

Indian Cotton Spinning Industry

Operating margins to contract in FY2024 despite an expected improvement in volumes

OCTOBER 2023



Bps: Basis points (one basis point is equivalent to one hundredth of a percent)

CAI: Cotton Association of India. All segments of the cotton trade and textile industry are represented in CAI

COCP: Committee on Cotton Production and Consumption. Advises the Indian government on matters pertaining to production, consumption and marketing of cotton

CCI: Cotton Corporation of India Limited. A Government of India agency, engaged in trade, procurement, and export of cotton

Cotlook A: An index representative of level of offering prices on the international raw cotton market. It is an average of the cheapest five quotations from a selection of upland cottons traded internationally

CY: Calendar Year

CY_i: Indian cotton year (CY_i) starts in October and ends in September.

CY_g: Global/ International cotton year (CY_g) starts in August and ends in July

ICAC: International Cotton Advisory Committee. An association of governments of cotton producing, consuming and trading countries

MSP: Minimum support price. A form of market intervention by the Government of India to insure agricultural producers against any sharp fall in farm prices

NCDEX: National Commodity & Derivatives Exchange. An on-line multi commodity exchange in India

QoQ: Quarter on quarter; **YoY** : Year on Year

RoDTEP: Remission of Duties and Taxes on Exported Products

TUFS: Technology Upgradation Fund Scheme

USDA: The United States Department of Agriculture. Responsible for developing and executing federal laws related to farming, agriculture, forestry, and food

Indian cotton yarn exports are likely to report a modest recovery in FY2024 after a decline in the previous year owing to an expected increase in demand from China and Bangladesh.



- Domestic cotton fibre prices, after witnessing a lifetime high in H1 CY2022, had declined steadily in H2 CY2022. In 8M CY2023, cotton fibre prices had declined by ~28% in comparison with the average cotton prices in CY2022 on account of a weak operating environment.



- Cotton yarn output fell by ~15% in FY2023 on a YoY basis owing to lower demand from garment manufacturers. Production volumes rose by ~4% on a YoY basis in Q1 FY2024 with moderation in cotton fibre prices. With drop in cotton yarn realisations, cotton spinners have increased their production volumes towards covering their fixed overheads, despite their margins remaining lower than their past levels. ICRA expects cotton yarn output and exports to increase in FY2024 as demand from downstream companies is expected to improve in H2 FY2024.



- The gross contribution margins for the spinners had reached a multi-year low in August 2023 on the back of high cotton fibre prices and reduced demand from downstream apparel companies, which impacted the prices of cotton yarn. After registering an improvement in H2 CY2022, the gross contribution margins declined subsequently in 8M CY2023. Notwithstanding an increase in margins on the back of higher demand from textile producers in H2 FY2024 and some moderation in cotton prices with the arrival of new season cotton stock, ICRA expects cotton yarn gross contribution to contract in FY2024 over FY2023 levels.



- Actual cotton sown area as on September 29, 2023 fell by ~3% on a YoY basis to 123.8 lakh hectares owing to a decline in Telangana, Andhra Pradesh and Karnataka amid uneven rainfalls. This impact had been partly offset by an increase in the area covered in Gujarat and Rajasthan. The minimum support price (MSP) has been increased by ~10% for the marketing season 2023-24. Cotton fibre prices are expected to moderate in Q3 FY2024 with new season cotton stock arrivals.

Highlights on financial performance

In spite of the likely moderation in debt-funded capex in FY2024, ICRA expects the capitalisation and the coverage metrics for spinning entities to weaken due to lower operating profitability.



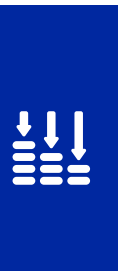
Bangladesh continues to be the largest export market for Indian cotton yarn despite a reduction in its share from ~37% in FY2023 to ~25% in Q1 FY2024. Also, the share of yarn exports to China had been on a rise since January 2023 after lifting of Covid-related restrictions in the said country. Overall, the share of cotton yarn exports to China rose to 23% in Q1 FY2024 from 11% in FY2023, offsetting the decline in exports to Bangladesh.



ICRA expects domestic spinners to report a modest volume growth of 5-7% in FY2024 on a YoY basis, primarily gaining through a shift in preference away from Chinese cotton and the likely improvement in demand from the apparel companies for spring/summer season in the US and EU regions.



ICRA expects the sample set of companies to report a 9-10% decline in revenues and 200-250 bps fall in margins in FY2024 amid a sharp drop in realisation and lower gross contribution level. ICRA expects the gross contribution on an absolute basis to stabilise at Rs.95-100 per kg for the remainder of FY2024, post witnessing one of the lowest gross contribution levels (Rs. 82 per kg in August 2023) in the last five years.



The industry had undertaken high debt-funded capex in FY2023, anticipating an improvement in demand. The spinners have now halted major capex plans in the near term due to limited order visibility in FY2024 and with their existing capacities being under utilised. With a weak operating profitability, the interest coverage ratio is expected to remain moderate (4.2x in FY2024 against 6.2x in FY2023) along with the debt-to-OPBDITA ratio (3.4x in FY2024 against 2.6x in FY2023). ICRA, however, expects a pick-up in capex announcement for FY2025, driven by the regular need to modernise machinery and flow of demand from H2FY2024 owing to the China-plus-one strategy of an alternative manufacturing location to China.



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