

## ***Cotton in bullish mode, Cotlook A index breaches US\$1/lb***

2012 has started on a positive note for cotton, with Cotlook A index breaching the US\$1/lb level. Similarly, cotton prices at KCA have also rallied and are at their two month high of PkR6,000/maund. In this regard, cotton production in USA, the world's third largest producer is forecast to fall by 13.4%YoY to 15.7mn bales on severe drought in Texas, while China's imports are forecast to grow 34%YoY as the country aims to build up the national reserve, where this reserve accumulation is expected to support prices and constrain mill use. The resurgence in cotton prices coupled with the weakness in PkR should prop up textile margins and export earnings in 2HFY12 where, amongst domestic textile plays, we continue our liking for NML (FY12F P/B: 0.38x and PER: 4.77x) where our target price of PkR48/share implies an Accumulate stance.

**Cotlook A index above US\$1/lb:** 2012 has started on a positive note for cotton, with Cotlook A index breaching the US\$1/lb level. Similarly, cotton prices at KCA have also rallied and are at their two month high of PkR6,000/maund. However, domestic cotton is still trading at a 26% discount to int'l cotton, which is higher than the historical discount of 20%, implying further upside from current levels on the domestic front. Recall that int'l cotton prices averaged US\$1.56/lb in FY11.

**US production estimates cut on Texas drought:** Cotton production in USA, the world's third largest producer is forecast to fall by 13.4%YoY to 15.7mn bales\* as per latest USDA estimates following the worst drought since 1895 in Texas, which is USA's largest cotton growing region. USDA also expect China to import more cotton in 2011/12, with imports expected to touch 16mn bales, up by 34%YoY as the country aims to build up the national reserve, where the reserve accumulation is expected to support prices and constrain mill use. However, despite the lower USA production, global cotton production for 2011/12 is expected to reach a record 123mn bales, which coupled with lower demand (down 4%YoY to 110mn bales) will help in replenishing global cotton inventory stocks (+29%YoY to 58mn bales).

**2HFY12 to be better for textiles:** The resurgence in cotton prices coupled with the weakness in PkR should prop up textile margins and export earnings in 2HFY12, albeit the persistent gas shortages does pose a risk to exports, particularly for smaller non-integrated players. As for NML, we view the recovery in cotton prices as encouraging, where our model suggests an EPS sensitivity of PkR0.30 for a US\$0.05/lb change in international cotton price, while we have already assumed average cotton price of US\$1/bl for FY12. NML is currently trading at a FY12F PBV and PER of 0.38x and 4.77x, respectively, and the scrip offers an upside of 18% to our target price of PkR48/share. Accumulate!