XYZ Textile Co. Valuation:
June 2010 Business Plan

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III. Business Strategy

XYZ is focused on the production of high-quality cotton yarns for use in numerous applications, such as knitting, weaving, and other cotton fabrics. XYZ’s customers in turn sell the fabrics they produce for downstream use in cotton apparel, linens and other cotton end products. XYZ currently has a high-volume manufacturing facility with a capacity of 32 tons per day, or over 10,000 tons per year.

Technology is a key part of XYZ’s differentiation. First, it increases labor productivity, which is important because labor is a key component in cotton manufacture. XYZ’s labor will have to be brought from nearby South Asia. However, despite the added cost of transportation and visas, XYZ’s labor force is expected to have a very low cost per unit of production primarily because of XYZ’s technology advantages.

Second, with flexible production of cotton yarn from 16s to 60s Ne count, XYZ is able to adjust production and raw cotton types and quantity to maximize profit potential based on the just-in-time quality and quantity requirements of the market and current price of yarn and raw materials.

Raw cotton represents a large component of cost. XYZ’s large 44,250 square meter plot allows for a number of strategies for minimizing the impact of fluctuations in the market price of raw cotton, (such as the ability to store up to 6 months supply of feedstock on site) and maximize return on investment with the option to move to higher value-added stages of production, such as production of higher-priced lycra yarn, knit hosiery, and weaving cloth.

The founders, foreseeing that operational excellence would be critical to success in the textile industry’s rigorous pricing environment, hired a highly experienced management team to drive the operation. Senior management at XYZ has more than 110 years of combined industry experience, in some of the most challenging locales in the world.

Quality is also critical to success. Cotton yarns, although a commodity product, must adhere to stringent quality standards to ensure acceptance and repeat business. XYZ is equipped with the best quality control equipment and the Quality Control Manager has 18 years of textile industry experience.

IV. Value Proposition

XYZ will compete broadly on the world commodity market for cotton yarn. XYZ expects to hold a favorable position within that market against other producers of high quality yarns for a number of reasons.
Market Overview

I. Supply Side

World production of yarn (synthetic and natural) was 61.8 million metric tons in 2009. The overall production of the cotton yarn segment was 21.4 million metric tons in 2009. The cotton yarn market is expected to continue growing as the world economy continues to recover, particularly as spurred by the robust growth of China as a more consumer-oriented economy. The following charts indicate the growth of this market over time:

| Table 3. Share of Cotton on Spun Yarn Production (2005-2009) |
|---------------|-------|-------|-------|-------|-------|
| Cotton Yarn   | 21,384* | 20,383 | 23,193 | 22,621 | 21,595 |
| TOTAL         | 61,800 | 59,174 | 63,496 | 60,002 | 57,838 |
| Share         | 35%    | 34%    | 37%    | 38%    | 37%    |
| Cotton Δ      | 5.40%  | -12.12% | 2.53%  | 4.75%  | n/a    |
| Total Δ       | 4.44%  | -6.81% | 5.82%  | 3.74%  | n/a    |

Source: The Fiber Year 2008/09 and DFC Analysis.

*Assumes output grew in proportion with overall cotton consumption (~4.8% in 2009)

The major feature of this chart is the discontinuity between the smooth secular growth trend prior to the devastating economic crisis of 2007 and the subsequent collapse in end-user demand for fabric products (see Figure 5 below). The result was a collapse in spun yarn production as numerous textile manufacturers went out of business or suspended operations. As can be seen in Figure 4 above, spun yarn production has yet to recover to the levels enjoyed by the industry in 2005.
II. Demand side

XYZ will target 100% of its production for export, according to which markets maximize company profitability. The most obvious targets for XYZ are those markets with a large downstream fabric and apparel manufacturing base that can use XYZ’s cotton yarn output. This base is in place for one of two reasons: either for export or to support domestic demand. Therefore, for purposes of identifying these key target markets, we use two sets of statistics: 1) clothing and textile exports to identify the large exporting industries, and 2) overall GDP size and growth, since apparel demand has historically tracked GDP and growth in affluence of the population. Lastly, since shipping cost is a significant though secondary cost factor, we also focus on those markets with easy shipping access from the port of Fujairah. We have listed countries below who meet our targeting criteria:

<table>
<thead>
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<th>Table 4. Top Six Potential Target Markets</th>
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<td>Yarn and Textile Exports</td>
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<tr>
<td>2007</td>
</tr>
<tr>
<td>China</td>
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<tr>
<td>India</td>
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<td>Bangladesh</td>
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<td>Pakistan</td>
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<td>Indonesia</td>
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<td>Turkey</td>
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China has by far the largest export oriented industry in clothing and textiles, and the government has declared it to be a “pillar industry of the nation.” Although China is a net exporter of yarn, it is an even larger net exporter of clothing by a large margin. So while is Chinese competition in certain segments of the yarn trade, the country offers an even larger target market for clothing exporters: users of yarn.
Critically, with China’s economic growth surging to 11.9% in the first quarter of 2010, it has begun to drive up prices of cotton and cotton yarn, to the extent that Pakistan and India have both imposed export barriers to try to conserve their domestic supply of cotton yarn. This action has only increased the international price and scarcity of cotton yarn, causing it to rise by 30-45% in a matter of months in some markets. Consequently, China has clearly taken the position of market maker in the world textile market. So despite the distance to the Chinese market, which imposes shipping costs on XYZ, the indirect effects of China’s surging demand in the local region represents a significant opportunity for XYZ.

In India, cotton prices have increased 25% and yarn prices have increased 40-45% from January to April of 2010, primarily because of the trade diversion resulting from Chinese demand. In response, the Indian government recently suspended its previous 7.67% export tax incentive (a tax credit) on yarn for a period of six months from April. The hope is that this will protect the domestic Indian fabric industry, which was being squeezed out by China, but of course the net effect is to drive up the international price of yarn. Although a significant amount of spun yarn capacity remains in India (see Figure 7 below), it is obviously not sufficient to support the domestic fabrics and clothing industry. Indeed, because of its proximity, size, and low capital intensity (and hence low labor efficiency and quality), India may be the most attractive target market for XYZ.
Bangladesh, despite having a large yarn industry of its own, is a net importer of yarn (see Figure 8 below). Its apparel export industry is growing very rapidly, exceeding the ability of its domestic yarn industry to support that growth. In an effort to drive development of domestic yarn spinning capacity, the Bangladeshi government placed a ban on yarn imports. However, this action drove the domestic price of yarn up by 77%, putting 600,000 small weaving shops out of business, and slowing an estimated 1.4 million more who were unable to buy enough yarn to operate at capacity. As a result, the import ban was lifted on 16 May.
Pakistan may be the market most drastically affected by China. With the rise of Chinese demand, Pakistani exports to China moved from 30 million kg in 2008 to 80 million kg in 2009, causing severe yarn supply shortfalls in the Pakistani apparel industry. As a result, the Pakistani government recently imposed an export duty of 15% on all yarn exports under the price of USD 3.50 per kg.

The Turkish and Indonesian markets will be more opportunistic targets. Indonesia in particular has its own cotton yarn-spinning infrastructure, but it is limited by 20-year-old machinery that typically runs at 70-80% efficiency, as compared to the 88% or more efficiency of XYZ’s plant. And with electricity costs at $0.80 per kWh, Indonesia has become a net importer of yarn to feed its fabric manufacturing plant.

Turkey is a key textile market as a gateway to Europe because it enjoys tariff free access to EU countries, and holds a strategic location on the trade route between Central Asian cotton fields and EU markets. Indeed, after the past two brutal years and a currency devaluation, Turkey began to show signs of life with apparel exports up by about 10% in January and February of 2010. However, the current fall in the Euro is cause for concern about the future of Turkish apparel exports, and therefore, of Turkish yarn imports. Despite such clouds on the horizon, Turkey still presents a solid opportunity because of its trade regime dynamics (see next section).

Opportunistically, XYZ will explore the local UAE and GCC market, although this will be a secondary focus. XYZ can afford to be particularly price competitive in the domestic market, while maintaining its high quality standards, since it can undercut the transportation costs of other yarn producers elsewhere. However, given that the local GCC market has few apparel producers, the global market will be the primary target for absorption of XYZ’s capacity.

III. Trade environment

The UAE has a number of trade advantages that can play to XYZ’s advantage. Opportunistically, tariff regimes can play to the UAE’s advantage. For instance, Turkey has anti-dumping duties of 15% to 25% on imports of cotton yarns from many countries. The UAE, however, has a large quota, and few competitors in cotton yarn production. In the highly competitive market for cotton yarns, an advantage of 15% to 25% in price could make Turkey a highly attractive market.

Secondly, there are multiple Free Trade Agreements currently under negotiation by the UAE through the GCC, with such large textile consuming countries and blocs as the EU, US, Japan, China, and Australia. It is hoped that in the longer term, FTAs could help establish the UAE as a growing hub for international clothing manufacturers. Should that happen, XYZ would have a significant advantage in the local UAE market.
About Us

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About NRCI

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