

July 08, 2010

## Pakistan Market

## Textile: Cotton arrivals and price outlook

MORNING BRIEFING



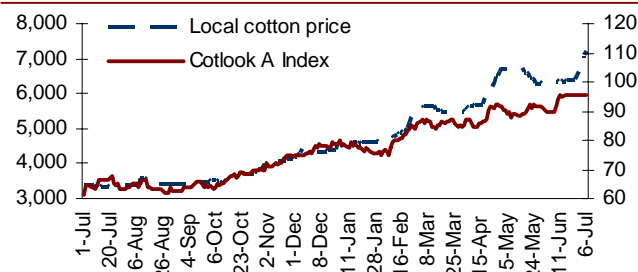
KSE100 Index: Closing 9789.69 ↑ (+214.49)

Cotton prices in the local market appear to continue trending up and have recently reached an all time high of Rs7,250 per maund compared to last year average of Rs4,598 per maund in FY10. In addition, the price parity between local and international prices has also shifted, with local prices now trading at a premium (currently 7%) to international prices (Cotlook A index) which currently stand at 95.7 cents per lbs (~Rs6,770 per maund). The current situation paints a bleak picture for the local textile industry which could see their margins being squeezed. Given the current market scenario and based on our discussion with industry experts, we have revised up, our average cotton price assumption for FY11 to Rs5,000 per maund (from Rs4,000 per maund earlier).

### Avg. price assumption for FY11; Rs5,000/maund

An expected late start to the arrival season due to shortage of rain in various parts of the country has led cotton prices to continue to escalate. Moreover, soaring demand from China and flat crop estimates for the country in FY11 has already raised concerns regarding higher cotton exports having to be to China from Pakistan. Further, increased regulation on exports from India in order to stabilize prices in its domestic market has limited the possibility of imports for Pakistan. Consequently, we have seen local cotton prices rocketing to Rs7,250 per maund in the beginning of the current season.

### Cotlook A versus local cotton price



Source: JS Research, Thomson Reuters

In contrast, international cotton prices (Cotlook A index) have risen at a slower pace and are currently hovering in the range of 95.7 cents per lbs (7% discount to local prices).

Going forward, we expect the prices to slide down and stabilize around Rs5,000 per maund once cotton arrivals for the present season commence (expected date: fourth week of July). We can see the textile companies taking a hit from this hike in prices in the form of lower margins.

### Cotton arrivals expected at 13.2mn bales in FY11

With increased sowing of the BT cotton seed, we estimate cotton arrivals in FY11 to grow by 4%YoY to 13.2mn bales. The government however has set a cotton production target of 14mn bales, which we believe is likely to be revised down considering the late start to cotton arrivals this the current season.

On the international front, the United States Department of Agriculture (USDA) has forecasted global cotton production to grow by 11%YoY in FY11 to 114mn with better crop estimates expected mainly for all the major cotton producers except China.

### Outlook: High cotton prices to affect textile units

We believe higher cotton prices will bode negative for the textile industry as their margins would be squeezed during FY11. Moreover, since local prices are trading at a premium, we believe this will limit textile sector's ability to export yarn on better margins this year.

Nonetheless, we maintain our 'Buy' call on Nishat Mills Limited (NML) and Nishat Chunian Limited (NCL) given their attractive valuations which is based on their equity portfolios and investments in the power sector. The stocks currently trade at an FY11E PEs of 5.0x and 5.6x, respectively.

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### Also in focus

#### Fiscal deficit for FY10 to stand at 5.8%

According to news reports, the provisional figure for fiscal deficit for FY10 has been estimated at Rs870bn, or 5.8% of GDP, higher than the revised IMF target of 5.1%. The slippage is primarily on the back of revenue shortfall, non materialization of budgeted foreign inflows and deficits on provincial budgets (against initial projections of surpluses). Moreover, the government's last-ditch effort to recover money due from Etisalat did not pay off either. However, we await official figures which are expected to be released in the next few weeks. To recall, the government has set a fiscal deficit target of 4% of GDP for FY11.

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