November 8, 2021

PAKISTAN TEXTILE

REP-019

MARKET VISTA

Local yarn margins to remain strong in FY22

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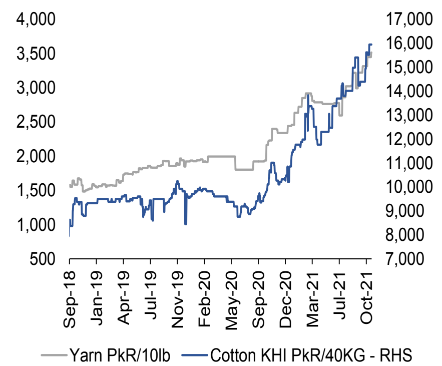
- **Local yarn margins currently stand at PkR261.5/kg or +61% vs PkR214.4/kg or +55% FYTD due to robust demand of downstream players. Yarn export prices were trading at a discount of 26.1% to local yarn prices which clocked in at PkR661/kg vs export prices of PkR523/kg in 1QFY22).**
- **On the global front, decline in Vietnamese exports will help India and Pakistan to fulfill export order originating from robust apparel demand form US and EU where Pakistan's 4MFY22 textile exports have reached an all-time high of US$6.04bn (+27%YoY) as per APTMA and PBS.**
- **Pakistan is currently engaged in talks with IMF for the revival of US$6.0bn support package with energy tariffs being the major sticky point. The local gas production (meeting 25%-30% of demand) has to be supplemented with expensive imports where the gas tariff currently in place requires government to give a major subsidy as the cost isn't being passed on to the end customer.**
- **With global textile dynamics continuing to remain favorable amid brewing trade war between US and China and as yarn margins remain downward sticky, the local textile sector finds itself in a sweet spot. In this backdrop, we like textile players with a higher concentration of spinning segment sales in their topline together with lower dependency of gas in their energy mix such as NCL.**

Local yarn margins to remain robust in FY22: Local yarn margins currently stand at PkR261.5/kg or (+61%) vs PkR214.4/kg or (+55%) FYTD, due to robust demand of downstream players. With high textile demand likely to persist in FY22 both on local and global front amid return to normalcy phenomenon, we expect the yarn margins to remain robust throughout FY22 (despite higher than expected cotton production which is expected to reach 9.5-10mn bales in FY22 vs 7.1mn bales in FY21). Yarn export prices were trading at a discount of 26.1% to local yarn prices which clocked in at PkR661/kg vs export prices of PkR523/kg in 1QFY22). On the global front, India has regained its place as the prominent export player in the region with Apr-Aug'21 export clocked in at US$164.1bn (+67.3%YoY). However, Vietnamese export fell for the third conservative month in Sep'21 to US$2.28bn, down 27.3% from US$3.2bn. Decline in Vietnamese exports were due to concerns over new wave of Covid-19 and a shortage of labor which will help India and Pakistan to fulfill export order originating from robust apparel demand form US and EU where Pakistan's 4MFY22 textile exports reached an all-time high of US$6.04bn (+27%YoY) as per APTMA and PBS.

Gas and power incentives may be withdrawn: Pakistan is currently engaged in talks with IMF for the revival of US$6.0bn support package with energy tariffs being the major sticky point. The local gas production (meeting 25%-30% of demand) has to be supplemented with expensive imports where the gas tariff currently in place requires government to give a major subsidy as the cost isn't being passed on to the end customer. Consequently, RLNG related circular debt has increased to PkR200bn which has gained IMF's attention and fund and authorities are locked in a negotiation process to ease the buildup of circular debt. Currently the GoP has given a subsidy package to the textile exports where these companies are being supplied gas at a subsidized rate of US$6.5/mmbtu, which may be discontinued going forward. To this end, we expect the players in Sindh and KPK to be at the biggest disadvantage owing to their higher dependency on gas, while the players in Punjab, having a diversified energy mix, will likely be least affected.

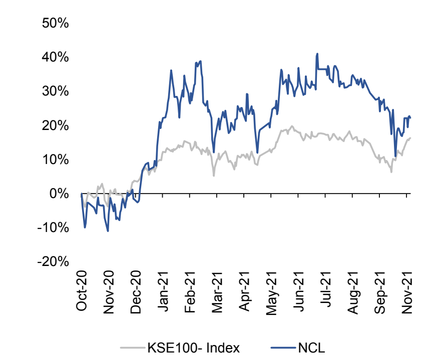
Investment Perspective: With global textile dynamics continuing to remain favorable amid brewing trade war between US and China and as yarn margins remain downward sticky, the local textile sector finds itself in a sweet spot. Consequently, we continue to see textile exports remaining strong. However, the recent development of a discontinuation of tariff subsidy given to textile sector does pose some concern. In this backdrop, we like textile players with a higher concentration of spinning segment sales in their topline together with lower dependency of gas in their energy mix such as NCL.

Yarn margins to remain robust in FY22



Source: Karachi Cotton Index, Bloomberg & AKD Research

NCL vs. KSE100 Index



Source: PSX & AKD Research

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