

## PAKISTAN TEXTILES

# MARKET VISTA

REP-019

## Strong cotton output to augment sector's profitability

- International cotton prices remained strong throughout 1QFY22, hovering around US\$112/lb with an increase of 10%QoQ in 1QFY22 taking cumulative CYTD increase of 32.6%. We expect international prices to ease in the coming months where potential higher production in key areas likely to offset increase in demand.
- Cotton prices have started receding, down 4%MoM to currently hover around Pkr14,393/maund but still at historically highest levels. However, the recent arrival of 3.85mn cotton bales (+2.0xYoY) for the mill use casts positive overtures on cotton production outlook where the current production target is set at 8.5-9.0mn bales for FY22. The same should result in containing import bill where last year raw cotton imports stood at 4.9mn bales vs. avg. 3mn bales pa. historically — potentially translating in to savings of US\$842mn.
- Local yarn margins currently stand at Pkr247.2/kg or (+64%) vs Pkr176.2/kg or (+60%) in FY21, due to robust demand outlook of textile products.
- Textile sector performance has remained sluggish (FYTD return: -ve 1.8%) despite significant positive developments supporting earnings outlook. Hence, we maintain our bullish stance on the sector where NML (TP: Pkr132/sh – 48% upside) stands as our top pick with the current price offering core operations virtually free.

**Rise in global cotton production targets to bring down prices:** International cotton prices remained strong throughout 1QFY22, hovering around US\$112/lb with an increase of 10%QoQ in 1QFY22 and cumulative CYTD increase of 32.6%. However, as per latest USDA report, global production/mill use is projected at 119.6/124.1mn bales, about 7.2/4.5mn bales higher than in FY21. We believe higher production in key areas – India (+4%YoY), Brazil (+16.3%YoY) and US (+18.1%YoY) – will help in offsetting upswing in commodity prices where we could see prices retreating to similar level achieved in FY21 (US\$83-85/lb), once the new crop reaches market.

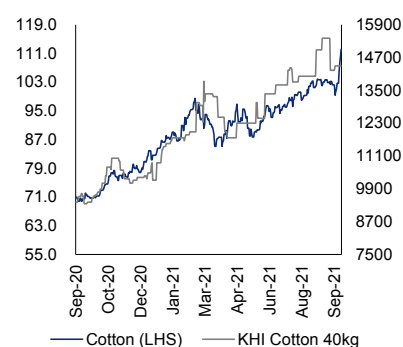
**Local production target of 8.6mn bales – a welcome news for textile players:** Cotton prices have started receding, down 4%MoM to currently hover around Pkr14,393/maund but still at historically highest levels. Cotton prices have surged by 49% during the past one year where low cotton production of 5.3mn bales compared to historical avg. of 8mn bales, amid robust demand from spinners pushed up prices. The recent arrival of 3.85mn cotton bales (+2.0xYoY) for the mill use casts positive overtures on cotton production outlook where the current production target is set at 8.5-9.0mn bales for FY22. Province wise Sindh/Punjab are expected to produce 3.5/4.5mn bales in FY22 on the back of better yield, improved sowing area and lower chances of exogenous factors playing out (pest/locust attack etc.). Moreover, we expect local demand to settle 12-13mn bales where country may still need to import 3-4mn bales to meet the demand

**A glimpse at Yarn margins:** Local yarn margins currently stand at Pkr247.2/kg or (+64%) vs Pkr176.2/kg or (+60%) in FY21, due to robust demand outlook of textile products. With high textile demand likely to persist in FY22 amid return to normalcy phenomenon, we expect the yarn margins to remain buoyant throughout FY22. Furthermore, local yarn manufacturers actively targeted Chinese and Bangladeshi markets for exports last year, which resulted in a shortfall of yarn in local market, which had to be fulfilled through imports. However, with local yarn margins at record levels and prohibitive international freight costs, we expect the trend to change this year and majority of local yarn demand to be met by local yarn manufacturers.

**A host of government incentives to keep profitability buoyant:** Various fiscal incentives have been offered to the export oriented textile sector in order to stimulate growth in exports. To this end, import duties on various raw materials such as filament yarn, were slashed in the federal budget FY22 which bodes positively for the value added textile sector. Textile sector is also recipient of cheap financing facilities by SBP under ETF and LTFF schemes where the borrowing rates have been set ~3% and 5% respectively. Financing under these facilities can be utilized in order to increase production capacity as well as managing working capital requirements. Fur-

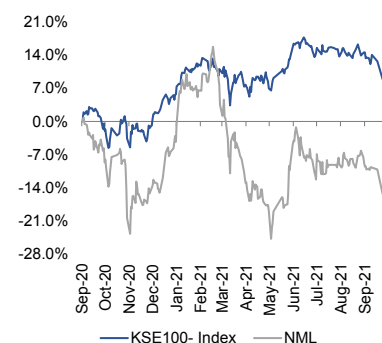
Mohsin Ali  
mohsin.ali@akdsecurities.net  
111-253-111 Ext: 646

Cotton Prices (US\$/lb)



Source: Karachi Cotton Index, Bloomberg & AKD Research

NML vs. KSE100 Index



Source: PSX & AKD Research



AKD Securities Limited

thermore, the turnover tax has also been reduced from 1.5% of sales to 1.25% of sales and is expected to be reduced further in the next federal budget.

**Investment perspective:** Textile sector performance has remained sluggish (FYTD return: -ve 1.8%) despite significant positive developments supporting earnings outlook. Moving forward, we expect earnings to remain robust in the near term where i) PKR depreciation, and ii) higher offtakes as global economies started reaching pre COVID levels could keep sector in the lime-light. Hence, we maintain our bullish stance on the sector where any dip in prices will provide an opportunity to take exposure in textiles. Our top pick for the sector is NML (TP: PkR132/sh – 48% upside) where the current price offers core operations virtually free.

## Disclosure Section

Neither the information nor any opinion expressed herein constitutes an offer or a solicitation of an offer to transact in any securities or other financial instrument and is for the personal information of the recipient containing general information only. AKD Securities Limited (hereinafter referred as AKDS) is not soliciting any action based upon it. This report is not intended to provide personal investment advice nor does it provide individually tailored investment advice. This report does not take into account the specific investment objectives, financial situation/financial circumstances and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. AKDS recommends that investors independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities or strategies discussed in this report may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Reports prepared by AKDS research personnel are based on public information. AKDS makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. Facts and views presented in this report have not been reviewed by and may not reflect information known to professionals in other business areas of AKDS including investment banking personnel. AKDS has established information barriers between certain business groups maintaining complete independence of this research report.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. Neither AKDS, nor any of its affiliates or their research analysts have any authority whatsoever to make any representation or warranty on behalf of the issuer(s). AKDS Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

We have taken all reasonable care to ensure that the information contained herein is accurate, up to date, and complies with all prevailing Pakistani legislations. However, no liability can be accepted for any errors or omissions, or for any loss resulting from the use of the information provided as any data and research material provided ahead of an investment decision are for information purposes only. We shall not be liable for any errors in the provision of this information, or for any actions taken in reliance thereon. We reserve the right to amend, alter, or withdraw any of the information contained in these pages at any time and without notice. No liability is accepted for such changes.

## Stock Ratings

Investors should carefully read the definitions of all ratings used in each research report. In addition, research reports contain information carrying the analyst's view and investors should carefully read the entire research report and not infer its contents from the rating ascribed by the analyst. In any case, ratings or research should not be used or relied upon as investment advice. An investor's decision to buy, sell or hold a stock should depend on individual circumstances and other considerations. AKDS uses a three tier rating system: i) Buy, ii) Neutral and iii) Sell with total returns (capital upside + dividend yield) benchmarked against the expected one year forward floating (variable) risk free rate (10yr PIB) plus risk premium.

## Valuation Methodology

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.)

### New Rating Definitions

<b>Buy</b>	> 14.5% expected total return (Rf: 8.5% + Rp: 6%)
<b>Neutral</b>	> 8.5% to < 14.5% expected total return
<b>Sell</b>	< 8.5% expected total return (Rf: 8.5%)

## Analyst Certification of Independence

The analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

## Regional Disclosures (Outside Pakistan)

The information provided in this report and the report itself is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject AKDS or its affiliates to any registration or licensing requirements within such jurisdiction or country.

Furthermore, all copyrights, patents, intellectual and other property in the information contained in this report are held by AKDS. No rights of any kind are licensed or assigned or shall otherwise pass to persons accessing this information. You may print copies of the report or information contained within herein for your own private non-commercial use only, provided that you do not change any copyright, trade mark or other proprietary notices. All other copying, reproducing, transmitting, distributing or displaying of material in this report (by any means and in whole or in part) is prohibited.

For the United States

## Compliance Notice.

This research report prepared by AKD Securities Limited is distributed in the United States to Major US Institutional Investors (as defined in Rule 15a-6 under the Securities Exchange Act of 1934, as amended) only by Decker & Co, LLC, a broker-dealer registered in the US (registered under Section 15 of Securities Exchange Act of 1934, as amended). All responsibility for the distribution of this report by Decker & Co, LLC in the US shall be borne by Decker & Co, LLC. All resulting transactions by a US person or entity should be effected through a registered broker-dealer in the US. This report is not directed at you if AKD Securities Limited or Decker & Co, LLC is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that Decker & Co, LLC and AKD Securities Limited are permitted to provide research material concerning investment to you under relevant applicable legislations and regulations.



**AKD Securities Limited**  
602, Continental Trade Centre,  
Clifton Block 8, Karachi, Pakistan.  
research@akdsecurities.net