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CORPORATE RESEARCH

Outlook for textile industry

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Date: May 11, 2010

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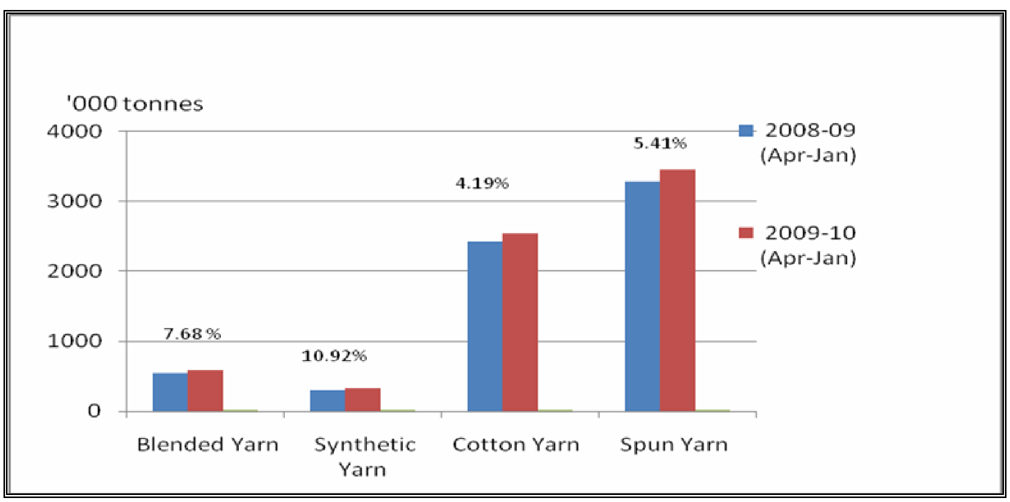
Summary:

After being severely battered by recession in the global markets and currency volatility in FY09, credit profiles of the textile companies are expected to improve with revival in the domestic demand and signs of improvement in the global markets. However, appreciation of rupee and significant rise in cotton prices raise concerns on the profitability.

Revival in the demand:

The revival in demand is clearly visible from the production growth observed during the period April 2009-January 2010 across product lines.

Chart 1: Trend in production of Yarn

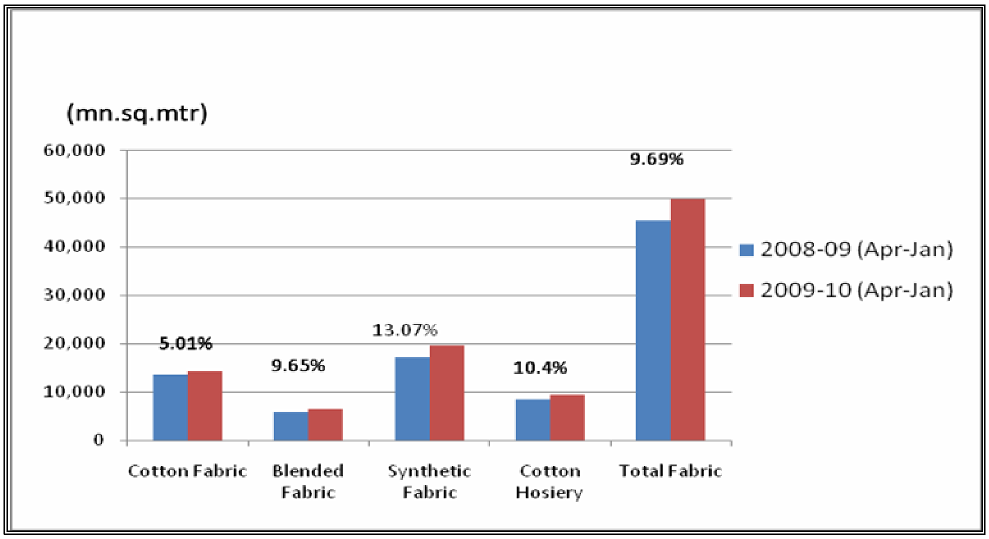


Source: CMIE

Total spun yarn production grew by 5.4 % during April 2009-January 2010 as against a 1.8 % decline witnessed during same period earlier year. Cotton yarn, which accounts for over 70 % of spun yarn production, grew by 4.2 % during April 2009-January 2010. Synthetic yarn and blended yarn, recorded a smarter recovery as their production grew by 10.9 % and 7.9 %, respectively.

Similarly, aggregate fabric production recorded significant jump (9.7%) during April 2009-January 2010 period, as against stagnancy witnessed during the same period previous year due to the impact of the global economic crisis.

Chart 1: Trend in production of Fabric



Source: CMIE

Improvement in production across product lines has been supported by revival in the demand as well as significant capacity additions/modernization initiatives undertaken by the industry during last few years aided by Technology Upgradation Fund Scheme (TUFS). With significant improvement in the production of textile products, there are clear symptoms of recovery in 2010.

The domestic market, after experiencing brief fall in demand consequent to global economic (turmoil, recorded a smart recovery supported by Government stimulus packages, improved liquidity and revival in the domestic demand. Going ahead, domestic markets are expected to grow at healthy pace supported by strong fundamentals such as rising disposable incomes, rising aspirations, favourable demographics and growth in 'organised retail'. However, competition is expected to be intense with growth in the organised retail, larger players going for retailing in an effort to forward integrate the value chain, international brands and retailers entering in India for growth opportunities. Therefore, longer discount seasons for timely liquidation of the inventories are likely to keep pressures on realisations.

On the international front, exports from India fell, *albeit* at a lower rate than the overall exports from the country during April-Dec09 period. As per the provisional data released by Ministry of Textiles, exports of textile products fell by 5.46% during the said period as compared to fall of 15.37% reported for overall exports from India. Export demand/performance as provided in the following table, India's textile exports faltered during FY09, falling way below the growth targets and still leave a lot to be desired.

Table 1: Trend in exports of major textile products

(Mn USD)

Item	2008-09 [P]	April-Dec'08	April-Dec' 09 [P]	% variation
Cotton Textiles				
Cotton Raw Incl. Waste	623	496	890	79.51
Cotton Yarn, Fabrics & Madeups	4119	3335	2485	(25.48)
RMG of Cotton including Accessories	8375	5898	5455	(7.52)
Sub total	**13117**	**9729**	**8830**	**(9.24)**
Manmade Textiles				
Manmade Staple Fibres	255	215	246	14.63
Manmade Yarn, Fabrics & Madeups	3026	2431	2552	4.97
RMG Manmade Fibre	1026	772	883	14.45
Sub total	**4307**	**3418**	**3682**	**7.72**
Grand Total Textile Exports	**20940**	**15908**	**15040**	**(5.46)**
Total Exports	**182631**	**147569**	**124888**	**(15.37)**
Share of Textile Exports as % of total exports	11.47	10.78	12.04	

Source: Ministry of Textiles

Sluggish export demand had varied impact on the domestic textile companies. Least affected were integrated, large domestic players and worst affected were the smaller exporters with limited presence in the textile value chain (such as cotton yarn players, garment exporters). Larger, integrated players benefited as the large global retailers have been increasingly consolidating their supplier base to few larger and integrated players to improve supply chain efficiency and reduce the costs. Larger-integrated players are thus increasingly reaping the benefits of scale and integration at the cost of smaller and fragmented players. With signs of continual recovery in the US markets, which accounts for largest share of exports from the country, exports are expected to gradually recover in 2011. However, sovereign debt crisis in certain European countries have brought back the concerns on global recovery.

Appreciation of the domestic currency from October'09 onwards, however, has impacted the competitiveness of the domestic exporters *vis a vis* other countries such as China, Bangladesh, Sri Lanka etc. as the currencies of these countries did not appreciate to the same extent against the USD as that of INR.

Profitability margins though improved from FY09 levels, pressures remain:

Fall in demand, higher fixed cost due to commissioning of expanded capacities, volatility in the forex markets which led to significant mark to market losses, actual losses on forward contracts and also on exotic derivative transactions, significant increase in the MSP prices for cotton, lower realisations due to weaker demand significantly impacted the profitability of the players in FY09. Some players even reported losses at operating level in FY09; worst affected were the cotton yarn exporters and standalone garment players.

With significant fall in petrochemicals (PTA, MEG) prices as well as fuel prices, improved domestic demand towards end of FY09, brought some hopes to the industry. With significant fall in raw material prices in Q4FY09, the synthetic textiles industry recorded the sharpest recovery. Depreciation of INR, lower raw material and fuel prices and improvement in the domestic demand saw improvement in the profitability margins in H1FY10. Concerns, however, do remain due to volatility in the forex markets along with reversal in INR/USD trend (appreciation), increase in the cotton prices, rise in raw material prices for synthetic textiles segment due to steadily rising crude oil prices. The impact is harder on the smaller players with limited presence in the textile value chain as their ability to pass on raw material prices and any economic shocks/volatility is limited.

The raw cotton prices have risen sharply from October'09, driven by strong demand from China and Bangladesh due to lower cotton production globally. Cotton being the principal crops of the country; cotton textiles play a dominant role in the overall textile production. With the rise in the raw cotton prices, cotton yarn prices have also moved up. In order to keep the prices of raw cotton/yarn under check, Ministry of Textiles imposed restrictions on export of raw cotton, which is likely to bring some respite to the exporters grappling with intense completion and rupee appreciation.

Synthetic textiles segment has benefited from substitution effect due to higher cotton and cotton yarn prices resulting in significant cost differential between cotton yarn and synthetic yarn prices. Being the fiber/fabric for masses, with an overall economic revival and high cotton prices, this segment is expected to benefit.

New capex activity to moderate; however, leverage to remain high

With fall in demand, stress on profitability/ losses in FY09, higher borrowings due to expansion projects, the credit profiles of most of the textile companies were impacted in FY09 leading to spate of downgrades during Q4 FY09 and beginning of FY10.

With improvement in business scenario and profitability, credit profiles of the companies especially the larger, integrated players and players in the synthetic textile segment have improved in FY10. Some of the larger players brought in equity capital to improve the leverage and support the long term working capital requirements. However, due to large debt funded expansion undertaken in the past, high leverage is likely to continue for some time. Players are expected to largely focus on completing existing expansions and optimize/stabilize the newly expanded capacities in the short term. Companies are likely to wait and watch for the sustainability of the global recovery to further undertake large expansions. However, capex for backward integration, line balancing, debottlenecking etc. cannot be ruled out in the short to medium term.

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