Low Prices and Government Intervention in India

Can Expansion in Cotton Consumption and Trade be Sustained
Low Prices and Government Intervention in India

WHY ME?
I’m not Indian
14 Years Since Visiting
I Didn’t Go For Business
Why me?

- 14/15 World’s Largest Producer
- 13/14 World’s 2\textsuperscript{nd} Largest Exporter
- 14/15 World’s 2\textsuperscript{nd} Largest Consumer
- 2014 World’s Largest Yarn Exporter
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THE HEART OF THE MATTER
The Heart of The Matter

• What is the impact of Government policy?
• Will that policy change?
• What role will CCI play?
• What is the driver of Indian consumption growth?
• Will India remain a significant exporter?
Disclaimer

“In the long run we are all dead”

Tract on Monetary Reform, John Maynard Keynes 1923
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GOVERNMENT POLICY: MINIMUM SUPPORT PRICE
Indian MSP

- Seed cotton price is underwritten by government (CCI)
- Different level by variety/staple
- Indian MSP is effectively a mechanism to pay the grower a subsidy and reduce carry burden for mills
- Stocks are auctioned later in the year by the CCI
Production and Planting History

Indian Production and Planting History

Yield & Acreage

MSP (Gujarat)
## Implication of a Seed Cotton Calc

### Breakeven Relationship

<table>
<thead>
<tr>
<th>MSP Calculation</th>
<th>Andhra Pradesh</th>
<th>Gujarat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Support Price</td>
<td>40.5</td>
<td>40.0 INR/kg of seed cotton</td>
</tr>
<tr>
<td>Lint Outturn</td>
<td>33.0%</td>
<td>34.5%</td>
</tr>
<tr>
<td>Loss</td>
<td>2.0%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Cotton Seed Outturn</td>
<td>65.0%</td>
<td>65.0%</td>
</tr>
<tr>
<td>Ginning costs</td>
<td>2.5</td>
<td>1.5 INR/kg of cotton seed</td>
</tr>
<tr>
<td>Gross Costs</td>
<td>43.0</td>
<td>41.5 INR/kg of seed cotton</td>
</tr>
<tr>
<td>Seed Price (estimate)</td>
<td>15.0</td>
<td>18.25 INR/kg of cotton seed</td>
</tr>
<tr>
<td>Seed Revenue</td>
<td>9.75</td>
<td>11.86 INR/kg of seed cotton</td>
</tr>
<tr>
<td>Net Costs</td>
<td>33.3</td>
<td>29.6 INR/kg of seed cotton</td>
</tr>
<tr>
<td>Break even lint value</td>
<td>100.8</td>
<td>85.9 INR/kg of lint</td>
</tr>
<tr>
<td>Ex Rate</td>
<td>61.7</td>
<td>61.7</td>
</tr>
<tr>
<td>Break even lint value</td>
<td>74.07</td>
<td>63.15 c/lb Ex Gin</td>
</tr>
<tr>
<td><strong>Break even lint value</strong></td>
<td><strong>77.8</strong></td>
<td><strong>66.4 c/lb CFR Far East</strong></td>
</tr>
</tbody>
</table>

**Gujarat will initially not trade at MSP as AP mills will import across state lines to avoid having to compete with CCI in their own state**
Indian Prices 14/15

- Gujarat Market trends towards MSP
- Oil Prices rise as import taxes are hiked
Indian Prices 14/15

MCX (dollarized) vs. NYF

Indian Basis CFR Far East
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WHAT ROLE WILL CCI PLAY?
08/09 Activity vs. 14/15 YTD

08/09 CCI activity

14/15 CCI activity

08/09 Purchases
08/09 Sales

14/15 Purchases
14/15 Sales
08/09 Activity vs. 14/15 YTD

08/09 CCI activity (cumulative)

14/15 CCI activity (cumulative)
CCI Activity and Market Impact

- Procure 25% of total crop
- Will carry minimal stocks into new crop year
- Sales pace in 14/15 will be slower than in 08/09
- MSP is very unlikely to decline in the next few years
- Planted area likely to remain stable due to price inelasticity
- Production volatility will be a function of weather
WHAT DRIVES INDIAN CONSUMPTION GROWTH?
Indian Consumption Patterns

**Consumption/mt**

- **2005/2006**: 3636
- **2006/2007**: 3941
- **2007/2008**: 4050
- **2008/2009**: 3865
- **2009/2010**: 4300
- **2010/2011**: 4474
- **2011/2012**: 4235
- **2012/2013**: 4540
- **2013/2014**: 4975
- **2014/2015**: 5225

**CAGR 2.6%**

**CAGR 7.2%**
China Substitution

China Yarn Imports

<table>
<thead>
<tr>
<th>Country</th>
<th>2010-2014 consumption increase</th>
<th>Increase in yarn exports to China*</th>
<th>%age of growth due to China</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>860k mt</td>
<td>554</td>
<td>64%</td>
</tr>
<tr>
<td>Vietnam</td>
<td>386</td>
<td>166</td>
<td>43%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>152</td>
<td>293</td>
<td>192%</td>
</tr>
<tr>
<td>World exChina</td>
<td>1,410</td>
<td>1,098</td>
<td>78%</td>
</tr>
</tbody>
</table>

* Cotton Equivalent
Indian Growth

GDP

CAGR 10.8%

World Bank 2013 US$

Population

CAGR 1.3%

World Bank 2013
Indian Consumption

- Long term modest upward trend underscored by GDP and population growth
- 4 year windfall in textile sector from China substitution amounts to nearly 5 percentage points of CAGR
- China yarn demand will be the biggest determinant of Indian consumption growth (or decline) in the next few years
- Relative increases in consumption in cotton surplus states (Gujarat, MP) at the expense of deficit states (Tamil Nadu)
WILL INDIA REMAIN A SIGNIFICANT EXPORTER?

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Declining Exports

Production vs. Consumption

Production Surplus vs. Exports
Export projections

- Consumption likely to grow faster than production, albeit with a potential challenge from reduced yarn demand from China
- CCI activity provides domestic mills with a carry vehicle reducing the normal incentives to export during harvest and import in the off-season
- If MSP is relatively high compared to the World price, mills may be incentivized to import even during the harvest – as witnessed this year
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SUMMARY
Summary

• MSP very unlikely to be reduced => Production should be stable
• CCI are committed to destock before 15/16 season
• Consumption trend is positive but heavily reliant on China yarn demand
• Export trend is downward from a high starting point. Will almost certainly remain a significant exporter for next few years
There’s no chance that the iPhone is going to get any significant market share. No chance.

Steve Ballmer
Microsoft CEO, 2007