Indian Spinning Industry: Trends & Outlook

Off take by Chinese mills under ongoing reserve cotton auctions in China a key focus for India’s cotton and cotton yarn exports

Quarterly Update: June 2016
Contents: What’s Inside

A. Global and Domestic Cotton Scenario
   - World cotton balance sheet
   - World cotton stock to use ratio vs. Cotlook A Index
   - China cotton balance sheet
   - World less China cotton balance sheet
   - Domestic cotton balance sheet and estimate for CY 2015/16
   - Domestic monthly cotton consumption and export
   - Domestic cotton arrivals

B. Trends and Outlook on Cotton Prices
   - Trend and outlook on international cotton prices
   - Comparative trend between cotton prices in India, China and Cotlook A index
   - Trend and outlook on domestic cotton prices
   - Cotton stocking with domestic mills
   - Spread between domestic cotton and PSF prices

C. Domestic Yarn Production and Exports
   - Monthly yarn production and inventory levels
   - Monthly yarn exports
   - Country wise yarn exports and share of exports in total production

D. Domestic Yarn Prices and Contribution Margin
   - Comparative trend between domestic and international cotton yarn prices
   - Comparative trend between domestic and international cotton yarn spread
   - Trend in domestic contribution margin in rupee and USD terms
   - Outlook on the Indian spinning industry

E. Financial Performance of Indian Spinning Industry

F. Annexure I: Rating Distribution of ICRA rated spinning companies and upgrade to downgrade ratio

G. Annexure II: Amended TUFS
Contents: What’s Inside

H. Company Section

- Ambika Cotton Mills Limited
- Bannari Amman Spinning Mills Limited
- Banswara Syntex Limited
- Damodar Industries Limited
- Deepak Spinners Limited
- Ginni Filaments Limited
- GTN Industries Limited
- K.P.R. Mill Limited
- Maral Overseas Limited
- Nahar Industrial Enterprises Limited
- Nahar Spinning Mills Limited
- Nitin Spinners Limited
- Rajapalayam Mills Limited
- RSWM Limited
- Supreme Tex Mart Limited
- Super Spinning Mills Limited
- Sutlej Textiles And Industries Limited
- Trident Limited
- TT Limited
- Vardhman Polytex Limited
- Vardhman Textiles Limited
- Winsome Textiles Industries Limited
- Winsome Yarns Limited
**Summary**

### Global and Domestic Cotton Scenario

**Global cotton stock position:** Global cotton production has witnessed a steep decline in CY2016, following the decline in production in key growing countries like China, India, Pakistan, and USA. The consumption has also been under pressure due to improved competitiveness of poly staple fibre (aided by decline in crude prices). The decline in cotton production has, however, been sharper compared to consumption. As a result, cotton consumption is estimated to exceed production for the first time in the last six years. Nonetheless, global cotton stock levels will continue to remain elevated as large cotton stocks were accumulated over the past five years. The global stock to use ratio for July ‘16 is expected to be marginally lower at ~94% vis-à-vis ~102% in July ‘15.

Going forward, despite the low prices in CY2016, global cotton production is expected to recover. Despite a decline in China’s cotton production, the expectation of recovery is led by higher production in the sub-continent and USA, aided by favourable growing conditions. China’s production on the other hand is expected to remain significantly lower than consumption. Hence, despite the expectation of recovery in global production levels, it is unlikely to surpass the consumption levels and should drive a gradual decline in global stock levels.

**China’s cotton stock position:** Due to the increasing labour costs, and reduced and selective (region wise) applicability of minimum support prices, the area under cotton cultivation and hence cotton production has shrunk in China in CY2016. This, coupled with reduced imports (as lower cotton import was issued), has trimmed down the cotton stock levels. However, despite this decline, China’s cotton stock position remains abnormally high. In ICRA’s view, the declining trend in China’s cotton production and imports will continue, and hence will facilitate a further decline in domestic and global stock levels.

China’s cotton reserve auctions began in the first week of May 2016 and are likely to continue till August 2016 at prices lower than last year’s auction prices. The quantity offered under auction shall suffice for domestic cotton requirement during this non-harvest period. The reduced prices and higher offer quantity reflect the intent of the Chinese government to liquidate cotton stock, which should in turn support cotton yarn production in China.

As China holds ~60% of the global cotton stocks, a decline in global stock levels to sustainable levels requires further reduction in China’s cotton stocks. In ICRA’s estimate, based on the current gap between China’s production and consumption, six more years are required to reach historical averages. A major upward change in area under cotton cultivation is not expected as the support price by the Chinese government for cotton has been marginally declining during the last two seasons, reflecting the intent of the government to clear the accumulated stocks. A sharper decline in China’s production could, however, accelerate the stock correction.
Summary: Continued...

**India’s cotton stock position**: India’s cotton production in CY2016 is estimated to be the lowest in five years following the crop damage in North due to pest attacks, and lower yields in other regions due to uneven rainfall. Moreover, cotton exports have been higher vis-a-vis previous year due to increased demand from neighboring countries. While the domestic cotton consumption has also been sluggish in line with the global trend, the sharper production decline and higher exports have squeezed the domestic cotton availability as was highlighted by ICRA earlier.

In ICRA’s view, as the consumption growth is sluggish and exports are likely to remain moderate with a downward bias due to the expected recovery in production in Pakistan, even a partial recovery in cotton production in CY2017 will support the improvement in cotton availability. However, an unforeseen decline in production from CY2016 level due to a reduction in area and/or lower yields may require the regulation of exports as was earlier witnessed in the years 2011 and 2012.

**Cotton Prices – Trends & Outlook**

**International prices**: International cotton prices continue to remain range bound because of high stock levels, though limited prospects of imports from China are resulting in a negative bias. In Q4FY2016, international cotton prices averaged at ~US$1.48/kg vis-a-vis ~US$1.52/kg in Q4FY2015. The range bound cotton prices, despite the decline in global production, also reflect consumption pressures because of cotton’s reduced competitiveness vis-à-vis polyester. Since January 2015, the cotton: PSF ratio has averaged at 1.2 times with a peak of 1.3 times in January 2016, which is the highest in the last many years, despite cotton prices prevailing at near lows of this period.

Going forward, competition from polyester will be a challenge for cotton consumption and will keep in check any upward pressures due to anticipated production shortfall vis-a-vis consumption for the 2nd consecutive year. While a sharp decline in cotton production in China accompanied by higher imports may support the upward movement in global prices, sufficient offtake at ongoing reserve cotton auction in China will, however, reduce China’s dependence on imports of cotton fibre as well as cotton yarn. This in turn will reduce cotton demand outside China, and will, therefore, keep international cotton prices under check. International cotton prices will also be influenced by the sowing data and weather conditions for CY2017.

**Indian prices**: Tightened domestic cotton availability due to a steep decline in production and higher exports, aided by demand from Pakistan, has firmly up the domestic cotton prices. Unlike in the previous season, when cotton prices declined below support prices during Q4FY2015 and stood lower at Rs. 87/kg, cotton prices in Q4FY2016 averaged at Rs. 93/kg. In ICRA’s view, the tightened domestic cotton availability will continue to keep the prices firm in the near term, though no major up-tick is expected. The medium-term price trend for CY2017 will become clear after the monsoon and sowing data is available.

**Domestic Yarn Production and Exports**

In FY2016, India’s spun yarn production grew at the slowest pace of ~3.2% in the last four years. This slow pace of growth in spun yarn production has been driven by factors like tepid domestic consumption and limited growth in exports. Furthermore, monthly production and consumption data does not signal meaningful and sustained revival as the total spun yarn production grew by 1.4% in H2FY2016 vis-a-vis growth of 4.9% in H1FY2016. As the domestic demand growth remains muted, a sustained and further decline in exports driven by increased mill utilisation in China supported by the release of reserve cotton stocks can adversely impact exports and thus warrants a cautious outlook on capacity utilisation.
Summary: Continued...

**Domestic Yarn Prices and Contribution**

Despite the sluggish domestic demand, the weakness in the Indian currency during Q4FY2016 and the resulting improvement in export realisations in rupee terms supported an increase in domestic yarn prices. The increase in yarn prices was also driven by the impact of firm cotton prices in the backdrop of tightened cotton availability. As the increase in yarn prices was higher than the increase in cotton prices, the average contribution margin in Q4FY2016 was ~Rs. 79.36/kg, which was higher by ~5% on QoQ basis, though lower by ~1% on a YoY basis.

Given the concerns on yarn export prospects due to the expected improvement in mill usage in China, and expectation of firm domestic cotton prices in the near term, under tightened cotton availability, the contribution margins of Indian spinning mills can come under further pressure in the coming quarters. As a result, the outlook on the Indian cotton spinning industry continues to remain cautious.
<table>
<thead>
<tr>
<th>Location</th>
<th>Contact Person</th>
<th>Mobile</th>
<th>Address</th>
<th>Phone</th>
<th>Fax</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gurgaon</td>
<td>Mr. L. Shivakumar</td>
<td>9821086490</td>
<td>Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon</td>
<td>+91-124-4545300, 4545800</td>
<td>+91-124-4545350</td>
<td><a href="mailto:livakumar@icraindia.com">livakumar@icraindia.com</a></td>
</tr>
<tr>
<td>Chennai</td>
<td>Mr. Jayanta Chatterjee</td>
<td>9845022459</td>
<td>5th Floor, Karumuttu Centre, 498 Anna Salai, Nandanam, Chennai-600035.</td>
<td>+91-44-45964300, 24340043/9659/8080</td>
<td>+91-44-24343663</td>
<td><a href="mailto:jayantac@icraindia.com">jayantac@icraindia.com</a></td>
</tr>
<tr>
<td>Hyderabad</td>
<td>Mr. M.S.K. Aditya</td>
<td>9963253777</td>
<td>301, CONCOURSE, 3rd Floor, No. 7-1-58, Ameerpet, Hyderabad 500 016.</td>
<td>+91-40-23735061, 23737251</td>
<td>+91-40-2373 5152</td>
<td><a href="mailto:adityamsk@icraindia.com">adityamsk@icraindia.com</a></td>
</tr>
<tr>
<td>Mumbai</td>
<td>Mr. L. Shivakumar</td>
<td>9821086490</td>
<td>3rd Floor, Electric Mansion, Appasaheb Marathe Marg, Prabhadevi, Mumbai</td>
<td>+91-22-30470000, 24331046/53/62/74/86/87</td>
<td>+91-22-2433 1390</td>
<td><a href="mailto:shivakumar@icraindia.com">shivakumar@icraindia.com</a></td>
</tr>
<tr>
<td>Kolkata</td>
<td>Ms. Vinita Baid</td>
<td>9007884229</td>
<td>A-10 &amp; 11, 3rd Floor, FMC Fortuna, 234/3A, A.J.C. Bose Road, Kolkata</td>
<td>+91-33-22876617/8389, 22800008, 22831411</td>
<td>+91-33-2287 0728</td>
<td><a href="mailto:Vinita.baid@icraindia.com">Vinita.baid@icraindia.com</a></td>
</tr>
<tr>
<td>Ahmedabad</td>
<td>Mr. Animesh Bhabhala</td>
<td>9824029432</td>
<td>907 &amp; 908 Sakar -II, Ellisbridge, Ahmedabad- 380006</td>
<td>+91-79-26585049/2008/5494, +91-79-2648 4924</td>
<td></td>
<td><a href="mailto:animesh@icraindia.com">animesh@icraindia.com</a></td>
</tr>
<tr>
<td>Bangalore</td>
<td>Mr. Jayanta Chatterjee</td>
<td>9845022459</td>
<td>'The Millenia', Tower B, Unit No. 1004, 10th Floor, Level 2, 12-14, 1 &amp; 2, Murphy Road, Bangalore - 560 008</td>
<td>+91-80-43326400, Fax: +91-80-43326409</td>
<td></td>
<td><a href="mailto:jayantac@icraindia.com">jayantac@icraindia.com</a></td>
</tr>
</tbody>
</table>