July 20, 2010

Pakistan Market

Textile: Local cotton prices on a mend

MORNING BRIEFING

KSE100 Index: Closing 10201.85 ↑ (+48.00)

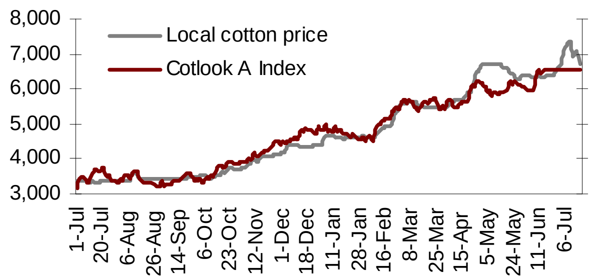
After touching a peak of Rs7,450 per maund and trading at an abnormal premium of 7% versus the international prices (Cotlook A index), local cotton prices have plummeted in the last couple of days. The prices currently stand and Rs5,800 per maund as supply concerns eased off in the local market on the back of timely start of the monsoon season and commencement of the cotton arrivals to the ginners. Therefore, we reaffirm our average cotton price assumption for FY11 at Rs5,000 per maund and reiterate our liking for the textile sector with a 'Buy' call on both Nishat Mills Limited (NML) and NIshat Chunain Limited (NCL).

Cotton price fall by 22% from its peak

Post a slight delay in arrivals and expected shortage in China, local cotton prices swelled to a high of Rs7,450 per maund. However, adequate rainfall and increased sowing of BT cotton seed suggests that government's target of 14mn bales is achievable.

On the international front, concerns regarding excess demand from China have also eased off as world cotton production is expected to grow by 11%YoY, according to United States Department of Agriculture (USDA). We believe prices could further go down from current levels once the arrival season fully kicks in, post August 2010. Thus, we reaffirm our cotton price assumption of Rs5,000 per maund in FY11.

Cotlook A versus local cotton price



Source: JS Research, Thomson Reuters

Textile sector outlook

Going forward, we expect margins for the textile companies to witness some pressure in FY11 compared to FY10 due to higher expected procurement price (Rs5,000 per maund versus Rs3,741). However, export concerns for the companies have eased off as the local prices have reverted to the historical trend of trading at a discount to the international prices. Moreover, bumper crop expectation bodes well for the standalone spinners as it could lead to the Regulatory Duty (RD) being removed post July 26, 2010, proving to be an earning enhancer for the spinners. Nonetheless, we believe the value added segment to be the top performer owing to relatively higher international product prices during the year.

We maintain our 'Buy' call on NML and NCL which currently trade at FY11 PE's of 5.8x and 4.7x respectively.

Key valuations for FY11

	NML	NCL
PE	5.79	4.70
PBV	0.70	0.57
Target price	65	24

Source: JS Research

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Also in focus

FY10 textile exports recorded at US$10.2bn

According to the data released by the Federal Bureau of Statistics, textile exports of Pakistan for the month of June, 2010 came at US$921.9mn, up 5.4%MoM and an increment of 9.9%YoY. The cumulative textile exports for the whole year FY10 were registered at record level of US$10.2bn, registering a 7.0% rise compared to FY09. The overall growth was predominantly led by yarn exports.

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