Azgard 9, Textile Industry and Macroeconomic Situation of Pakistan

Sahr Shahzad,
Aymun Musaddaq
Waasay Khan
Umer Naseem Khan

BBA-2K10-A

5/26/2012

The purpose of this report is to draw conclusions and recommendations for Azgard 9, A denim and yarn manufacturer while analyzing the Macroeconomic situation and the Textile Industry of Pakistan.

Macroeconomic Situation:

The Macroeconomic situation will provide an insight on how the economy is functioning currently and what is the future outlook for it and what are the investment prospects

Key Pointers of Pakistan's Macroeconomic situation:

- GDP is expected to record growth in excess of +3.0% during CY12.
- Fresh political trends emerging from the possibility of elections is likely to spur fresh policy initiatives, help boost business confidence and investment flows resulting in a sharp upward re-rating of asset values;
- Oil prices are trending above $100/barrel and increasing electricity and gas tariffs.
- CPI is projected to increase and average close to 11.0% during CY12 as further PKR depreciation will lead to imported inflation
- PKR is overvalued and that it will not intervene to prevent market movements(State Bank of Pakistan)
  4%-5% depreciation is projected for 2HFY12 with a target of 93.4 - 94.5 for the PKR.
- The Stock Market continues its cyclical bull trend, and as risk due to the political and unstable situation is high so investors can expect high returns.
- Per capita income in dollar term rose from $ 1073 last year to $ 1254 in FY 2010-11, thereby showing tremendous increase of 16.9 percent.

Analysis:

Although the economy is still growing but it is a crucial stage, Interest rates are increasing which might attract foreign capital but domestic investment will as a result decrease. A current account deficit pushes the government to borrow from the state bank which in turn leaves little money for the private sector and this is the cause of the increase in interest rates. Due to high inflation rates locally produced good are becoming less competitive but at the same time due to depreciation of the exchange rate of Pak rs, imports are costing more and consumer are caught in a spiral. The per capita income increase is mainly due to the inflation rate while purchasing power still remains low. For the industries the energy crisis is heavily affecting output, on the other hand the stock market seems to be in its bullish phase and investors can continue to keep hopes from it in future, In conclusion Pakistan promises good returns provided it can work on the energy crisis, make its exports more competitive support industries such as the textile industry which have suffered majorly in the energy crisis. At the end all of this downward spiral was provided a boost by the western recession from 2008 onwards and since then Pakistan's economy has been caught in a vertigo.

Industry Analysis:

The textile industry of Pakistan is one which has majorly developed after partition, and Pakistan's textile exports comprise the greatest part of its total exports. Major players are ,Ahmed Hassan, Gul Ahmed, Hussain Industries, Chenab Group, Nishat Mills, JK Fibre Mills and Spinning Mills, , Younus Textile Mills and Kohinoor Mills. Finished products comprise of cotton yarn, thread, cotton cloth, Tents and canvas, cotton bags, towels, garments, hosiery and other made ups. The segment is predominantly operating with stable setups in Faisalabad, Lahore and Karachi. (Chart in Annexure). Total Textile Establishments are 3950 approx (Table in Annexure). Customers of the Textile industry are both domestic and foreign, Major importers of Pakistani textiles comprise of the European union and US including Germany, Italy, Belgium, Spain, Netherlands, France, Portugal and South Africa, Bangladesh, China, UAE, Hong Kong. Main Competitors in region are China, India and Bangladesh. They have more skilled Human Resource, Hind end value products, Economic Stability, Brand Loyalty and Low costs

Total cotton production has remained steady over the past years, While production of cloth has increased over the past few years which indicated inclination towards high end value products, Cotton prices spiked in the

FY2010-11 and exports were at a high $14billion. But this was just a temporary boom mainly due to the low cotton output of China and India's ban on low end value cotton products. This increased demand temporarily for Pakistani raw cotton and yarn but this year prices have stabilized as Chinas crop is set to step back into the market.

If we look at the suppliers of the Textile, 51% of Textile producers have more than five suppliers (World Bank 2011) which decreases the bargaining power of suppliers and places the industry in a strong position.

The exports are the backbone of the Textile Industry and due to low value end products customers are preferring China, India and Bangladesh over Pakistan, also the lag in delivery time mainly due to the energy crisis, places the foreign customers in a strong bargaining position and cuts down the proft margins for textile manufacturers. There is very less threat of new entrants in the industry as the overall outlook is very bleak, the industry is suffering from energy crisis and many mills have remained shut during the previous years and this trend is ever so increasing, the ROE of the texile industry has been declining since 2005, there was a little spike in 2010 mainly due to the increased exports but the decreasing trend is expected to continue, so investors keep losing confidence in the industry there for there is low threat of new entrants, so profits are not expected to be further spread. Competition remains high from foreign export markets, There is no such threat of substitutes as the industry is itself a vertically integrated whole except the increased import of Man Made Fibers over the years,(Graph in Annexure)
Before analyzing and concluded about the textile industry, A SWOT analysis brings more facts to the spotlight.

Strengths:

- Established export market

- Large domestic market
- Access to raw material

Weaknesses:

- -Negative voluntary perception
- -Fragmented industry structure, most producers with limited economies of scale
- -Lack of marketing and selling initiatives
- -Low value added, largely commodity products
- -Low price image
- -Limited use of modern technology
- -Unskilled labor force

Opportunities

- Improving product mix and a general move towards more value added products
- Demand for home furnishing from Pakistan is growing in developed countries
- Women wear as a huge potential

Threats

- Political instability and inconsistency in policy framework
- Rising cotton prices to push production cost for value added segment
- Natural calamities disruptions in supply of raw materials due to variables weather patterns
- Fashion life cycle
- Adverse changes in government policies

The Industry ROE has been declining for the past 5 years, it went positive in FY2010-11, due to the increased exports for which the reason has been stated above, Overall if we look at Porters five forces model for the textile industry it is as follows

Bargaining Power of Customer: High

Bargaining Power of Supplier: Low

Threat of New entrants: Low

Threat of Substitutes: Low

Competition: High

The Industry itself is profitable but the economic situations do not support it to harness its potential.

Company Analysis:

One of the oldest business founders in Asia with a history of over a 100 years, the Shaikh family has owned and managed various business sectors such as cement, power and banking in the country. Azgard9 (ANL) is listed on the Karachi stock exchange and is vertically integrated consisting of various processes of spinning weaving, stitching, dyeing and finishing. The company was previously known as Nafees Denim Mills, however ANL started production officially under this name in 1997. Ever since 2005, the production unit of the company has doubled the total production as the company introduced expansion of stitching weaving and spinning facilities, all of which is available online. ANL's mission is to become 'a major global fashion apparel company'.

Arzgard9 is one of the most flourishing businesses in the country with a substantial demand for yarn, denim fabrics and garments in the local as well as the international market. The company has a very successful as well as a strategic alliance with the most renown brands in the world such as GAP, Zara, Tommy Hilfiger, ESPIRIT, Levis and H&M to name a few. The company aspires to become a truly global player by fully leveraging its human as well as its physical assets. However, there are significant barriers and challenges that are being faced by the company, particularly in 2009, it has taken many steps and measures to consolidate its customer base specially in the European Union and the North American economies as they have a direct impact on the external demand.

That is why the company is striving to keep up with the global economic situation, both in the short run and the long run, to maintain its position in terms of having the highest sales in the market by cutting costs, considering IPO debt profiling and all in all, looking at the holistic picture as a denim business model and manufacturing unit. The company is striving to increase its production units to a capacity of 65% in March 2012 to regain its footing and rebuild its capacity as cost efficiently as possible. The dynamics involved in achieving these goals is estimated to require a period of one year.

Ratio Analysis:

Gross Profit to Sales: the gross margin represents the proportion of each dollar company retains after incurring the direct costs related to the production of the goods and services sold by the company. The higher the percentage, the more dollar amount the company saves on each dollar of its sales as profit.

Operating Profit to Sales: operating profit is much more reliable figure for investing analysts. That is for making intercompany comparisons and financial projections. It gives an idea that how much a company makes on each dollar of sales. The higher the margin, the better it is for the company. And when determining the performance of the company, it is best to consider the change in operating profit margin over time and to compare the figures with those of its competitors. It basically explains what the profit of the company is remaining after dealing with the company's variable cost of production. Important thing to remember is that, to have a better operating profit margin, it is advisable for the company to pay for its fixed costs such as interest on debt.

Profit before tax to sales: it is the company's earnings before tax. The higher the pre-tax margin, the profitable the company is. The pre-tax margin provides the indication of which way the company's profitability is headed.

Profit after tax to sales: Company's profit might be increasing but that doesn't mean that the company's profit margin is necessarily improving. This indicates that the company needs to control its costs if the after-tax margin is low.

Return on capital employed: ROCE helps investors to determine the growth forecast of the company and serves as a reliable measure for the company and investors. It calculates the profitability and efficiency of the company's performance.

Return on equity: ROE measures the company's profitability by calculating how much profit the company generates on the investment made by the shareholders.

Earnings per share: this ratio serves as an indicator for company's profitability. It is part of the company's profit that is allocated to the outstanding share of the common stock.

Current ratio: it is a ratio which determines the liquidity of the company to pay its short-term debts. It explains the efficiency of the company's operation to turn its product into cash.

Debt to equity ratio: a high debt to equity ratio explains that the company has been forceful in financing its projects with debt. And the company would however earn more if the finance is not out sourced.

Leverage ratio: it is an evaluative tool to use to help the company decides the capital adequacy and to place limitations to the extent to which the banking firm can leverage the capital base.

The ROE increased from 11.52 % in 2006 to 33.64% in 2008, showing that the efficiency of the way in which the company utilized shareholder funds increased. This ratio however decreased after this point, reaching 4.75% in 2010. However it was noted that shareholde5r funds remained almost constant and that it was the net profit decreased which caused this ratio to decline.

The GP to sales ratio increased from 24.62% in 2006 and peaked at 34.15% in 2008. After this it gradually fell in 2009 and then abruptly hit rock bottom at 1.02%. This indicates that COGS sky rocketed over the years, eating away all income earned, this can be attributed to the large purchase of inventory. The operating profit shows a similar pattern, peaking at 28.18% in 2008, gradually decreasing in 2009 and then sharply falling in 2010. This similar pattern continues and affects almost all ratios which are a result due to the company having a financially strong year in 2008 and financially weak years in 2006 and 2010.

The ROA improved till 2008, showing that the company utilized its assets in a better, more efficient way, but decreased afterwards due to the decline in profits which has adversely impacted many other ratio as well.

With the taxes being higher in years in which higher profits are earned and smaller in years in which profits are less, the profit after taxes ratio is a complete reversal to this trend. In years in which taxes are lower, this ratio is high and vice versa. This clearly explains this ratios decrease from 2006 to 2008, following an increase in 2009.

These ratios clearly indicate that although sales have increased over the years, so have costs. Also that the rate at which expenses grew was slower that the rate at which sales grew till 2008 after which the situation completely reversed, with the rate of growth in expenses being greater than the rate of growth in revenues.

The current ratio has fluctuated over the years, being lowest in 2009 at 0.91% and highest in 1.51 and 1.5 in 2007 and 2010. Thus this depicts that the current assets covered current costs at least 1 time. However this may not be considered satisfactory as Current assets should cover current liabilities at least 2 times.

The EPS decreased over the years, from 4.97% in 2006 to 0.003 in 2009. Showing that the earnings on each share decreased, making shares less desirable.

The Fixed asset turnover peaked in 2008 at 1.2 times and then gradually fluctuated over the years. This shows that Azgard replenishes its assets at least 1 time each year. The TIE ratio however opposed the trend mentioned. It continues to increases over each successive year, rising from 0.6 times in 2006 to 1.3 times in 2010, meaning that in 2010, profits covered interest expenses at least 1.3 times.

The main trend identified in all ratios is the same. Due to the increase in rate at which costs grew after 2008, profits declined accordingly.

References:

http://www.pakboi.gov.pk/index.php?option=com_content&view=article&id=180&Itemid=137

http://www.aptma.org.pk/Pak_Textile_Statistics/tec.ASP

http://www.moip.gov.pk/

http://www.ptj.com.pk/Web-2011/08-2011/Dr-Noor-Ahmed.htm

http://www.tdap.gov.pk/tdap-statistics.php

http://www.sbp.org.pk/departments/ihfd/Sub-Segment%20Booklets/Textile%20Fabric.pdf

http://www.iin.com.pk/SectionCategories.aspx?Id=412&operationId=85&

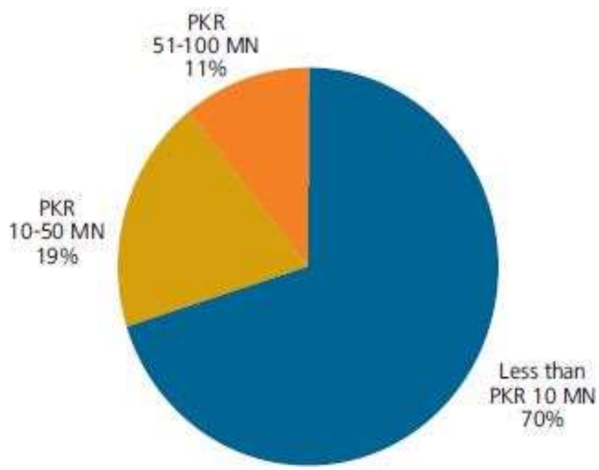
http://www.sbp.org.pk/departments/stats/bsa.pdf

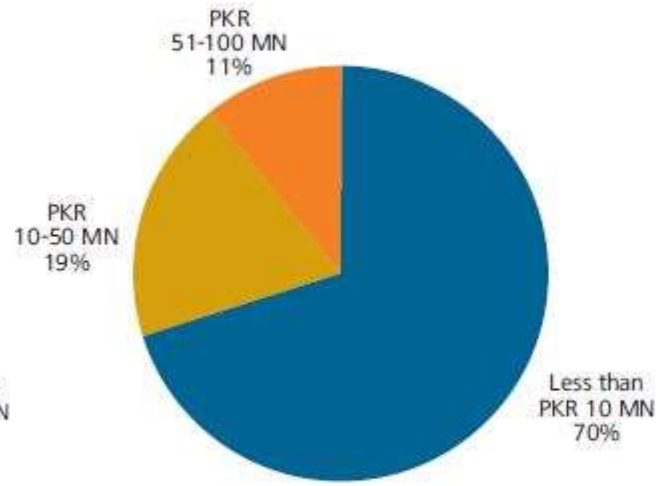
http://www.pacra.com/pdf/Textile%20Sector10.pdf

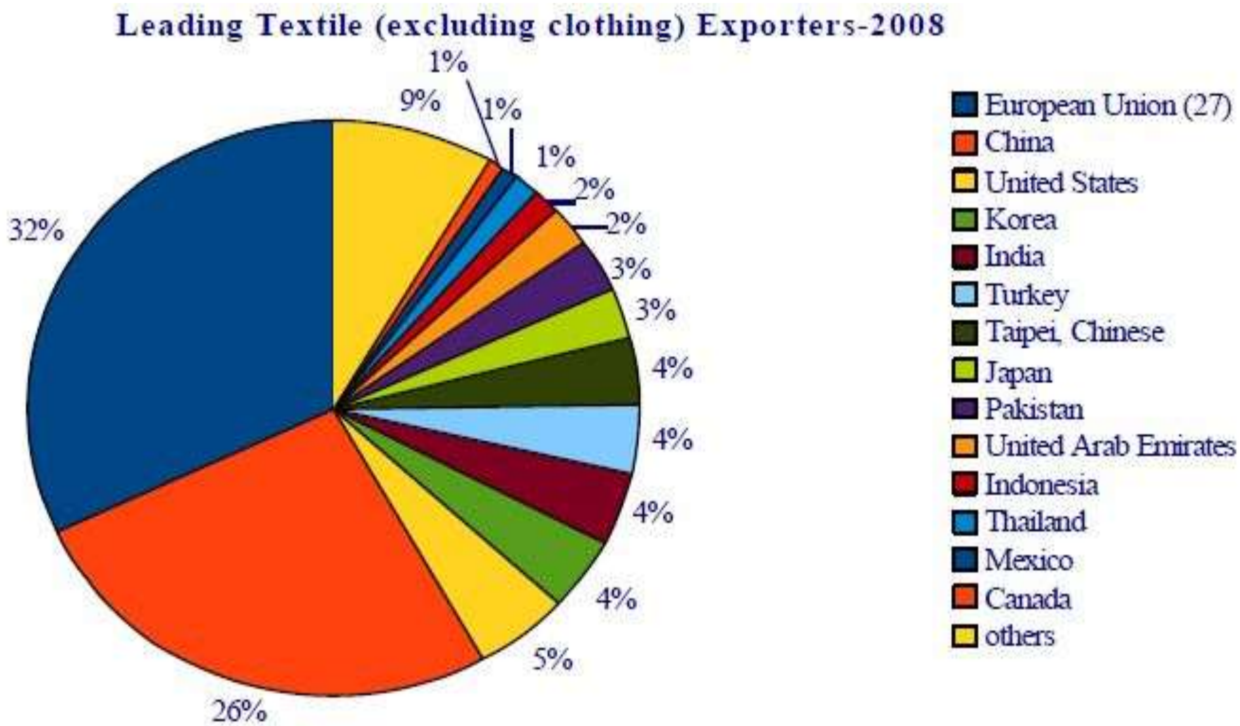
http://www.pacra.com/pdf/azgard9.pdf

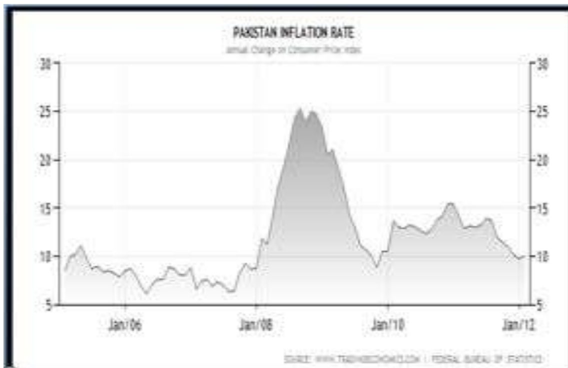
http://www.aptma.org.pk/

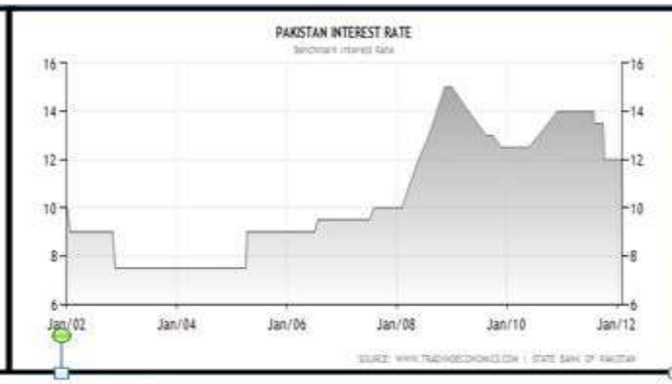
Annexure:
World Bank 2011

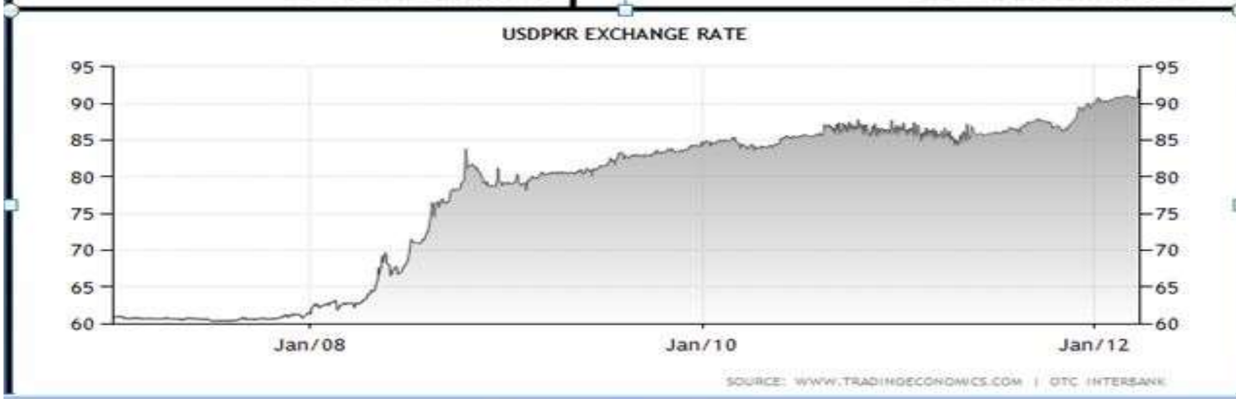






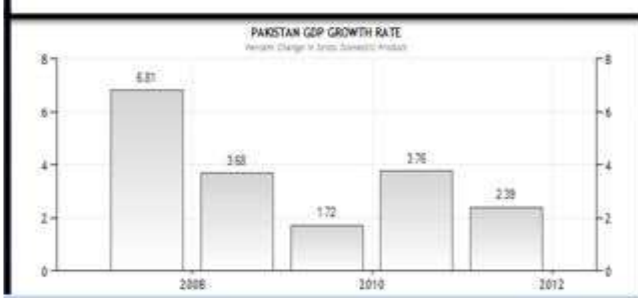

PAKISTAN INFLATION RATE
Jan/06
Jan/08
Jan/10
Jan/12

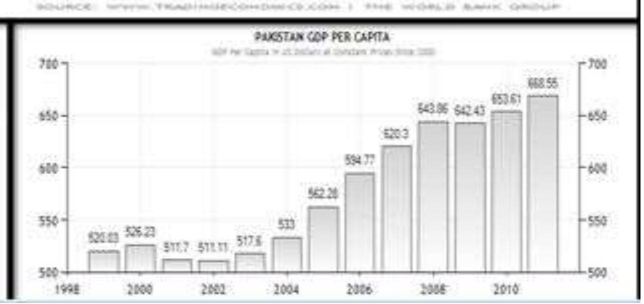

PAKISTAN INTEREST RATE
Jan/02
Jan/04
Jan/06
Jan/08
Jan/10
Jan/12


USDPKR EXCHANGE RATE
Jan/08
Jan/10
Jan/12
SOURCE: WWW.TRADINGECONOMICS.COM | OTC INTERBANK

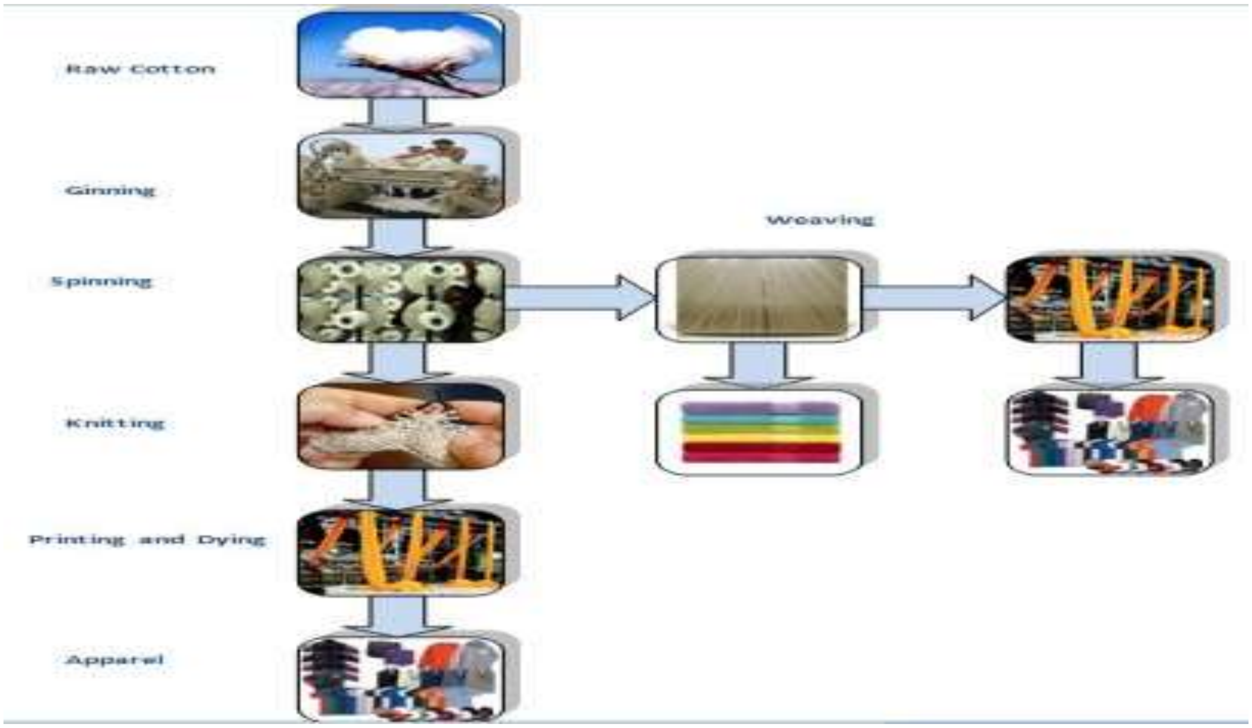

PAKISTAN BALANCE OF TRADE
Balance of Trade (million USD)
Jan/09
Jan/10
Jan/11
Jan/12
SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL BUREAU OF STATISTICS


PAKISTAN GDP
62.192
62.974
73.952
72.31
72.307
83.245
97.978
109.6
127.5
143.203
163.891
161.981
174.799
1998
2000
2002
2004
2006
2008
2010

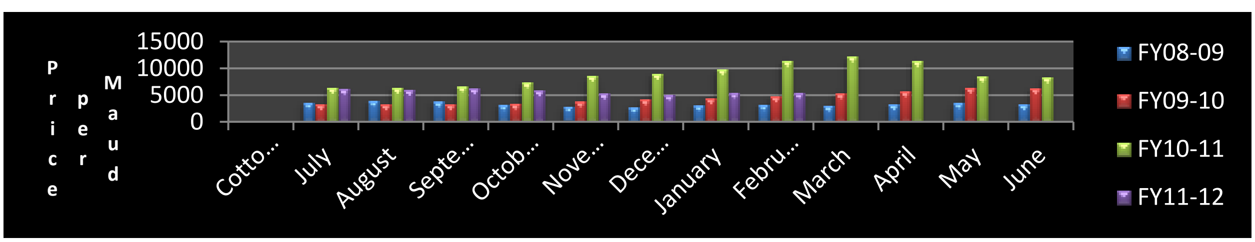

PAKISTAN GDP GROWTH RATE
6.81
3.68
1.72
3.76
2.39
2008
2010
2012

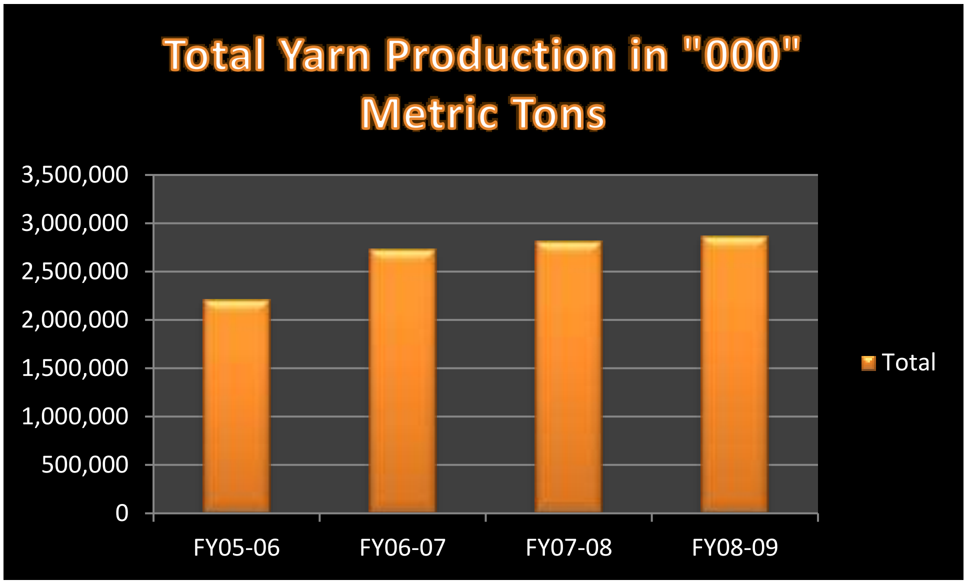

PAKISTAN GDP PER CAPITA
520.03
526.23
511.7
511.11
517.6
533
562.28
594.77
620.3
643.86
642.43
653.61
668.55
1998
2000
2002
2004
2006
2008
2010

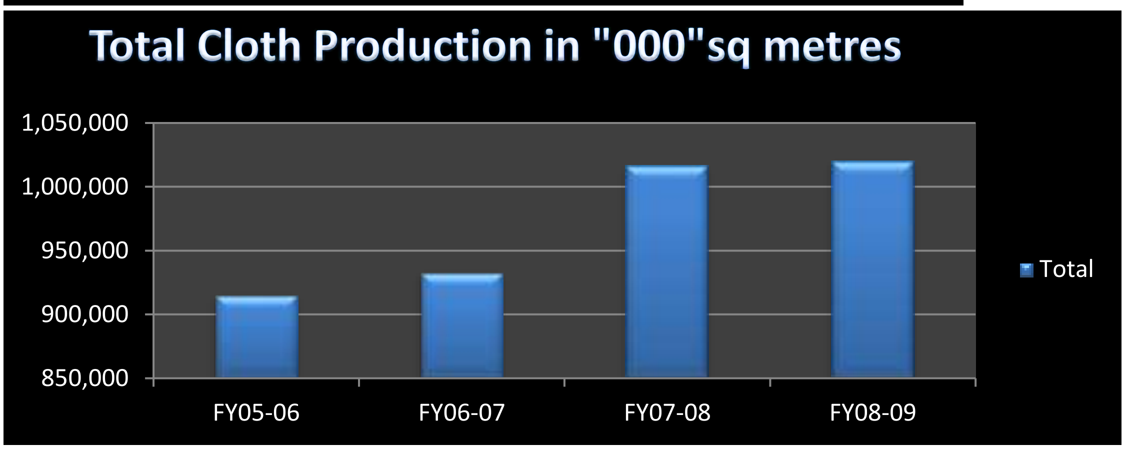
Location of Textile Businesses
Rest of Punjab 2%
All over Pak 28%
Faisalabad 18%
Karachi 38%
Sialkot 4%
Lahore 10%

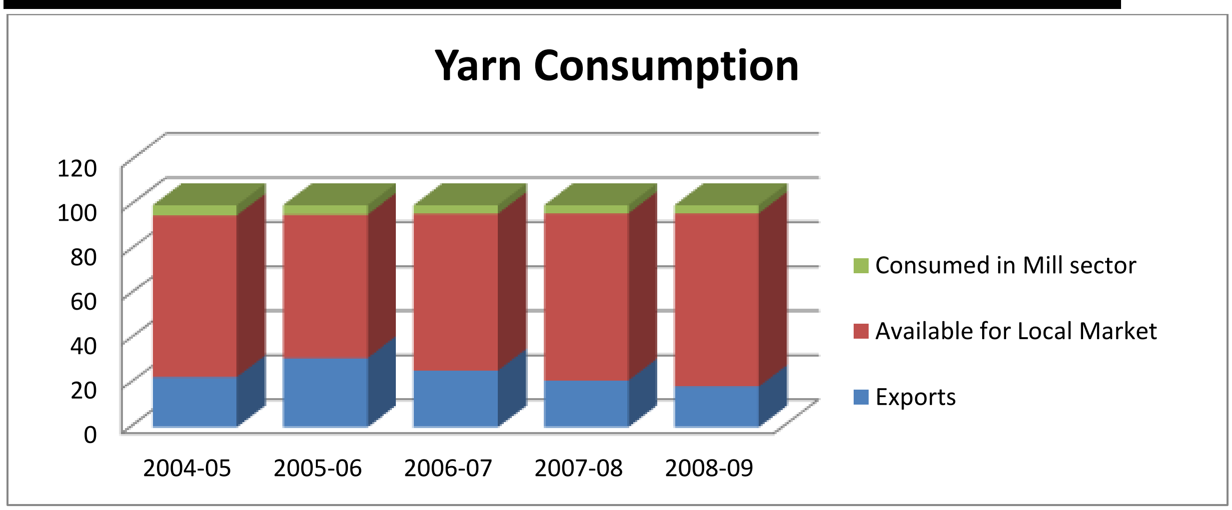

Raw Cotton
Ginning
Spinning
Knitting
Printing and Dying
Apparel
Weaving

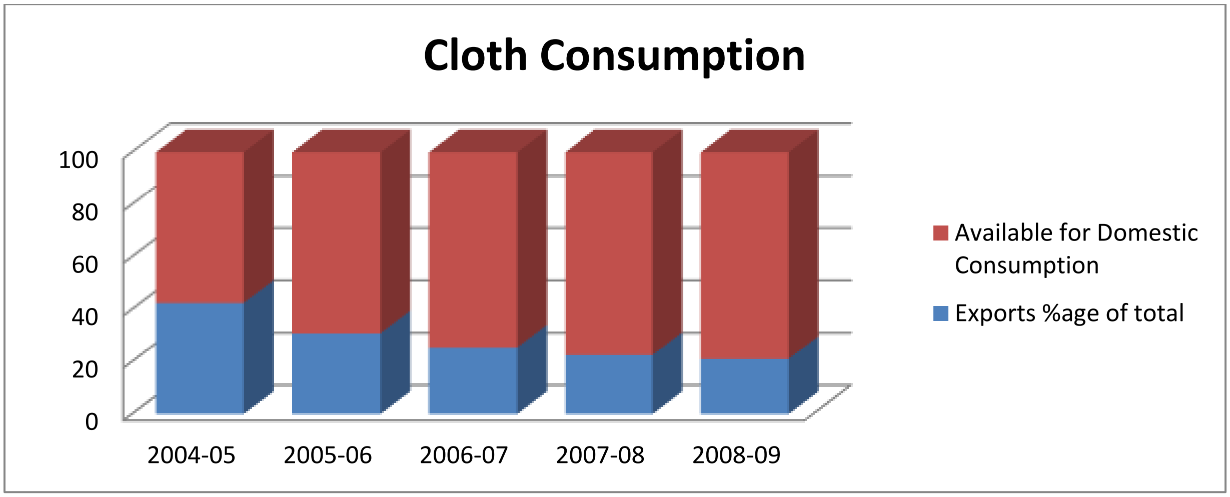

Production (000) Bales
20000
10000
0
FY05-06
FY06-07
FY07-08
FY08-09
FY09-10
FY10-11
Production (000) Bales

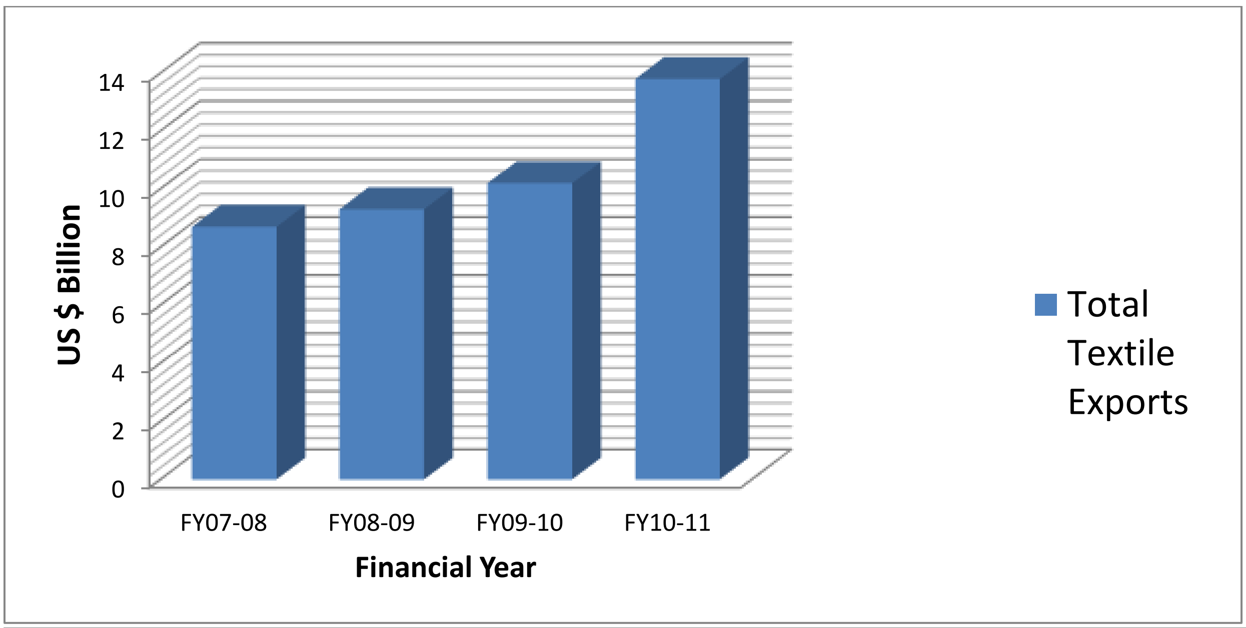

Price per Maud
15000
10000
5000
0
Cotto...
July
August
Septe...
Octob...
Nove...
Dece...
January
Febru...
March
April
May
June
FY08-09
FY09-10
FY10-11
FY11-12

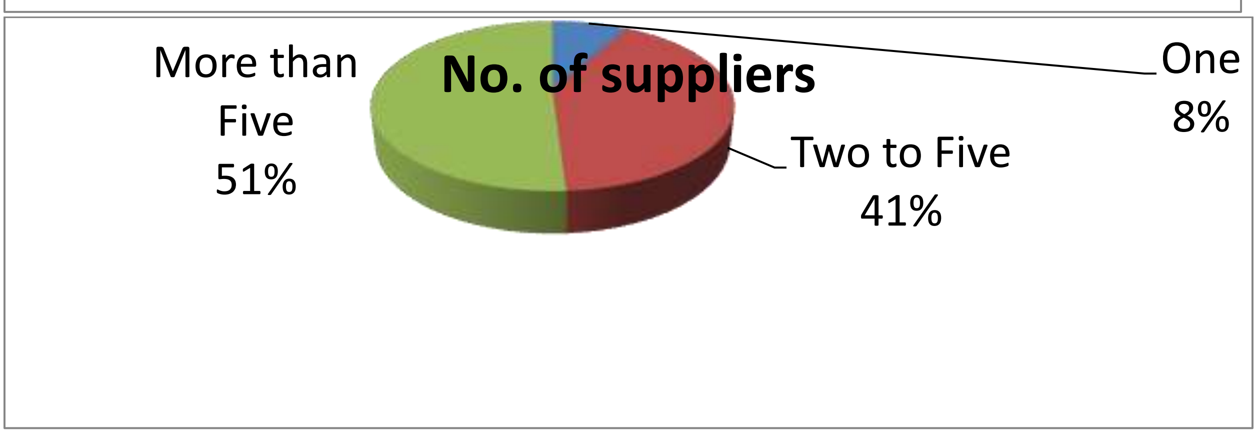

Total Yarn Production in "000" Metric Tons
3,500,000
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
FY05-06
FY06-07
FY07-08
FY08-09
Total

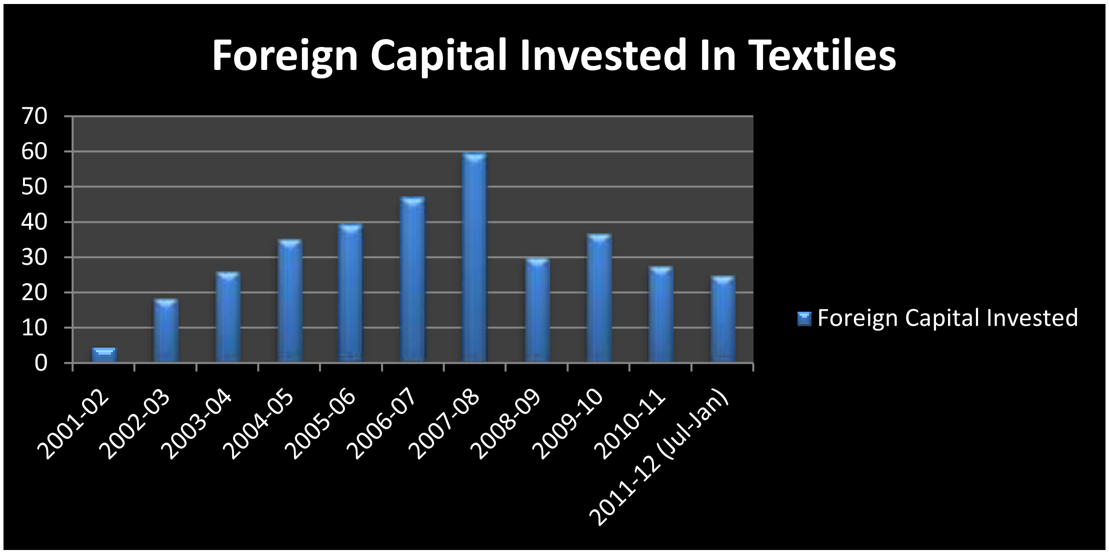

Total Cloth Production in "000"sq metres
1,050,000
1,000,000
950,000
900,000
850,000
FY05-06
FY06-07
FY07-08
FY08-09
Total

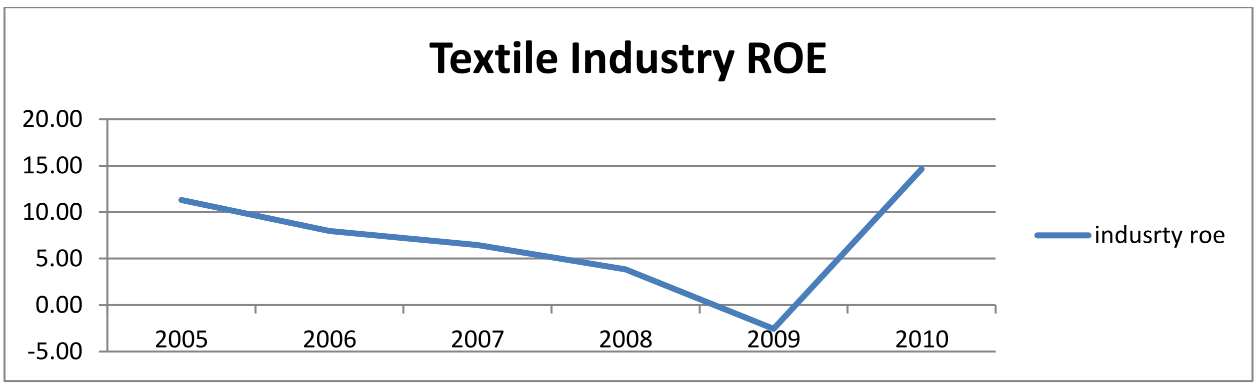

Yarn Consumption
120
100
80
60
40
20
0
2004-05
2005-06
2006-07
2007-08
2008-09
Consumed in Mill sector
Available for Local Market
Exports


Cloth Consumption
100
80
60
40
20
0
2004-05
2005-06
2006-07
2007-08
2008-09
Available for Domestic Consumption
Exports %age of total


US $ Billion
14
12
10
8
6
4
2
0
FY07-08
FY08-09
FY09-10
FY10-11
Financial Year
Total Textile Exports


No. of suppliers
More than Five 51%
One 8%
Two to Five 41%





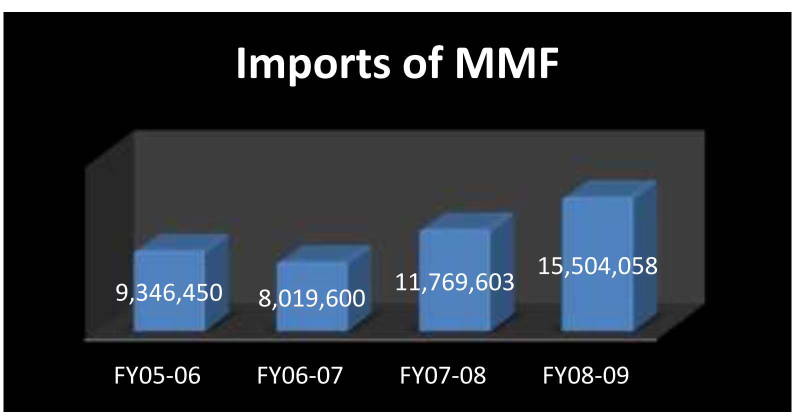
Rs Value (000)

Commodity	FY08-90	FY07-08
Cotton Waste	27,637	9,917
American Cotton	15,034,990	18,021,098
Cotton Egyptian	153,279	4,540,722
Other Cotton	35,131,998	58,155,392

Total	50,347,904	80,727,129

Rs Value (000)

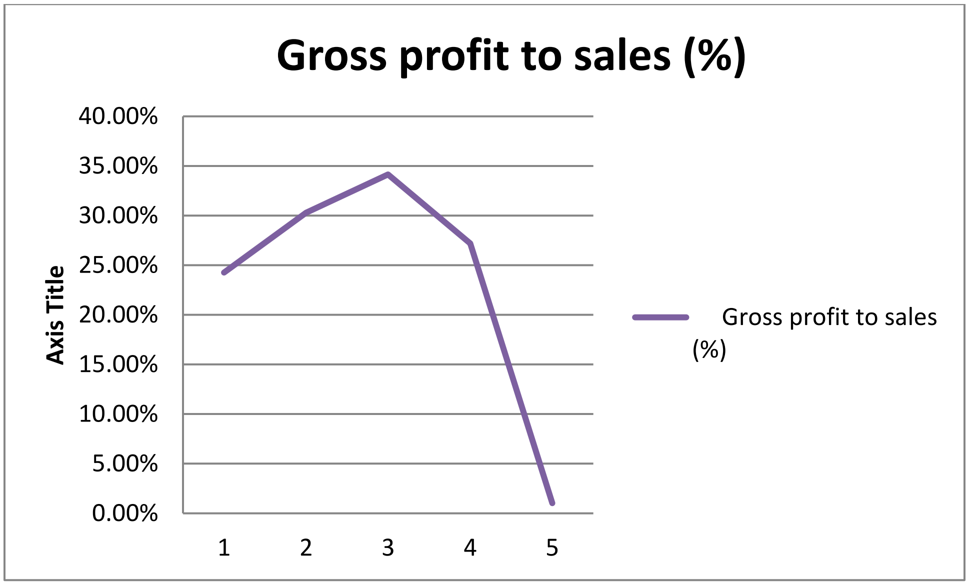
Commodity	FY08-90	FY07-08
Cotton Waste	27,637	9,917
American Cotton	15,034,990	18,021,098
Cotton Egyptian	153,279	4,540,722
Other Cotton	35,131,998	58,155,392
Total	50,347,904	80,727,129

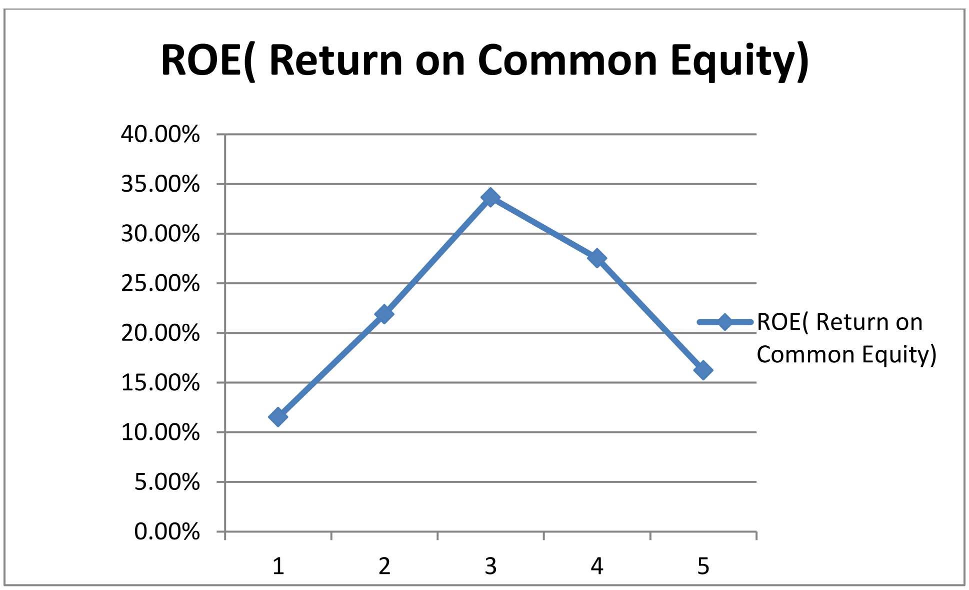


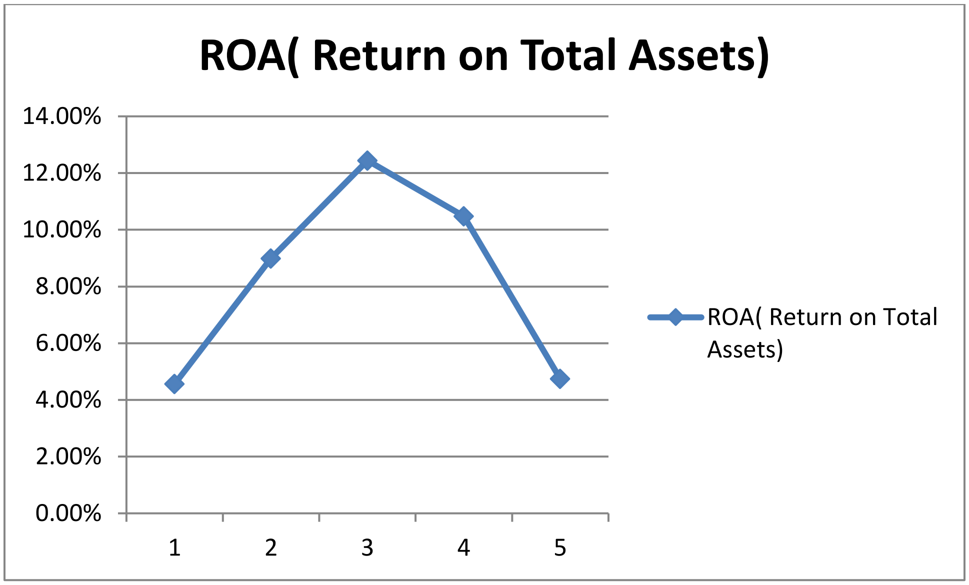
	2006	2007	2008	2009	2010
Operating performance (Rs. 000)					
Sales–Net	4,889,682	6,628,342	10,113,499	11,737,856	17,602,765
Export Sales–Gross	4,128,679	5,430,603	8,222,204	792,047	684,251
Local Sales–Gross	756,303	1,262,415	1,966,476	2,267,394	1,546,626
Gross profit	1,186,321	2,007,353	3,453,276	3,191,493	180,212
Operating profit	795,030	1,572,168	2,849,745	2,616,316	(530,541)
Profit before tax	1,260,084	1,151,460	999,502	178,722	(4,528,950)
Profit after tax	1,144,515	1,079,453	897,283	60,531	(4,702,240)
EBITDA	1,056,866	2,124,951	3,405,857	3,991,254	1,665,347
Financial position (Rs. 000)					
Total Equity	9,174,168	9,720,054	10,124,083	14,500,553	10,269,064
Share capital	3,788,839	3,788,823	3,827,118	4,879,343	4,548,718
Share premium	2,633,371	2,633,387	2,737,841	2,737,841	2,358,246
Capital reserve	944,891	897,239	884,732	899,114	105,125
Unappropriated profit / (accumulated loss)	1,807,067	2,400,605	2,764,494	2,677,561	(1,845,738)
Minority interest					
Shares Deposit Money	–	–	–	–	–
Surplus on revaluation of fixed assets	257,361	239,073	219,356	3,969,152	3,724,869
Non–Participatory Redeemable Capital – Secured	5,786,172	7,479,094	6,674,515	875,272	3,953,868
Long term liabilities (leases & LT deposits)	11,267	–	20,427	15,775	37,135
Deferred liabilities	–	–	–	–	–

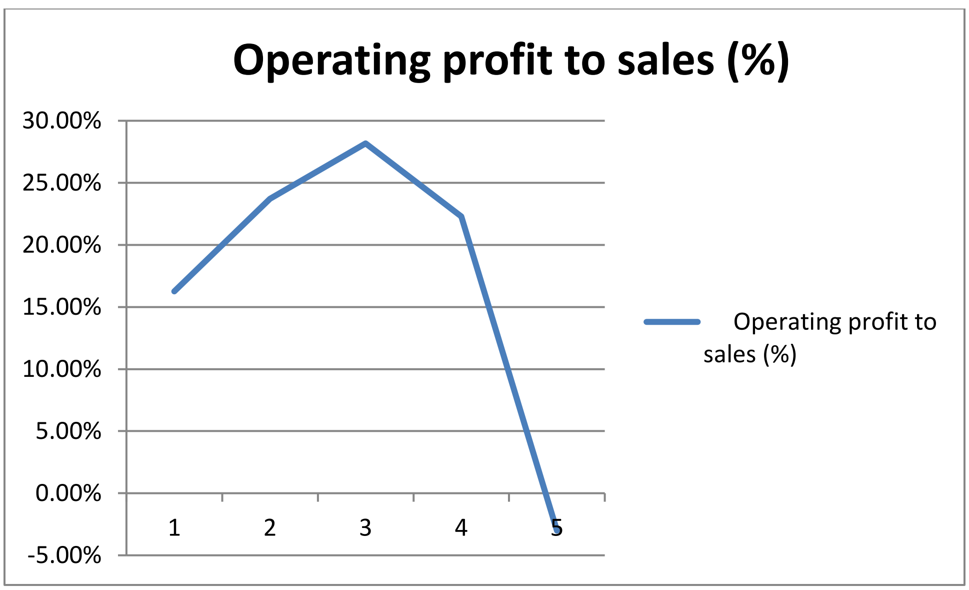
Current liabilities					
Current portion of Long term liabilities	450,047	981,049	1,470,921	2,356,508	1,531,656
Derivative financial liability	32,022	34,369	50,536	–	–
Short term finances	6,006,118	3,820,689	6,574,080	8,911,333	8,035,475
Creditors, accruals & other liabilities	1,275,610	1,348,567	2,686,842	1,891,312	2,811,260
Provision for taxation	195,249	–	–	–	–
Unclaimed dividends	22,312	9,694	14,686	63,183	32,729
	7,949,336	6,194,368	10,797,065	13,222,336	12,411,120
Operating fixed assets and Capital work in progress	7,752,546	7,811,638	8,653,620	14,054,500	13,835,133
Intangible Assets	60,545	51,143	33,536	15,396	8,289
Long term deposits & investments	6,323,396	6,412,144	7,541,421	12,052,756	2,692,146
	14,136,487	14,274,925	16,228,577	26,122,652	16,535,568
Current Assets					
Stores, spares and loose tools	101,762	125,469	201,693	404,451	473,028
Stock in trade	2,022,511	2,246,132	4,034,103	4,414,852	3,763,161
Trade debtors	1,134,897	1,657,197	1,777,232	3,126,881	3,185,586
Derivative financial asset	555,680	388,993	175,673	45,298	–
Short Term Investments	3,788,316	3,889,496	4,018,853	2,942,047	10,969,811
Other current assets	1,413,425	1,004,944	789,515	833,012	–
Cash & cash equivalents	580,906	45,433	82,073	204,345	166,257
	9,041,817	9,357,664	11,143,094	11,970,886	18,557,843
Net working capital	1,092,481	3,163,296	8,999,649	12,803,050	19,981,856
Total capital employed	15,228,968	17,438,221	16,574,606	24,871,202	22,682,291

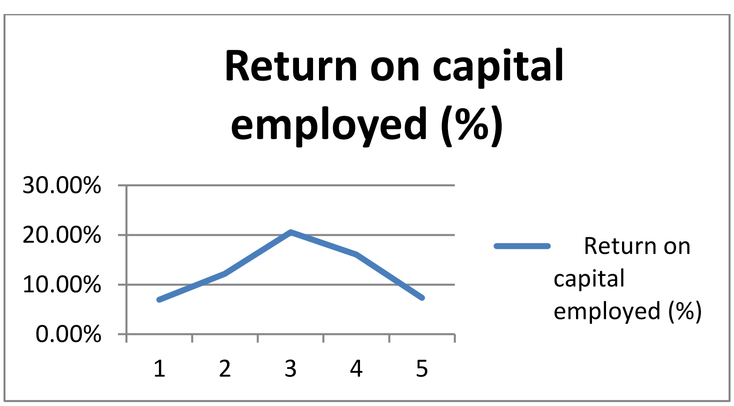
Profitability analysis						
Gross profit to sales (%)	24.26%	30.28%	34.15%	27.19%	1.02%	
Operating profit to sales (%)	16.26%	23.72%	28.18%	22.29%	-3.01%	
Profit before tax to sales (%)	25.77%	17.37%	9.88%	1.52%	-25.73%	
Profit after tax to sales (%)	23.41%	16.29%	8.87%	0.52%	-26.71%	
Return on capital employed (%)	6.94%	12.19%	20.55%	16.05%	7.34%	3.91%
Return on equity (%)	11.52%	21.86%	33.64%	27.52%	16.22%	5.85%
Earnings per share (Rs.)	4.97	3.26	2.65	0.003	(10.403)	-2.08%
Financial analysis						
Financial charges to sales (%)	13.27	16.02				
Current ratio (times) *	1.1374305	1.51067292	1.03204843	0.90535334	1.49525933	0.91
*(excluding current portion of LT liabilities)						
Debt to equity (ratio)	40 : 60	46; 54	40:60	40:60	25:75	1.82
Leverage ratio (times) / Debt to equity (times)	1.46	1.37	1.48	1.11	1.44	
Inventory turnover (times per year)	1.83	2.17	2.26	1.93	2.07	4.54
Fixed assets turnover (times)	0.6	0.8	1.2	0.8	1.3	0.83
Interest cover (Rs.)	2.96	1.48	1.97	2.63	2.29	1.83
ROA(Return on Total Assets)	4.56%	8.99%	12.44%	10.48%	4.75%	4.60
ROE(Return on Common Equity)	11.52%	21.86%	33.64%	27.52%	16.22%	-

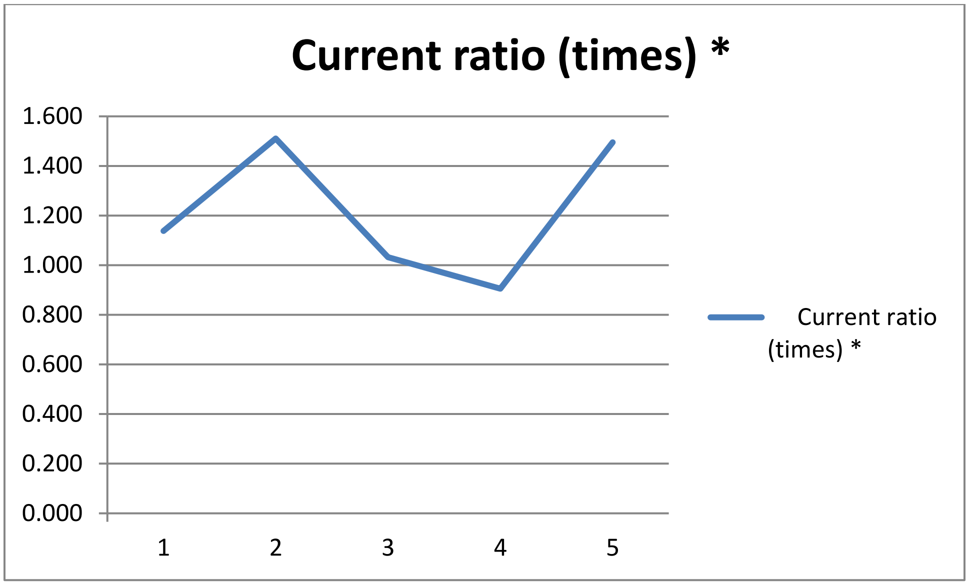

Gross profit to sales (%)
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
Axis Title
1
2
3
4
5
Gross profit to sales (%)

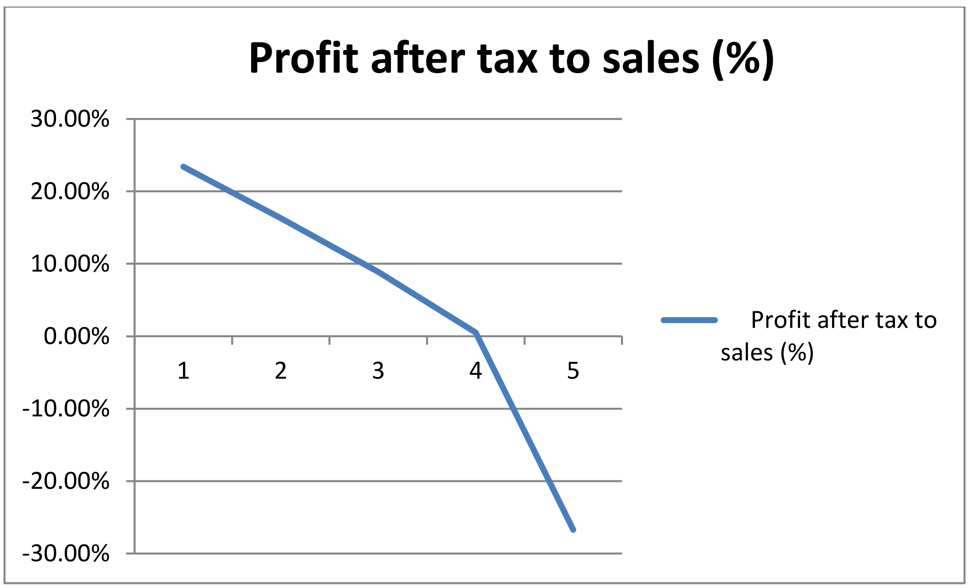

ROE(Return on Common Equity)
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
1
2
3
4
5
ROE(Return on Common Equity)


ROA(Return on Total Assets)
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
1
2
3
4
5
ROA(Return on Total Assets)


Operating profit to sales (%)
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
1
2
3
4
5
Operating profit to sales (%)


Return on capital employed (%)
30.00%
20.00%
10.00%
0.00%
1
2
3
4
5
Return on capital employed (%)


Current ratio (times) *
1.600
1.400
1.200
1.000
0.800
0.600
0.400
0.200
0.000
1
2
3
4
5
Current ratio (times) *


Profit after tax to sales (%)
30.00%
20.00%
10.00%
0.00%
-10.00%
-20.00%
-30.00%
1
2
3
4
5
Profit after tax to sales (%)