JS Research

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Pakistan Market

MORNING BRIEFING

Textile sector 4QFY10 earnings outlook

KSE100 Index: Closing 10114.65 ↑ (+135.58)

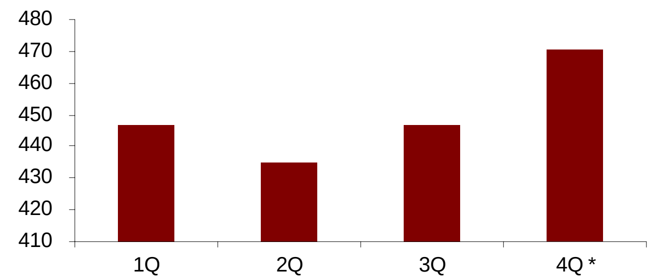
We anticipate the textile sector to continue its commendable performance during the last quarter of FY10. Our view is supported by the export data released by the Federal Bureau Statistics (FBS) for 11MFY10. With two months data available, average monthly value added exports (53% share in total textile exports) have already grown by 5% compared to the 3Q. On the flip side, yarn exports on average have declined by 7% in Apr-May versus 3QFY10, post imposition of the Regulatory Duty (RD) on export of yarn. Overall, as yarn exports only comprise 14% of total exports, the effect of decline in yarn export revenues would be more than offset (for the composite units) by rising value added exports which fetch better margins. However, the profits of stand-alone spinners would take a hit in 4QFY10 due to a likely fall in volumetric export sales as evident from the export numbers.

Despite an impressive performance in FY10E, recently soaring cotton prices would put some pressure on the sector's margins, going forward. However, we maintain our 'Buy' call on NML and NCL not only on the back of their sound core business but also due to their exposure in the power sector.

Value added exports to bolster 4QFY10 earnings

Due to the imposition of RD, the composite units are more focused on value added product to be able to cash in on higher margins.

Average value added exports in FY10 (US$ mn)



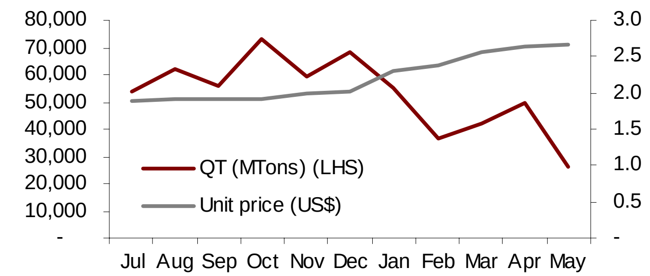
*Source: FBS & JS Research; * Apr-May*

Traditionally, with orders from foreign buyers for their summer season, sales usually pick up during the last quarter of a fiscal year. This is evident from the average monthly exports for Apr-May 2010 too which have increased by 5% relative to 3QFY10. In addition to higher exports volumes, rising prices have also supported this growth in the value added exports (knitwear, bed wear, towel and ready made garments).

RD to hit stand-alone spinners

While home textile exports have shown an up-tick during most of 4QFY10, yarn exports on an average monthly basis have fallen by 7% compared to 3QFY10. This decline is likely to be mitigated for the larger composite units due to higher export sales in the value added segment. However, the stand-alone spinners can see their toplines getting squeezed during the 4QFY10, in our view.

Cotton yarn exports in FY10



Source: FBS & JS Research

To recall, the spinning segment reported healthy profits of Rs3.6bn (based on a sample of 20 companies which hold 80% of market capitalization of the total spinning industry) in 9MFY10. Though yarn prices are still strong, the imposition of RD is likely to restrict volumetric export sales in June 2010. Moreover, local cotton prices have recently surged to new highs and currently trade at a premium to international prices; limiting the spinner's ability to export yarn on better margins.

9MFY10 Spinning sector profitability

(Rs mn)	9MFY10	9MFY09	% Δ
Net Sales	56,359	43,252	30%
Gross Profit	8,499	5,025	69%
Gross Margin	*15.1%*	*11.6%*	*350bps*
Operating Profit	6,993	3,233	116%
Other Income	683	(12)	NM
Financial Charges	3,421	3,884	-12%
Net Profit / (Loss)	3,558	(886)	NM

Source: JS Research

Outlook:

Albeit the textile sector's strong performance in FY10E, we believe rising cotton prices bodes negative for the sector's profitability, going forward. Nevertheless, better crop estimates expected mainly for all the major cotton producers, apart from China, during the year can relieve some pressure off of cotton prices which have been soaring lately. Cotton prices are still expected to be higher by 28% higher than last year's procurement price (for major textile companies) of Rs3,910 per maund.

We however maintain our 'Buy' call on Nishat Mills Limited (NML) and Nishat Chunian Limited (NCL) given their attractive valuations based on their strong core business, equity portfolios and investments in the power sector. The stocks currently trade at FY11E PEs of 5.3x and 5.8x, respectively.

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