

## PAKISTAN TEXTILE

### Value addition is the 'name of the game'

- Textile exports for the month of Dec'18 were recorded at US\$1.14bn (+3.6%MoM/0.6% YoY), pulling up 1HFY19 exports to US\$6.65bn, relatively flattish YoY
- Value-added exports continued their up-trend seen since Jul'17 on the back of export incentives, taking 1HFY19 export sales under the header to US\$5.02bn (+3.7%YoY), while non-value added segment pulled down overall growth, (-9.3%YoY in 1HFY19 vs. +3.3% YoY in the same period last year)
- Local cotton prices have inched up recently on the back of strong demand and crop shortage, however, prices are expected to come under pressure due to the abolition of customs duty and sales tax on import of cotton, expected to encourage imports
- i) Extension in export incentives for 3yrs, ii) tariff rationalization of utilities, and iii) reduction in import duties on certain raw materials, all indicate the favorable GoP policies for the sector to enhance exports.
- With exports averaging 58% of our textile universe's topline and every 1% devaluation in domestic currency in-turn raises our Textile Universe earnings by 0.85%, the sector is poised to continue exhibiting outperformance. We have an overweight stance on the sector with NML (TP:PKR158/sh) being the value added, diversified income play as our top pick.

**Dec'18 textile exports up 0.6%YoY driven by value added segment:** Textile exports for the month of Dec'18 were recorded at US\$1.14bn (+3.6%MoM/0.6%YoY), pulling up 1HFY19 exports to US\$6.65bn, remaining flat on YoY basis. Bifurcating exports into value added and non-value added, value added exports continued their up-trend seen since Jul'17 on the back of export incentives, where Dec'18 export sales were recorded at US\$0.9bn (+5.8%YoY) while getting a further uplift through year-end sales. That said, 1HFY18 value added exports were recorded at US\$5.02bn, +3.7%FYTD, lower than 9.5%YoY recorded in the corresponding period last year. Consequently, we believe exporters passed-on currency devaluation benefit to final customers (unit prices are down 3-30% across value added segments), a common practice aimed at augmenting sales volumes. The upward shift in value added exports is countered by non-value added segment decline, down 9.3%YoY in 1HFY19 vs. growth of 3.3%YoY in the same period last year, despite higher unit prices on the back of climbing cotton prices.

**Cotton prices to come under pressure:** Local cotton prices started Dec'18 at ~PKR8900/maund, however, the prices decreased towards mid-dec, in line with international prices as Cotlook also declined from USC86-81/lb. Local cotton prices have returned to the high ground after that due to a shortage in production where the cotton production is expected to clock in at 10.8-11mn bales (down 9%YoY) against the initial target of 14.4mn bales. Moving forward, local cotton prices are expected to come under pressure after the recent decision by Economic Coordination Committee to abolish customs duty (5%) and sales tax (5%) on import of cotton. The decision bodes well for the exporters who rely on imports for long staple fiber which aids in producing high quality products.

**Outlook:** i) Extension in export incentives for 3y – albeit at lower rates (ranging 2-4% vs. 4-7% previously), ii) tariff rationalization of utilities (i.e. electricity at USC7.5/KwH, gas at US\$6.5/mmbtu), and iii) reduction in import duties on certain raw materials, all point to the favorable Govt. policies for the sector to push exports upward. We believe the recent rounds of currency devaluation are yet to reflect in exports (indicated by margin profiles of the sector), possibly allowing the manufacturers to lower prices further to penetrate markets. With exports averaging 58% of our textile universe's topline and every 1% devaluation in domestic currency raising our Textile Universe earnings by 0.85%, the sector is poised to continue outperforming KSE-100 index on the back of profitability growth (1y outperformance: 3.7%). Potential resolution of trade dispute between US and China could improve global growth prospects and commodity prices for the textile manufactures whereas down turn in Europe on the back of Brexit related issues (consuming ~30% of Pakistan's exports) would act as headwinds.

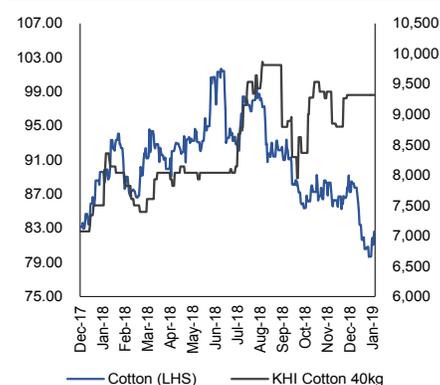
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Textile Exports for Dec'18 (USDmn)

(USDmn)	Dec'18	YoY	1HFY19	YoY
Raw Cotton	-	-90.7%	14	-73.6%
Cotton Yarn	76	-29.7%	548	-17.1%
Cotton Cloth	172	-3.8%	1,053	-1.4%
Other Yarn	2	8.7%	15	0.8%
<b>Total Non-Value Added</b>	<b>250</b>	<b>-14.2%</b>	<b>1,630</b>	<b>-9.3%</b>
Knitwear	260	10.1%	1,484	11.1%
Bed Wear	193	9.1%	1,159	3.1%
Towels	64	-0.3%	378	-0.8%
Tents	17	18.8%	49	-0.8%
Garments	238	3.6%	1,261	1.0%
Synthetics	25	4.4%	148	-0.2%
Madeups	60	4.9%	348	2.2%
Others	31	-16.7%	199	-8.9%
<b>Total Value Added</b>	<b>888</b>	<b>5.8%</b>	<b>5,026</b>	<b>3.7%</b>
<b>Textile Exports</b>	<b>1,138</b>	<b>0.6%</b>	<b>6,656</b>	<b>0.2%</b>

Source: PBS & AKD Research

Cotton Prices (Usc/lb)



Source: KCA, Bloomberg and AKD Research



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Buy	> 19% expected total return (Rf: 13% + Rp: 6%)
Neutral	> 13% to < 19% expected total return
Sell	< 13% expected total return (Rf: 13%)

### Old Rating Definitions (Discontinued)

Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

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To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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