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## Pakistan Market

## MORNING BRIEFING



## Textile sector: Remarkable growth of 85% in 1HFY10 KSE100 Index: Closing 10506.20 ↓ (-50.99)

Pakistan's textile sector registered a stellar earnings growth of 85%YoY in 1HFY10. The spinning sector turned to profitability and posted an impressive earnings growth, compared to the corresponding period last year. Weaving and composite sectors also noted improved earnings by 39% and 8%, respectively. For our analysis we have taken a sample of 18 spinning, 5 weaving and 15 composite companies which represent 80%, 94% and 85% market capitalization of their respective sectors.

### Textile sector: Earnings up by 85%

The textile sector's topline grew by 15%YoY to Rs121.1bn in 1HFY10 amid a rise in export based revenue due to the depreciating rupee (3% in 1HFY10). However, owing to escalating input prices, gross margins deteriorated by 195bps during the period under review. Decline in other operating expenses (down by 34%YoY) and finance cost (down by 20%YoY) somewhat mitigated the effect of the rising cost of goods sold. The 6-month KIBOR during this period averaged at 12.5% (down by 213bps). As a result, the sector registered earnings growth of 85%YoY to Rs4.5bn.

Textile Sector (Rs mn)	1HFY10	1HFY09	Δ%
Net Sales	121,128	105,065	15%
Gross Profit	18,512	18,105	2%
Gross Margin	15.3%	17.2%	-195bps
Operating Profit	11,852	11,180	6%
Other Income	1,478	1,963	-25%
Financial Charges	8,050	10,058	-20%
Net (Loss) / Profit	4,463	2,407	85%

Source: Company accounts & JS Research

### Spinning sector: Impressive u-turn to profitability

In 1HFY10, the spinning sector registered revenue of Rs32.3bn (up by 19%YoY) in comparison to the same period last year. This was predominantly on the back of global production shortfall which resulted in a hike in cotton prices. Consequently, spinners apart from the local market were able

to sell a large chunk in the international market which provided higher margins comparatively. In 1HFY10, export of cotton yarn increased by 26%YoY to US\$728.4mn. Moreover, other income drastically improved by 172% to Rs256mn primarily on the back of higher dividend flows and the finance cost declined by 19%YoY to 1.8bn, which further cushioned the bottom line. As a result, the spinning sector ascended into profitability of Rs1.4bn versus a loss of Rs0.4bn in 1HFY09.

Spinning Sector (Rs mn)	1HFY10	1HFY09	Δ%
Net Sales	32,289	27,131	19%
Gross Profit	4,506	3,471	30%
Gross Margin	14.0%	12.8%	116bps
Operating Profit	3,306	1,916	73%
Other Income	256	94	172%
Financial Charges	1,795	2,213	-19%
Net (Loss) / Profit	1,392	(412)	NM

Source: Company accounts & JS Research

### Weaving sector: Earnings up by 39%

The weaving sector's revenue dwindled to Rs7.3bn (a decline of 2%YoY) with gross margins at 11% (down by 117bps). The finance cost reduced by 24% to Rs369mn which supported the bottom line as it reflected an improvement of 39% to arrive at Rs72mn.

Weaving Sector (Rs mn)	1HFY10	1HFY09	Δ%
Net Sales	7,314	7,422	-2%
Gross Profit	828	927	-11%
Gross Margin	11.3%	12.5%	-117bps
Operating Profit	442	529	-16%
Other Income	40	45	-12%
Financial Charges	369	484	-24%
Net (Loss) / Profit	72	52	39%

Source: Company accounts & JS Research

### Composite sector: Earnings improve by 8%

The topline for the composite sector improved by 16% to Rs82bn. High input costs caused gross margins to plunge to

16% (down by 328bps). As was the case with the other two sectors, declining KIBOR rate kept the financial charges down to Rs5.9bn. Consequently, the net profit improved by 8% to Rs3.0bn in 1HFY10.

Composite Sector (Rs mn)	1HFY10	1HFY09	Δ%
Net Sales	81,525	70,513	16%
Gross Profit	13,178	13,708	-4%
Gross Margin	16.2%	19.4%	-328bps
Operating Profit	8,104	8,735	-7%
Other Income	1,183	1,823	-35%
Financial Charges	5,886	7,361	-20%
Net (Loss) / Profit	2,999	2,767	8%

Source: Company accounts & JS Research

### Outlook: Textile policy & macro recovery hold key

The spinning sector led a dominant role in driving the textile growth to 85% in 1HFY10. However, the excessive yarn export was a one off phenomenon and going forward, we expect this trend to normalize as the GoP has set a target of 14mn bales in FY11 and the world cotton production is also expected to increase by 10%. Moreover, with recent developments in the textile policy, particularly the mark-up rate facility which will relieve the pressure off the financial cost, will bode well for the textile industry. The two companies under our coverage, NCL and NML have diversified into the power business which minimizes the risk of their core business. Hence, we maintain our 'Buy' call on both the scrips which trade at FY11 PBVs of 0.7x and 0.9x, respectively.

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