

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

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ICRA RESEARCH SERVICES

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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 cotton consumption is expected to exceed cotton production for second consecutive year in CY2017

Reserve cotton stock auctions in China reflect the intent of the Chinese government to liquidate cotton stock, which should in turn support cotton yarn production in China. This is a negative for the Indian spinning industry

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 quota 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.

Even a partial recovery in cotton production in India in CY2017 will support improvement in domestic cotton availability from current tightened levels

Cotton: PSF ratio is at the highest level in the last eight years despite the cotton prices prevailing near lows of this period

FY2016 was the second consecutive year of low growth in India's spun yarn production

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 firmed 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.

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.

Please contact ICRA to get a copy of the full report

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