due to come online in Sept. 2009. Textile Policy with an export target of US\$25bn by the end of the policy period (five years), no doubt, can act as a focal point for the contracting industry but addition of NPL into NML's equity portfolio is a major trigger for the company, we believe.

What market has failed to recognize is Rs9 per share value of NPL into NML's portfolio. The aforementioned impact itself proves to have an upside of 20% on current NML price. Add this to our Sum-of-Parts target price, the scrip is trading at a discount of 33% to the market. NML's share from its core earnings on its target price stands at Rs38, whereas Rs27 per share is contributed by its strong equity portfolio. Moreover, the new Textile Policy looks set to shore up NML's top line by giving it an opportunity to increase its margins by cutting back on their local sales. Moreover, reduction in export financing (down 100bps) and relaxation in long term loans facility is likely to bring down the finance costs. Hence, we are upgrading our stance to 'Buy' on current levels.

Valuation: 33% discount to market on FY10 PE

NML has already posted a more than decent return year-to-date (98%) on the back of strong earnings reported in 9MFY09, owing to devaluation in rupee. However, we believe there still remains a huge upside potential of 34% to our revised SoP based target price of Rs65. Our revision in our fair value is mainly based on the fact that NPL is set to come online in September 2009, which adds an attractive Rs9 per share upside at current levels. Moreover, textile policy would be another growth trigger for NML.

At current levels, the stock is trading at a respective PE of 5.1x and 4.1x on FY10F and FY11F, at a discount of 33-36% to the market's FY10F and FY11F PE of 7.5x and 6.5x,

respectively. Hence, the addition of NPL into its already strong investment portfolio, consisting MCB Bank (53%) and DG Khan Cement (20%) is another compelling case to take exposure in NML.

Nishat Power

Nishat Power Limited, a wholly owned subsidiary of NML, is an RFO (Residual Furnace Oil) based IPP (Independent Power Producer) with a nameplate generation capacity of 200MW, based on reciprocating engine technology. The total cost of this project is US\$204mn, with debt to equity structure of 80:20. Nishat Power has a negotiated project life of 25 years offering a US\$ IRR of 17.5%. As per company's management, the project is expected to commence its commercial operation by Sep 2009.

Trade Agreements – Trigger for the top line

The recent talks between Pakistan and EU, with regards to a Free Trade Agreement (FTA) are another positive prospect for NML. According to the Finance Minister Shaukat Tarin, EU has given Pakistan a GSP plus (Generalized system of Preferences) status through which Pakistan's export will be available at preferential rates in the EU. Similarly, the US has also agreed to give market access to Pakistan's textile products with deliberations expected to be held soon to transform this understanding into a formal agreement.

Top line – Exports to stem up revenues

Despite deteriorating economic conditions in 9MFY09, NML posted net profits of Rs1.2bn (up 61%YoY) in its core operations owing primarily to company's export earnings in rupee terms. Resultantly, gross margins went up by 6% from 14% in the corresponding period last year. However, amid promising global economic recovery and approval of the Textile Policy (salient features to follow), we believe NML's export revenue to gain momentum going forward.

Declining interest rates

With debt to equity ratio of 63% (as of Mar 31, 2009), declining interest rates are set to rekindle the company's

bottom line. 6-Month KIBOR has come down significantly to 12.4% from 15.7% since the start of the year. This declining trend, due to improved liquidity in the interbank bank, is set to improve NML's profits going forward. NML's reliance on short-term borrowings means that the company can benefit from a cut in interest rates. We have already witnessed a 200bps reduction in interest rate since the beginning of 2009 and are of the view that interest rates could come down by an additional 100bps by the year end. We believe, the improved liquidity is likely to bode well for the company.

For further details please see our short report titled "Textile Policy? NML has got more to offer" released earlier.

bilal.qamar@js.com
92 (21) 111-574-111 (ext. 3099)

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

JS RESEARCH IS AVAILABLE ON BLOOMBERG, CAPITALIQ & THOMSON REUTERS