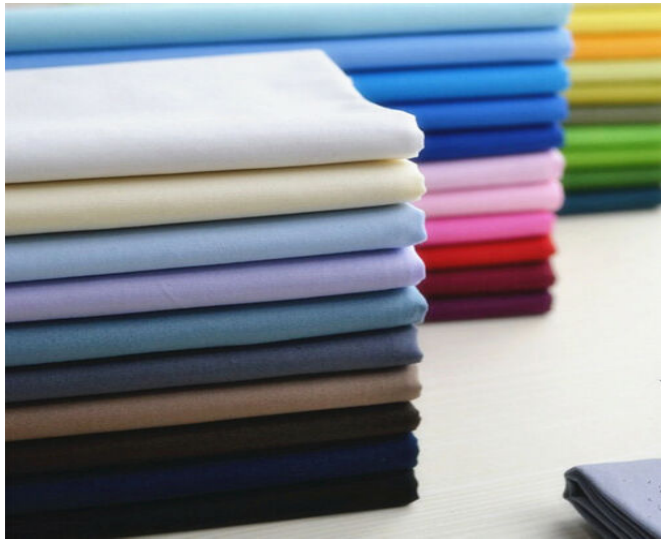
SECTOR STUDY . DECEMBER 2023



Composite & Garments

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CONTENTS

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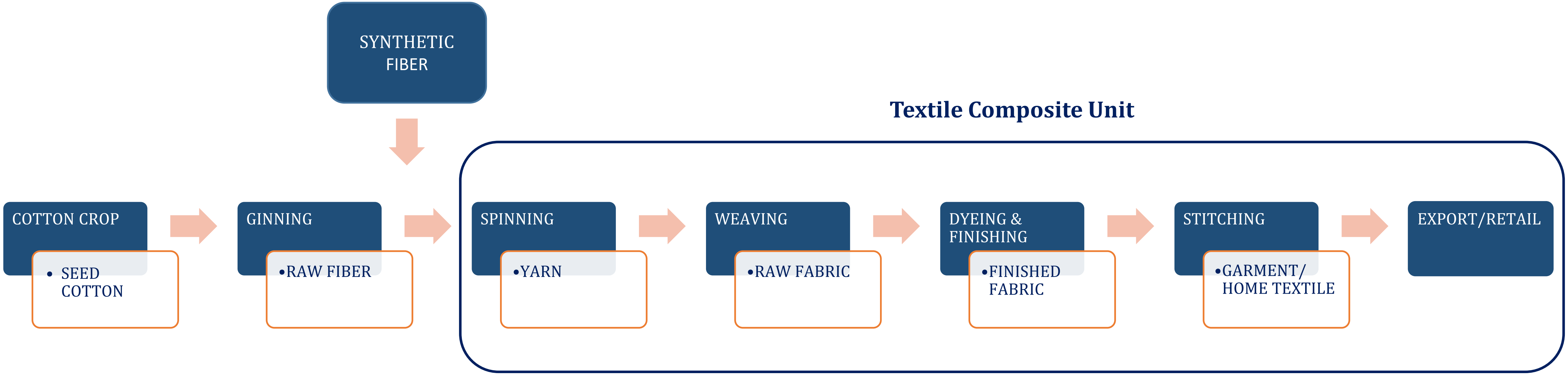
Introduction | Textile Value Chain

- Textile value chain comprises all stakeholders and activities which provide or receive value from designing, developing, making, distributing and consuming a textile product, including the extraction and supply of raw materials. The value chain, therefore, covers all stages of a textile product's life, from supply of raw materials to disposal after use and also includes all stakeholders that can influence these activities. The following flow chart depicts the major processes along with the output of every process of the textile cluster's value chain .
- A Composite textile unit comprises two or more processes from spinning of yarn till finished goods are produced.



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Global | Overview

- **Size:** The market size of the global textile and apparel industry was recorded at USD~610bln in CY22 and is expected to reach USD~653bln by End-CY23, representing growth rate of ~7.0% YoY. However, a decline in cotton crop yields is predicted in major cotton producing countries such as China, India and Australia in MY23/24 and cotton being the major input in the textile and apparel industry, the sector is going to be negatively impacted by this reduced crop. Global area under cultivation for cotton crops in MY23/24 is expected to be ~31.8mln Ha. The global market size is forecasted to grow to USD~831bln by End-CY27 at a CAGR (Compound Annual Growth Rate) of ~6.2%.
- **Demand Drivers**: The growth of textile industry in CY23 was affected by the Russian-Ukrainian war that led to economic sanctions on many countries and also caused supply chain disruptions leading to a surge in prices in the textile sector. Additionally, due to increased global inflation and economic slowdown, the industry grew at a slower rate than the last year. Online shopping is expected to help grow the apparel industry as it increases the geographical outreach of the apparel market.
- **Region Wise Textile Market**: The largest regional textile market is Asia-Pacific. It includes countries such as India, China and Pakistan which are amongst the top producers of cotton. Moreover, due to the availability of cheap labor, these countries along with Bangladesh have become textile producing hubs. They cater to both growing local demand and export demand from other regions.
- China is the largest exporter of textiles followed by Bangladesh and Vietnam and India. Meanwhile, the European Union and United States are two of the largest importers of textile finished goods such as garments and apparel.
- Since Dec’20, the US has actively sought to ban cotton imports from China’s Xinjiang region under the Uyghur Forced Labor Prevention Act, this ban is still in place This enforcement comes in response to efforts to ban forced labor from the region, ~90% of China’s cotton was grown in the Xinjiang region in China in MY22/23.
- As a result, significant importers such as Vietnam and Bangladesh have reduced their acquisitions owing to the heightened vulnerability of Chinese fabric containing cotton fiber sourced from the Xinjiang autonomous region.

Source: Business Research Company, USDA, The Guardian

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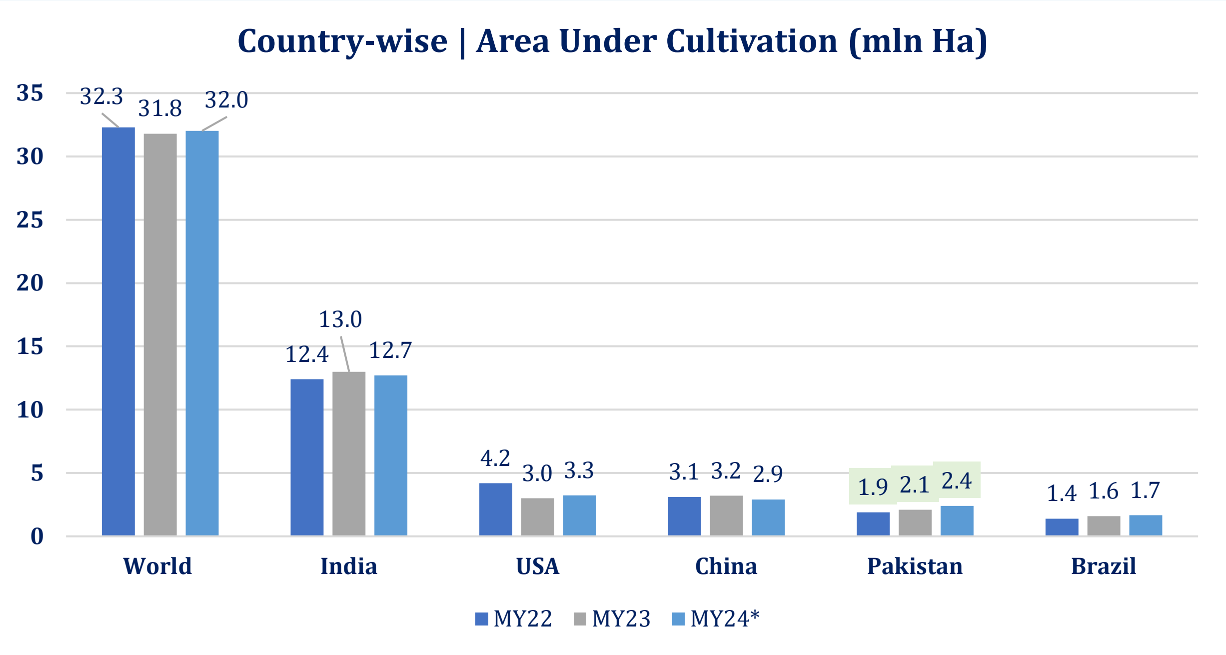
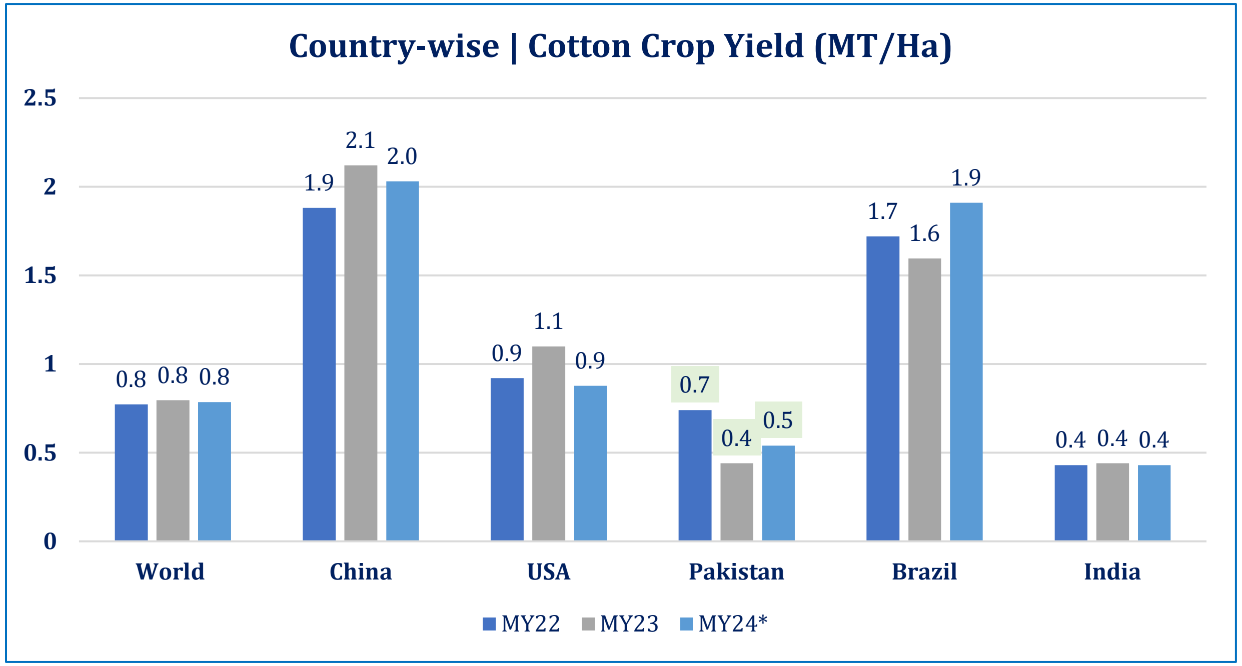
Global | Cotton Dynamics





- Global area under cultivation for cotton crop is projected to be ~32.0mln Ha in MY24 (MY23: ~31.8mln Ha). In MY24, India is expected to record the highest area under cultivation in terms of cotton crop, followed by the USA with an expected area equivalent to ~3.3mln Ha (MY23: ~3.0mln Ha).

- With China having ranked third in line in terms of area under cultivation, the forecast cotton yield for the country in MY24 is set at ~2.0 MT/Ha (MY23: ~2.1 MT/Ha), Xinjiang region (the largest cotton producing region) in China is expected to experience a decline in cotton production of ~8.1% on a YoY basis due to adverse weather conditions in MY24.

***Note:** Data in the graphs has been taken from USDA*
**Nov'23 USDA projections.*

Source: USDA, PES, PCCC, PCGA

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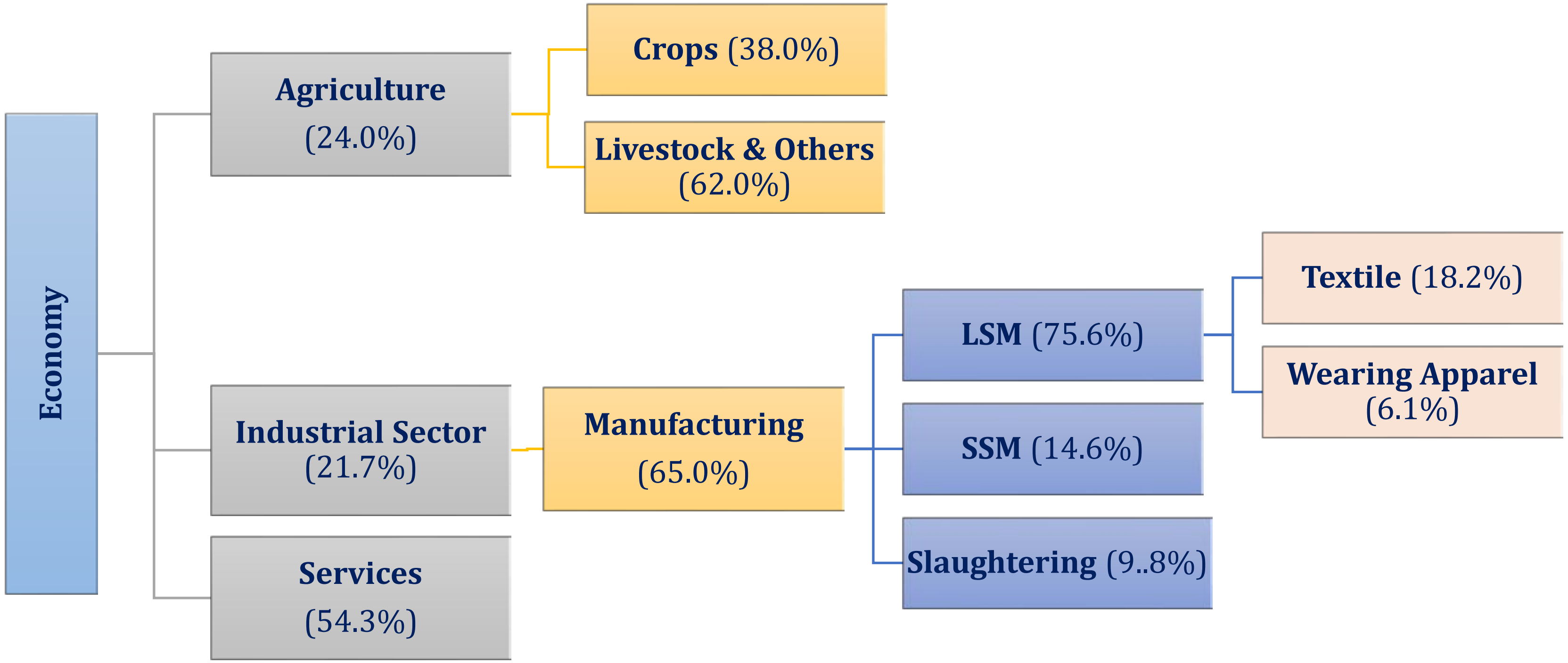
Local | Overview

- In FY23, Pakistan's GDP (nominal) stood at PKR~79.7trn (FY22: PKR~63.3trn), contracting, in real terms, by ~0.17% YoY (FY22: ~6.17%). Industrial activities in FY23 held ~22% share in the GDP while manufacturing activities made up for ~65% of value addition in industrial activities.
- Large Scale Manufacturing (LSM) in Pakistan is essential for the economic growth considering its linkages with other sectors, as it represents ~75% value of all manufacturing activities in FY23. The LSM fell by ~10.3% in FY23 (FY22: ~11.7%) and further declined by ~1.9% in the 3MFY24 (3MFY23: declined by ~0.4%).
- The Textile sector is classified as a Large Scale Manufacturing (LSM) industrial component within the industrial sector. In FY23, the textile industry's weight in the QIM was recorded at ~18.2%.



Source: PBS

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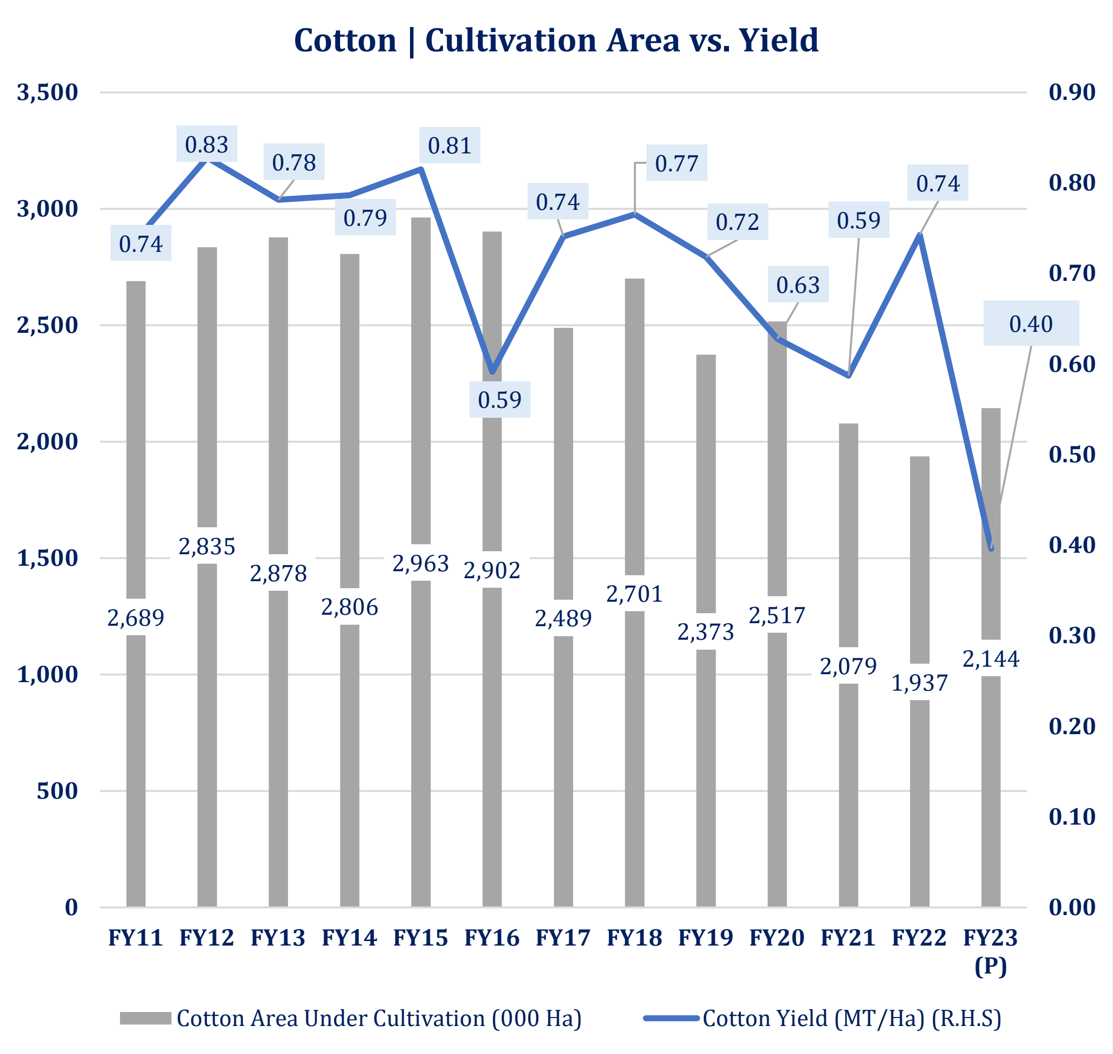
Local | Cotton Dynamics

- During FY11-15, cotton cultivation and yield remained largely stable. In FY16, ~27.2% decline in cotton yield resulted from pink bollworm infestation and low prices, discouraging pesticide investment. FY17 registered a ~14% reduction in the cultivation area as farmers, influenced by lower prices, shifted to growing maize and sugarcane. In FY19, the cultivation area declined by ~12.4% due to reduced farmer incentives, leading to lower cotton output. However, FY22 witnessed ~25.4% increase in yield, attributed to favorable prices, improved farming practices, and enhanced seed inputs.

- In FY23, despite a ~10.7% YoY increase in cultivation area, cotton yield declined by ~45.9% due to floods in Aug'22, resulting in ~41% YoY decrease in cotton production to ~4.9mln bales. Maize cultivation grew by ~4.1%, while rice declined by ~15.9% during FY23.

- For FY24, the targeted yield is set at ~0.6 MT/Ha, but stagnant cultivation area is expected due to higher local prices for Maize and Rice, offering better profits for farmers.

- Overall, the acreage of cotton has been shrinking compared to maize, rice, and sugarcane crops due to non-profitability, with additional factors such as susceptibility to pests, poor agricultural practices, and lack of fertilizers contributing to the decline in cotton production.



***Note**: Targeted yield for FY24 has been taken from USDA Nov'23 report.*

Source: USDA, PES, PCCC, PCGA

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Local | Cotton Dynamics

- Pakistan's cotton production plunged ~41% YoY in FY23 owing to supply-chain disruptions in the wake of Aug'22 floods. On the other hand, a ~7.5% decline in cotton imports was also witnessed during the year.

- FY24 target for cotton production is set at ~12.7mln bales, of which ~61% has been meet as of Dec'03, CY23 (or ~7.8mln bales). Of this, Punjab and Sindh comprised ~47% and ~51%, respectively, during the period.

- Meanwhile, imports during 4MFY24 clocked in at ~0.06mln bales (SPLY: ~0.2mln MT). One potential reason for the decline in imported cotton could be lower local demand for Textile products on the back of high inflation, which has adversely affected the purchasing power of buyers, leading to decreased spending on imported quality fabric.

- To encourage cotton production in FY24, the GoP announced an incentive in the form of Minimum Support Price (MSP) of PKR~8,500/40kg bag for the FY24 cotton crop.

Pakistan's Cotton Supply (000 Bales)

	FY18	FY19	FY20	FY21	FY22	FY23
Opening Stock	**2,265**	**2,440**	**2,510**	**3,200**	**2,175**	**1,925**
Production	11,946	9,861	9,148	7,064	8,329	4,910
Imports	3,521	2,439	3,157	5,043	4,636	4,023
Total Supply	**16,911**	**14,740**	**15,658**	**15,664**	**15,004**	**11,335**
Local Consumption	15,085	12,156	11,540	13,129	13,199	9,265
Exports	207	75	75	3	16	68
Closing Stock	**2,440**	**2,510**	**3,200**	**2,175**	**1,925**	**1,525**

Note: *Data in the table has been taken from USDA, except Cotton Production and Trade Statistics.*

Source: PBS, PES, MoF, PCCC, USDA

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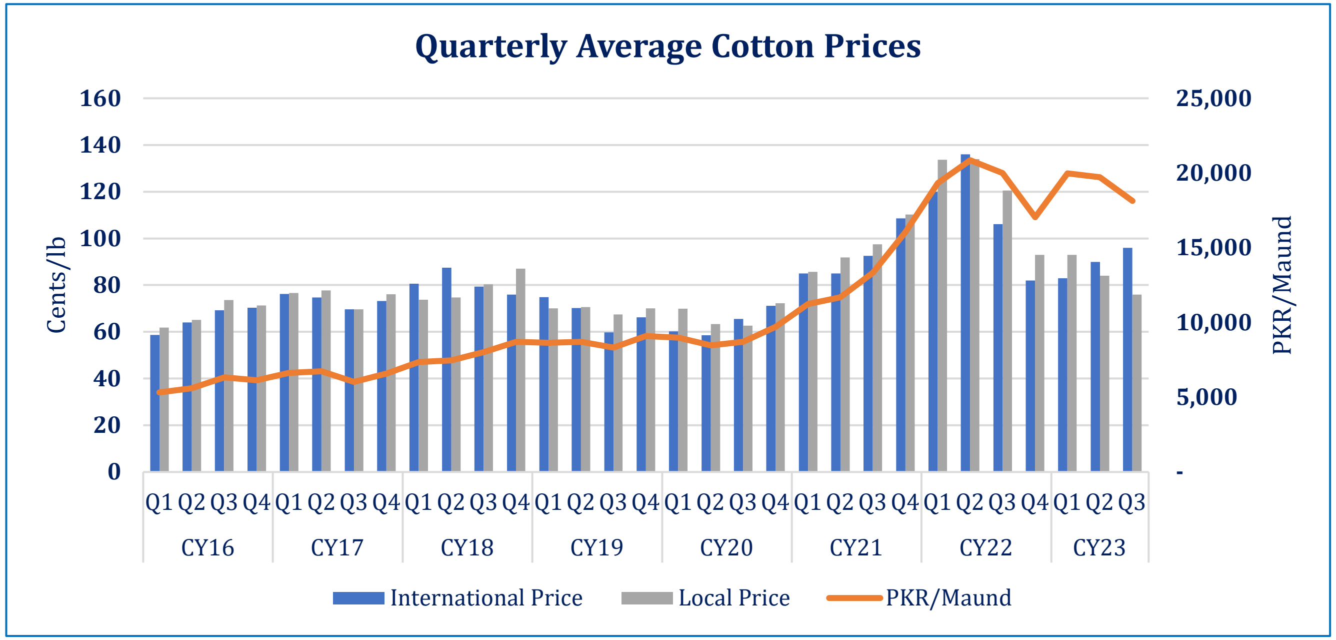
Cotton Dynamics | Prices

- Global cotton prices have historically (CY16-CY20) fluctuated between ~60-80 cents/lb, influenced by supply-demand dynamics and unforeseen events during CY16-CY20. The COVID-19 pandemic caused a dip to ~60 cents/lb. However, the 1QCY21-2QCY22 period registered a peak of ~136 cents/lb due to a global economic uptick. In CY22, prices remained high until May'22, reaching an eleven-year peak (~134 cents/lb) on the back of global economic recovery and increased textile demand. However, lower cotton prices during 3QCY22-1QCY23 resulted from China's sluggish import demand, as the world's largest cotton importer and producer.
- During CY16-CY20, the average delta between global and local cotton prices was recorded at ~2 cents/lb. Local cotton prices, in PKR/maund, exhibited little volatility during this time but grew steeply post-CY20, reaching PKR~2,200/maund in Sep'22. Local cotton prices averaged PKR~19,274/maund during 9MCY23 and are expected to remain rangebound during FY24 due to increased expected local production.



Average Cotton Prices	FY19	FY20	FY21	FY22	FY23	1QFY24
International (Cents/lb)	76	62	76	114	89	96
Local (Cents/lb)	78	68	78	123	95	76
Local (PKR/maund)	8,604	8,742	10,290	13,476	18,916	18,141

Note: *Cotton Conversion Units - 1 Maund =37.3kg;1 Bale =170kg;1 Bale =4.6 Maund.*

Source: PCCC

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Local | Industry Snapshot

- In FY23, Textile Group contributed ~3.0% to the country's GDP, reaching a market size of PKR~2,585bln, up ~8.0% YoY. The manufacturing industry, in textile sector, contributed ~25.0% to the industrial value addition.
- However, Textile exports were down ~14.6% in FY23, constituting ~59% of the country's total exports. Factors such as a global economic slowdown, damaged cotton crop due to flash floods of Aug'22, high interest rates, energy prices and inflation impacted the overall Industry.
- Similarly, Textile imports during the year declined ~21.8%, attributable to import restrictions imposed by the SBP during May'22-Jun'23 on the import of raw materials and machinery.
- The Sector is dominated by ~59 organized composite units, with ~32 listed on the PSX. These entities employ both forwards and backward integration to enhance efficiency. The Sector produces a diverse range of finished goods, including knitwear, towels, home textiles, readymade garments, and yarn, among other articles.
- As per IMF's directives, the GoP withdrew the Regionally Competitive Energy Tariff (RCET) for export-oriented sectors in May'23. Moreover, gas prices were revised upwards as of Nov'01, CY23 lowering the competitiveness of Pakistan's export prices.

Particulars	FY22	FY23	4MFY23	4MFY24
Textile Industry Size based on LSMI weightage (PKR bln)	2,404	2,585	N.A.	N.A.
% of GDP	4%	3%		
Cotton Crop + Ginning	*698*	*516*		
Manufacturing + Garments*	*1,707*	*2,069*		
YoY Growth (%)	41%	8%		
Textile Exports (USD mln)	19,330	16,501	5,940	5,565
Exchange Rate (USD/PKR)	178.0	248.0	223.4	288.6
Share in Country's Total Exports (%)	***61%***	***59%***	***62%***	***58%***
Textile Imports (USD mln)	4,787	3,741	1,293	882
Avg. Exchange Rate	178.0	248.0	223.4	288.6
Share of Country's Total Imports (%)	**6%**	**7%**	**6%**	**5%**
No. of PACRA-rated/ Listed Players (All Segments)	~130			
Association	APTMA			

**includes production of knitwear, towels, bedwear, yarn, unprocessed fabric.*

Source: PBS, TCO, PSX, PBIT

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Local | Yarn Production

Production of Yarn (MT)	FY19	FY20	FY21	FY22*	FY23*
Coarse	790,223	707,732	792,771	795,510	620,935
Medium	823,784	735,970	826,441	830,098	647,356
Fine	395,655	350,824	350,824	345,874	349,623
Super Fine	85,699	75,891	85,975	86,404	67,345
Synthetic/Blended	1,335,929	1,179,211	1,385,574	1,383,496	1,009,502
Total	**3,431,290**	**3,049,628**	**3,441,585**	**3,458,740**	**2,694,760**

- As depicted above, Pakistan's annual production of yarn has remained relatively stable over the past few years (FY18-23). In FY23, production of yarn declined ~23.6% YoY to ~2.7mln MT, owing to lack of technology and institutional financing for the improvement in the production levels of yarn.
- During 3MFY24, ~0.6mln MT of yarn was produced. Synthetic or blended yarn, which includes Polyester-Viscose and Polyester-Cotton, has the largest share of total yarn production. Moreover, there is greater production of coarse and medium type yarn as compared to fine and super fine cotton yarn.

**Estimated*

Source: TCO, PBS, PES

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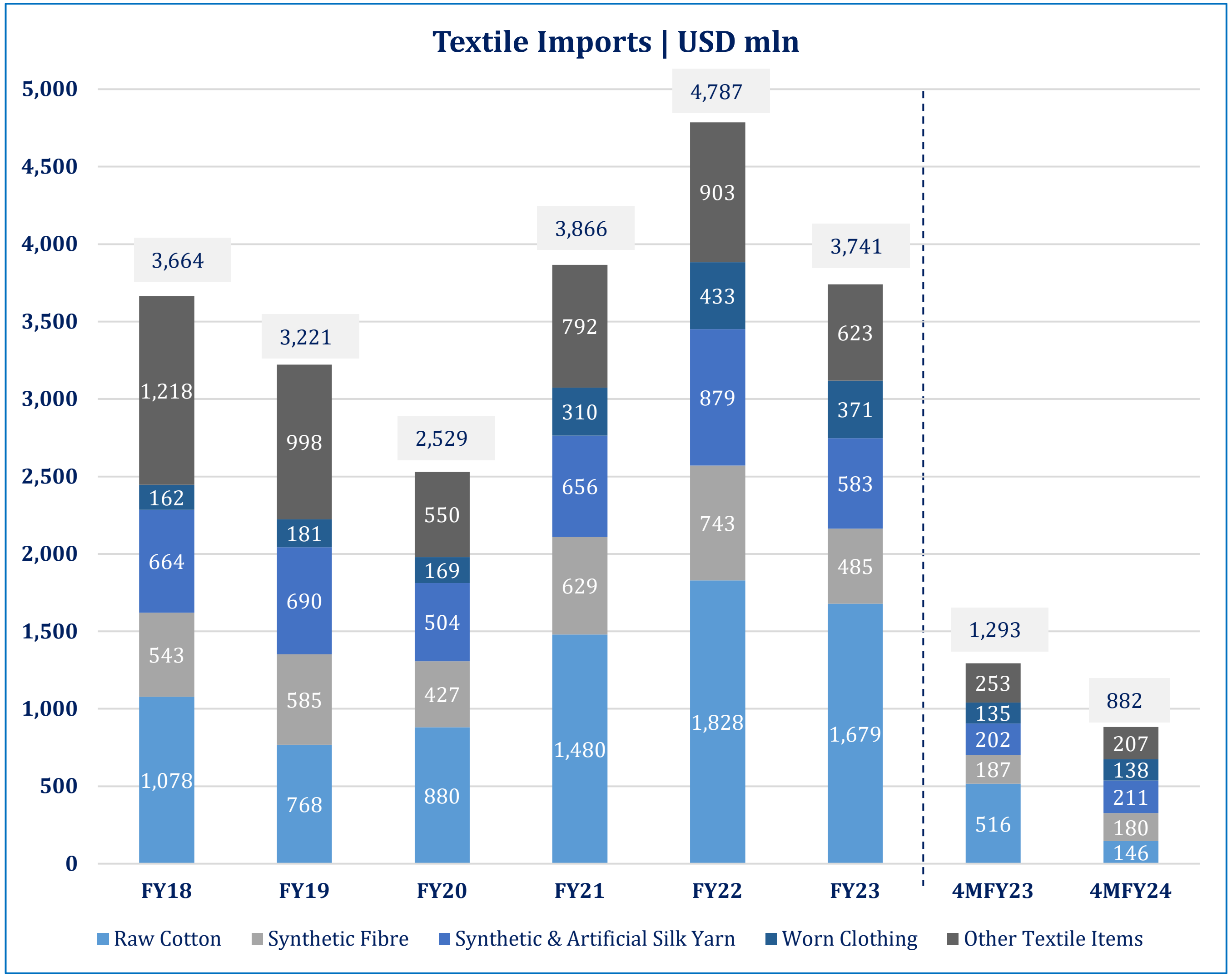
Local | Segment-wise Textile Imports

- Amid import restrictions imposed by the SBP during May’22-Jun’23, the country’s textile import bill declined ~21.7% YoY during FY23. Additionally, inflationary pressure was a likely contributor to the decline in textile imports in volumetric terms.
- During the year, a significant volumetric dip was registered in the synthetic fibre segment (~39.0% YoY), followed by synthetic and artificial yarn (~32% YoY). Meanwhile, in volumetric terms, worn-out clothing imports dropped ~19.0%, whereas, raw cotton imports fell by ~13.2% YoY.
- During 4MFY24, textile import bill was down ~31.7% YoY and can be associated with the higher interest rates and considerable ~39.0% PKR depreciation.
- In volumetric terms, a significant decline of ~70.6% was registered for raw cotton imports, recording at ~0.06mln MT in 4MFY24.



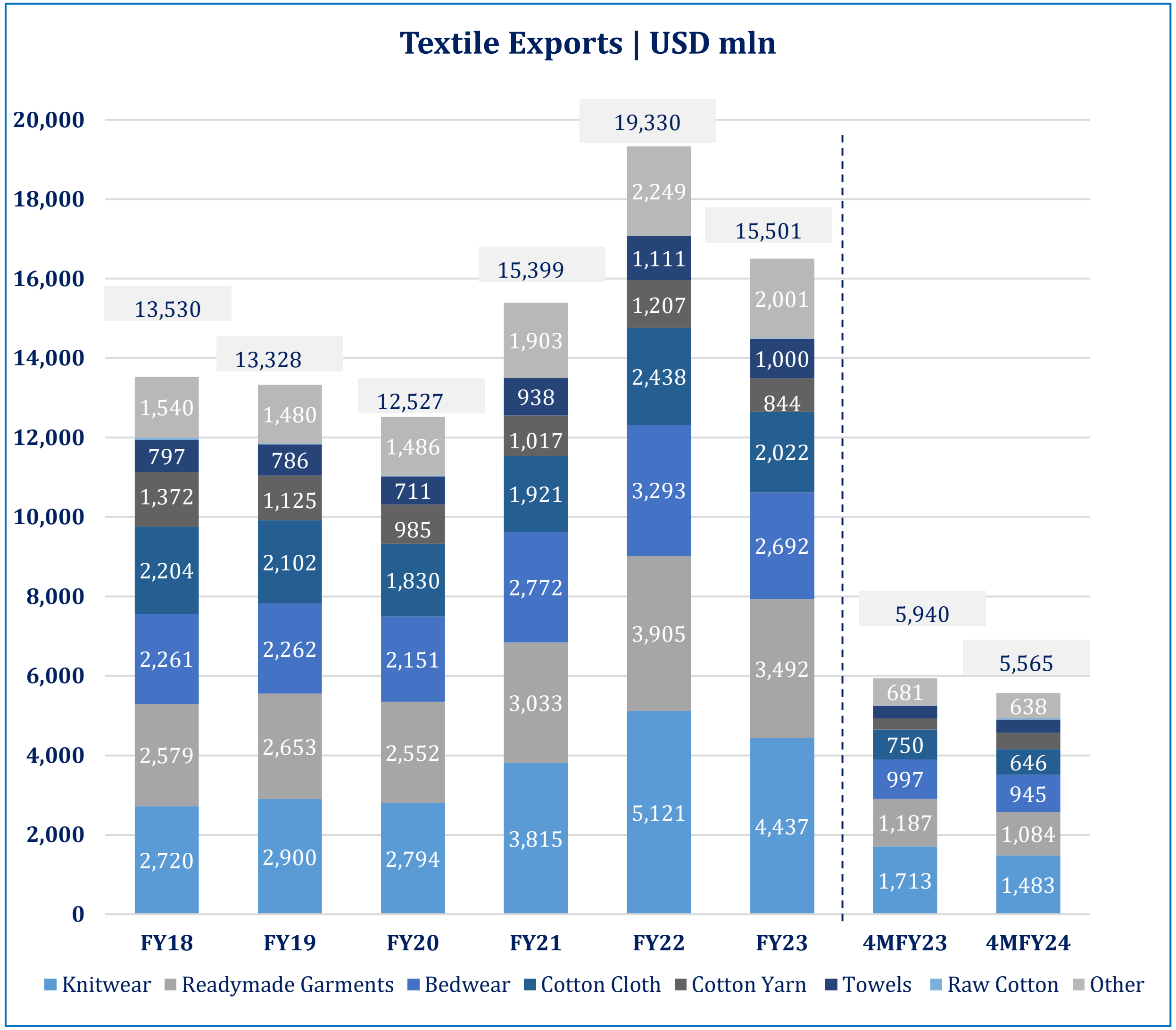
***Note**: Segment-wise Total Imports are highlighted in the chart.*

Source: PBS

Composite and Garments

Local | Segment-wise Textile Exports

- Challenges facing the Sector in FY23 included import restrictions during May’22-Jun'23, flash floods of Aug'22, weak global demand, currency depreciation and a shortage of foreign currency for essential machinery imports.
- Despite a volumetric increase of ~28.0% in Readymade Garments (RMG) exports during FY23, ~10.6% YoY decline in USD terms was observed, due to low-quality produced. Similarly, there was ~30.0% reduction in cotton yarn exports both in USD as well as volumetric terms.
- During 4MFY24, export receipts for raw cotton and cotton yarn surged ~137.0% and ~42.8% YoY, respectively. On the other hand, export value of knitwear declined by ~13.4%, while in volumetric terms registered an uptick of ~38.4%.
- In FY24, an anticipated ~127.0% increase in crop production is likely to boost the overall textile exports. However, the potential slowdown in China's growth poses a risk to exporter countries like Pakistan.
- The GSP+ scheme has played a crucial role in expanding Pakistan's bilateral trade, providing a competitive edge against key textile industry players, India and Bangladesh, which do not hold GSP+ status. Maintaining this status is critical for Pakistan's textile export competitiveness in EU member states, especially beyond the EU review in Dec '23.

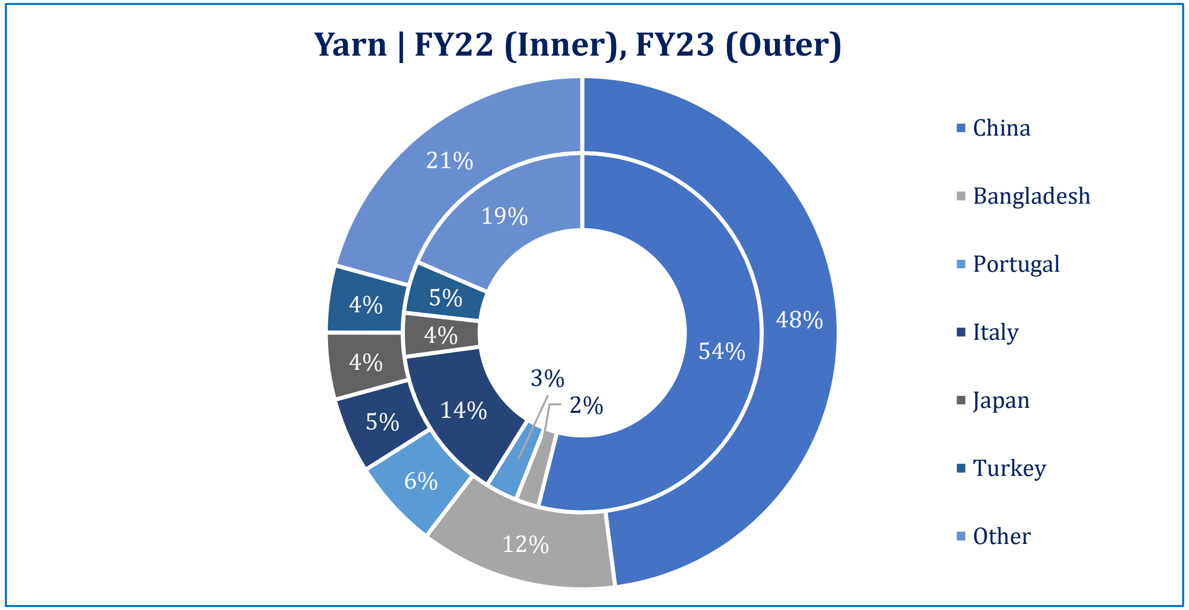


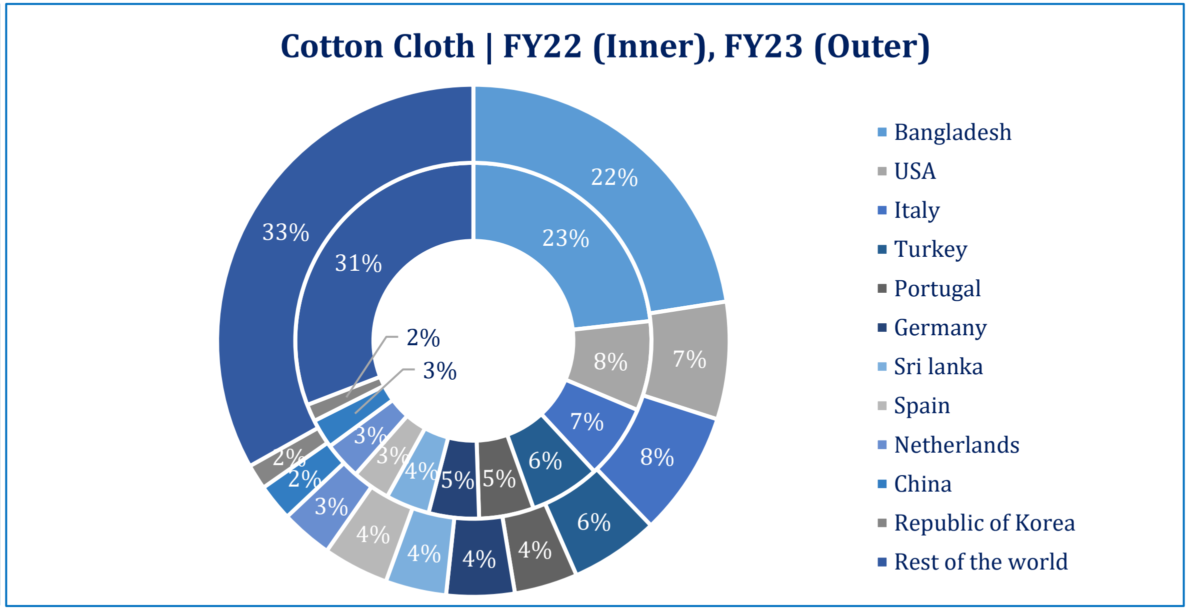
Note: Segment-wise Total Exports are highlighted in the chart.

Source: PBS

Composite and Garments

Export Destinations | Yarn and Cotton Cloth





- In FY23, yarn exports accounted for ~7% of the total receipts from the textile sector, up ~64% YoY in volumetric terms and ~43% in value terms. China is Pakistan's largest yarn customer followed by Bangladesh accounting for ~48% and ~12%, respectively. Another large export customer is Portugal, ~6% to yarn export revenue. Going forward, China's slow economic growth is expected to negatively impact exports of Yarn due to weak demand in FY24.
- In FY23, cotton cloth accounted for ~12% of the total receipts from the textile sector, although these were down ~24% YoY in volumetric terms and ~17% in value terms. With respect to cotton cloth exports, ~22% were concentrated towards Bangladesh in FY23, which is a significant player in the global textile finished goods market. Other export destinations for cotton cloth include European countries such as Italy, (~8%), Turkey (~6%), Portugal, Germany and Spain (~4% each), Netherlands (~3%), as well as the USA (~7%). Rest of the world includes Japan and UK, to name a few.

China's expected slow economic growth data as per MoF Economic Outlook Nov'23

Source: TDAP, PBS, SBP, MoF

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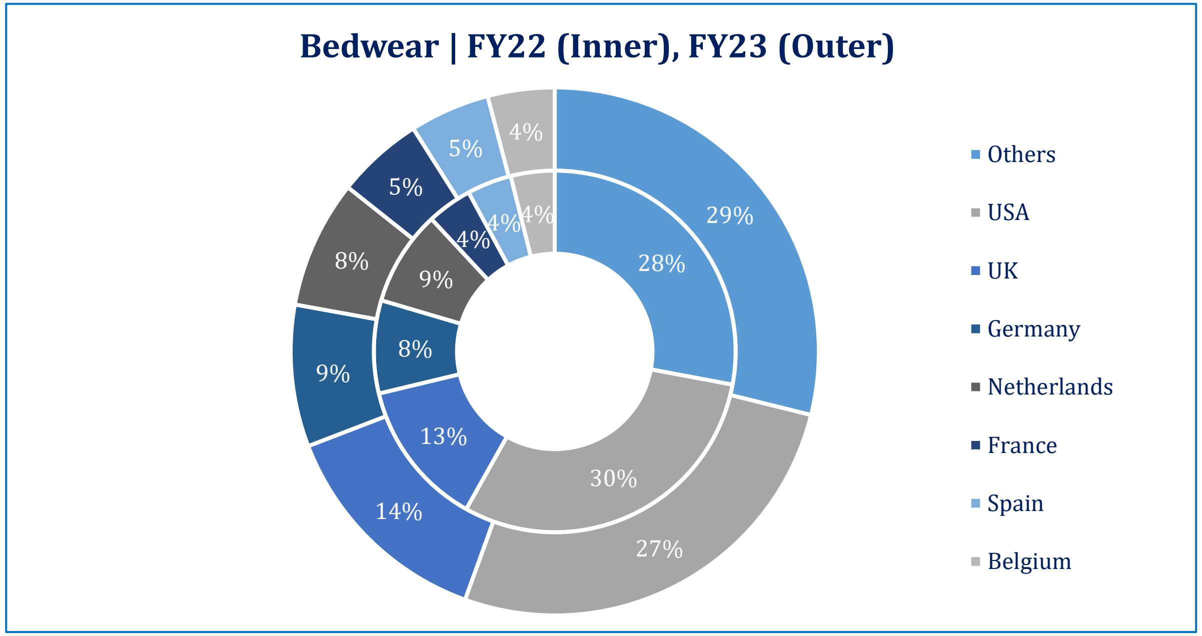
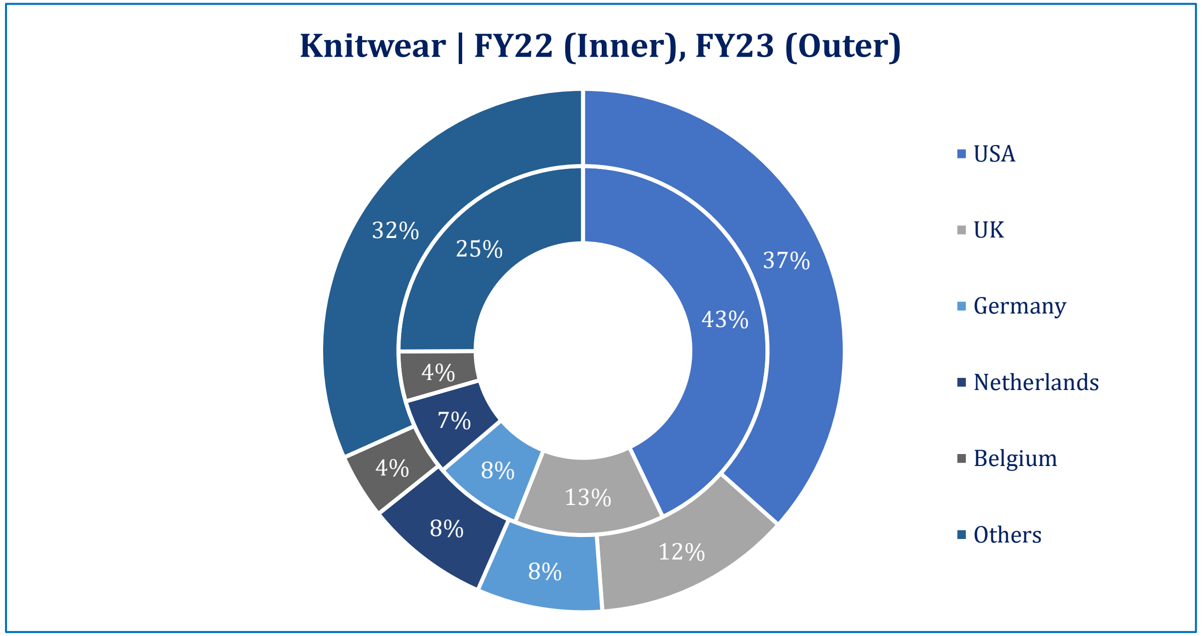
Export Destinations | Bedwear & Knitwear





- In FY23, the USA was Pakistan's largest customer of bedwear. UK was the second largest customer with ~14% of bedwear exported, followed by Germany (~9%) and Netherlands (~8%). Other countries included UAE, Australia and Canada. Bedwear accounted for ~16% of the revenue generated from the textile segment in FY23 and decreased by ~21% in volumetric terms and by ~18% in USD.

- In FY23, knitted fabrics orders from the USA generated ~37% of export revenue while those to the UK generated ~12%. The third highest export revenue from the sale of knitted fabrics was generated from Germany (~8%). Other countries which served as destination points for knitted fabrics exports (FY23) included Italy and Canada. Knitwear accounted for ~27% of the receipts from the total textile sector in FY23, increasing ~10% YoY in volumetric terms but declining ~13% in value terms.

Others in Bedwear include UAE, Australia, and Canada amongst others.
Others in Knitwear include Italy and Canada amongst others.

Source: SBP

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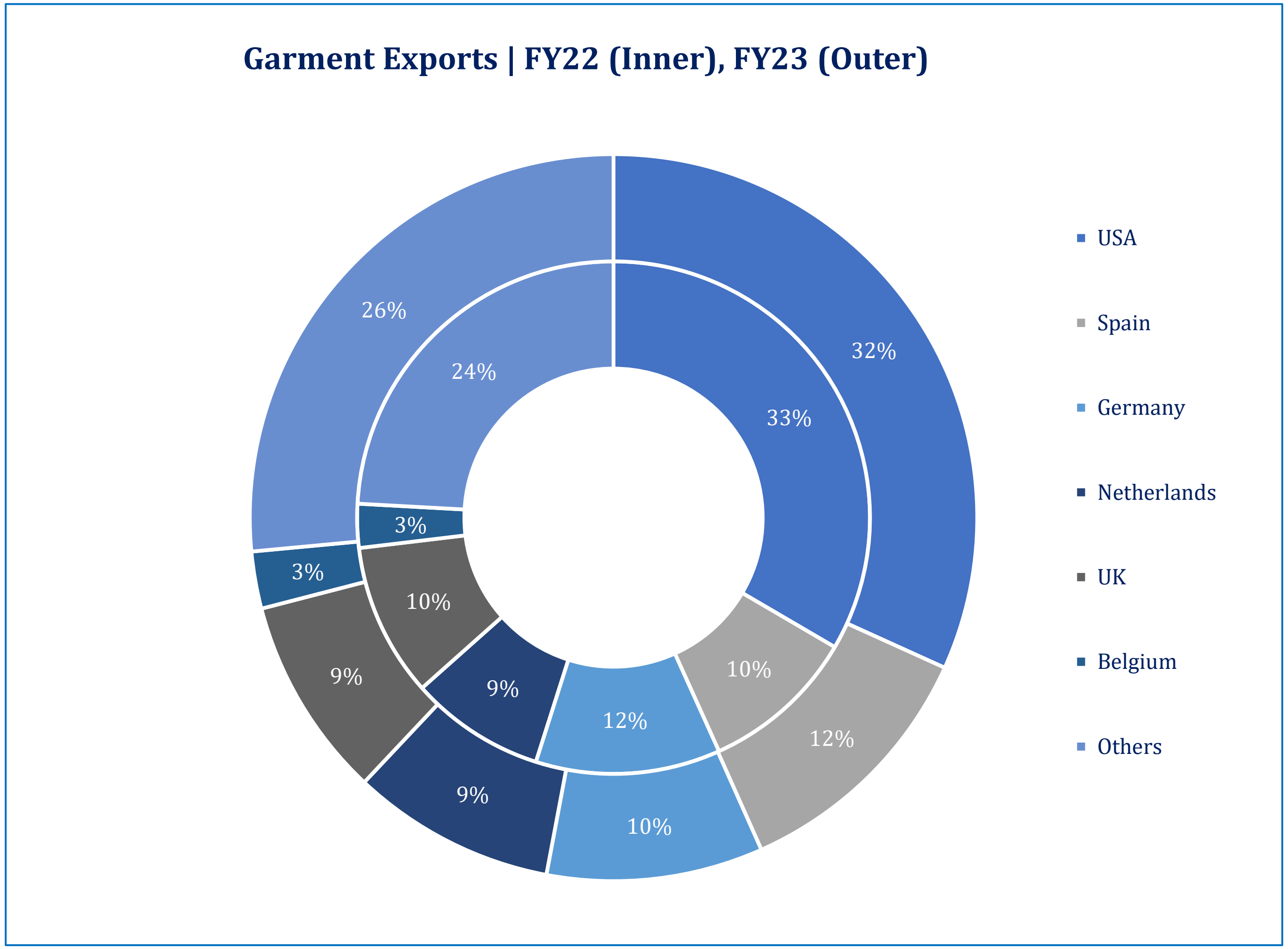
Export Destinations | Garments

- In FY23, ~32% of garments export sales revenue was generated from the USA, Pakistan's largest garments customer, and ~12% from Spain. Other major destinations included Germany and Netherlands and Belgium, accounting, respectively, for ~10% and ~9% of export receipts from the garments segment.

- Other top destinations for garments exports in FY23 included France, Australia, Canada and Italy.

- During the year, the garments segment generated ~21% of the total revenue receipts from the textile sector (4MFY24: ~19%).

- Additionally, in FY23, despite a decline in the exports receipts of garments (~11%), there was ~28% volumetric increase YoY.



Source: SBP

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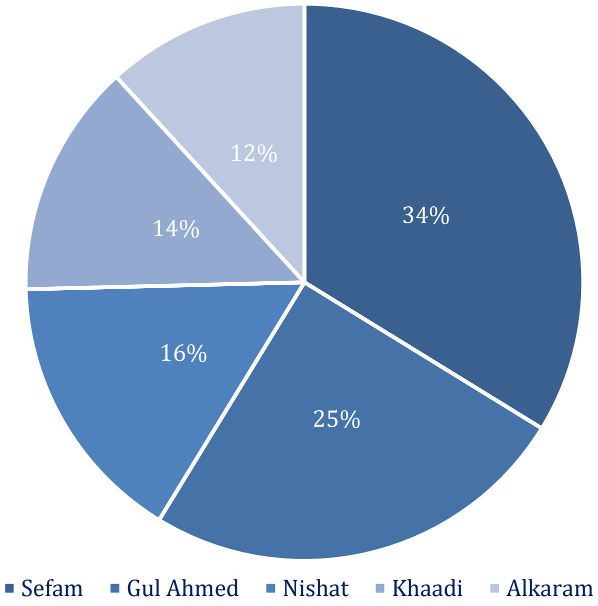
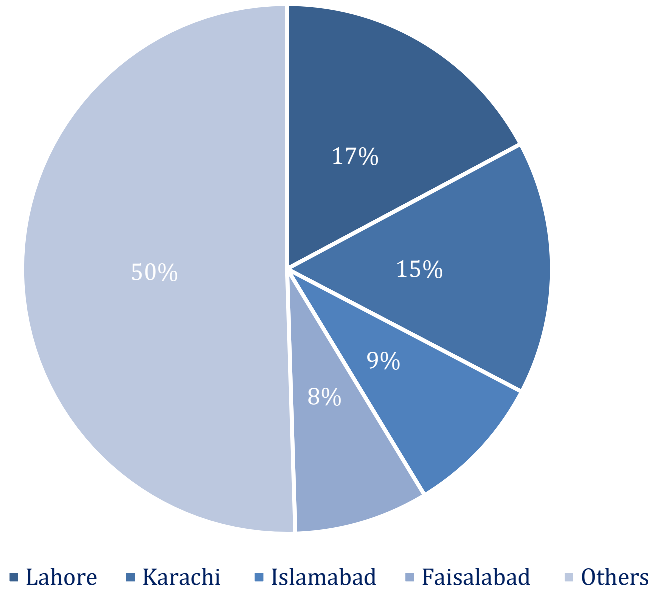
Local | Garments

Market Share | Pakistan's Top 5 Retail Brands* | FY23



Retail Outlets | Average Geographical Dispersion* | FY23



- The garments segment is referred to as an ancillary textile industry with production operations ranging from small-to medium to large-scale. Contribution of readymade garments (or wearing apparel) to the national Large-Scale Manufacturing (LSM) index was recorded at ~6.1% during FY23.

- The clothing retail industry is highly diverse when it comes to operating structure and size. While the major brands operate via retail outlets and online platforms, the smaller brands majorly conduct their sales operations via the latter. A majority of these companies have a horizontally-integrated value chain, operating with spinning and weaving units.

**Average Geographical Dispersion estimated using number of outlets across Pakistan.*
***Note:** Market Share is estimated using number of outlets of top 5 retail brands in Pakistan.*

PACRA Internal Database, Company Financials and Company Websites, PBS

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Business Risk

Identified Risk Factors	Degree of Risk Exposure	Description
Low Domestic Cotton Production	Medium	➢ Local production formed ~43% of total cotton supply in the country during FY23. ➢ Declining prices in the local market encourages farmers to grow more profitable crop like Wheat, Maize and Rice.
Increasing Dependence on Imported Cotton	Medium	➢ Imports comprised ~35% of total cotton supply in the country during FY23 (SPLY: ~31%). Imports have grown ~65% in the past five years (FY19-23), while local production declined by ~50%. ➢ Increasing imports expose the Industry to exchange rate fluctuations.
Climate Change Impact (e.g. Aug'22 floods)	Medium	➢ ~40% of the cotton crop was wiped out during FY23, resulting in a decline in cotton yarn and cloth output.
Reduction in Value Addition	Low	➢ Net Trade Balance (FY23) of USD~13bln emanated from increasing reliance on imports, as highlighted above.
High Input Energy Costs	High	➢ Since the removal in Mar'23, ~50% of the Industry capacity has remained idle. ➢ Power tariff for industrial consumers currently sits at ~15cents/kWh, up from ~9cents/kWh during FY20-22. High electricity and gas prices serve to increase cost of production for each Segment player. ➢ W.e.f. Nov 01, 2023, gas prices were hiked to PKR~2,100/MMBTU for the export-oriented sectors of the economy including the textile sector.
Increasing Interest Rates	Medium	➢ MPR increased by ~15bps to 22% as of Jun'23. Since then it has remained stable at this rate. However, the discount window of 3%, available in the form of EFS/ LTFF, with ~67% of country's total discounted borrowing availed by the Industry in FY23, high interest rates are likely to result in low Net Margins for Industry players.
Removal of GSP+ Status	Low	➢ For Pakistan, the Scheme has been extended for another 4 years but includes stringent conditions. ➢ Failure to comply will result in the loss of one-third of country's exports to the EU, ~80% of which comprise Textiles.

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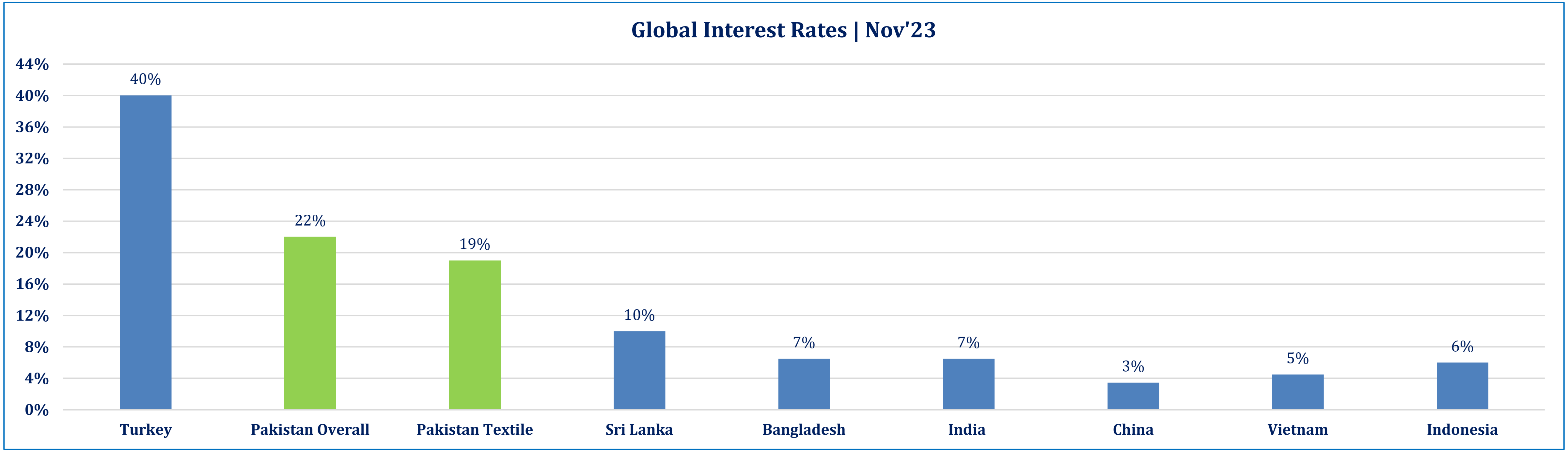
Business Risk | Interest Rates



- The interest rates stand at 22.0% as at Nov’23 (Nov’22: 16.0%). Pakistan has the second highest interest rate in the region. This serves to increase the cost of borrowing for the sector which has experienced a considerable jump in borrowing costs ~126.0% during FY23.
- However, the Sector benefits from subsidized financing facilities in the form of short term Export Finance Facility (EFS) and Long Term Financing Facility (LTFF). In Dec’22, the SBP linked these to the policy rate such that the difference between the former two rates and the latter was reduced from 5.0% to 3.0%.

Source: Trading Economics, globalpetrolprices.com, APTMA, OGRA

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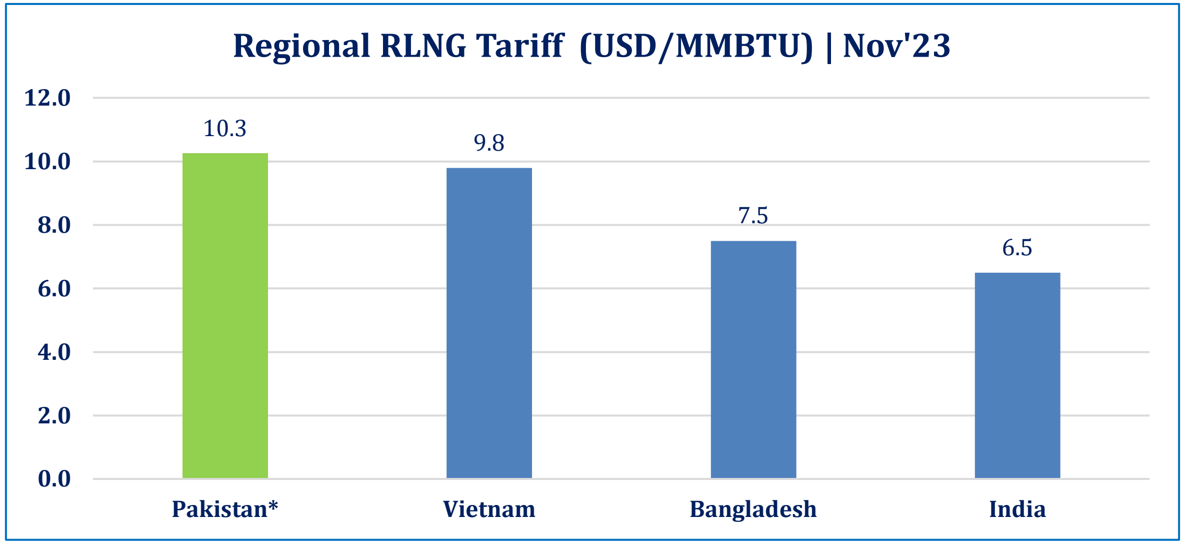
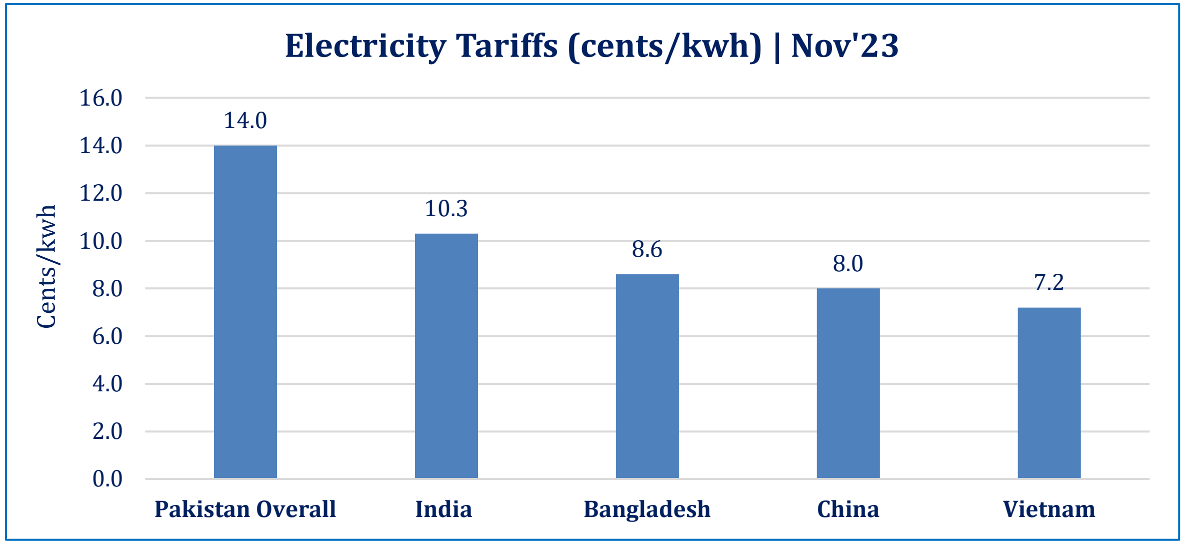
Business Risk | Electricity & Gas Tariffs





- Currently, the Sector is facing higher input costs (including energy costs) making the export prices less competitive amongst competitors such as Vietnam, Bangladesh and India. Pakistan textile industry has the highest gas tariff ~10.3 USD/MMBTU as of Nov’23 amongst the other competitors. Furthermore, the onset of winter implies gas curtailments for the Sector, further exacerbating input costs.
- Disruptions in electricity supply from the national grid (loadshedding and fluctuations) due to obsolete infrastructure and disconnection of gas supply make it challenging to rely on these energy supply sources.

Pakistan’s LNG Tariffs are the average of Sindh and Punjab Tariffs.

Source: Trading Economics, globalpetrolprices.com, APTMA, OGRA

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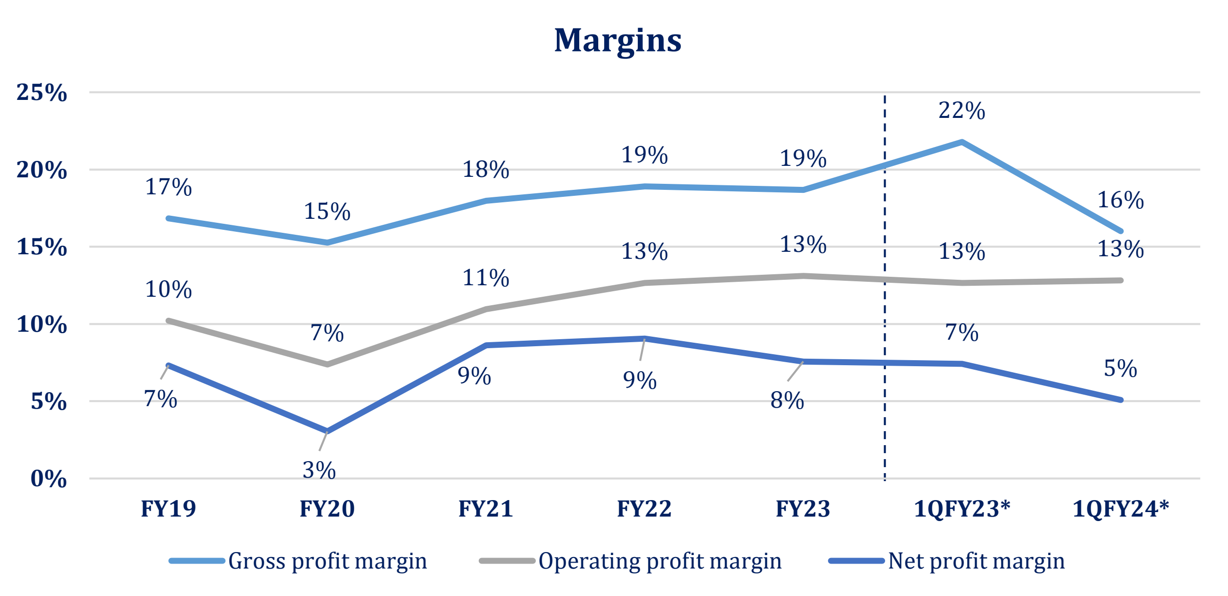
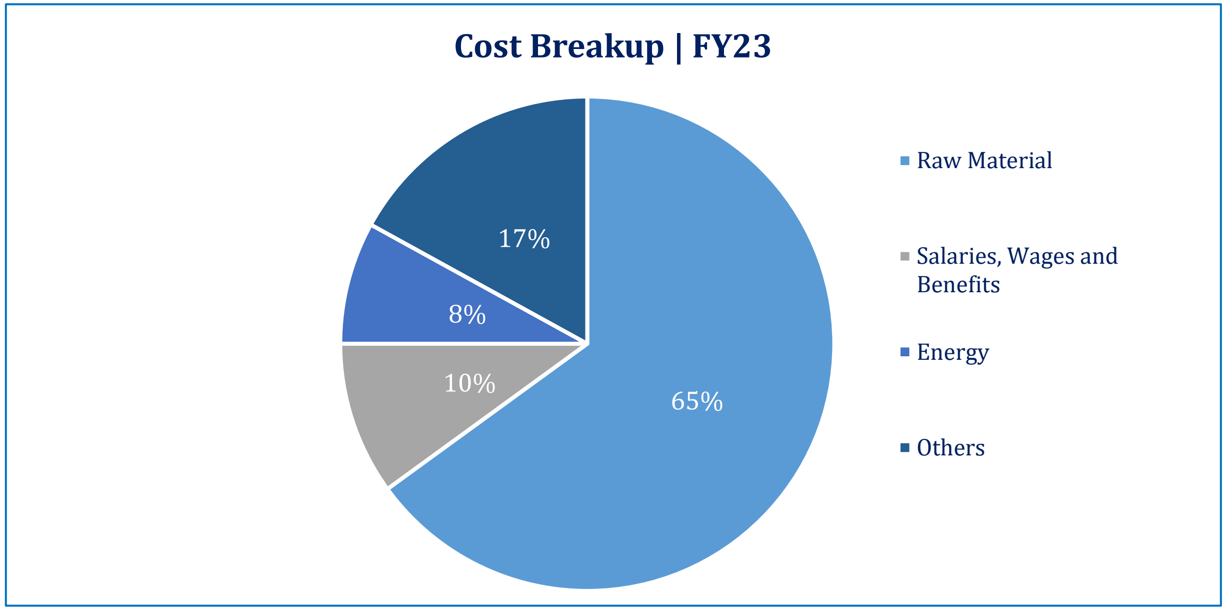
Business Risk | Margins & Cost Structure





- In the FY23, the gross profit margin maintained its stability at ~19%, balancing the rise in the cost of sales of ~20% with a corresponding increase in sales. Similarly, operating margins remained at ~13% in FY23 (FY22: ~13%), owing to the increase in operating costs (especially the energy costs) which nullified the increase in gross profit. Similarly, net margins dipped to ~7% from ~9% in FY22, owing to higher finance costs which grew by ~127% YoY owing to the increase in policy rates during the year.

- In 1QFY24, the gross margin, operating margin and net margins stood at ~16%, ~13% and ~5% respectively. Gross margins declined by ~27% due to an increase in cost of sales by ~36%. Whereas, the major contributor of a decrease in net margin was ~17% rise in finance costs. Raw material is the most significant component of the cost of sales (~65%) and this dependency highlights the susceptibility of margins to the input source.

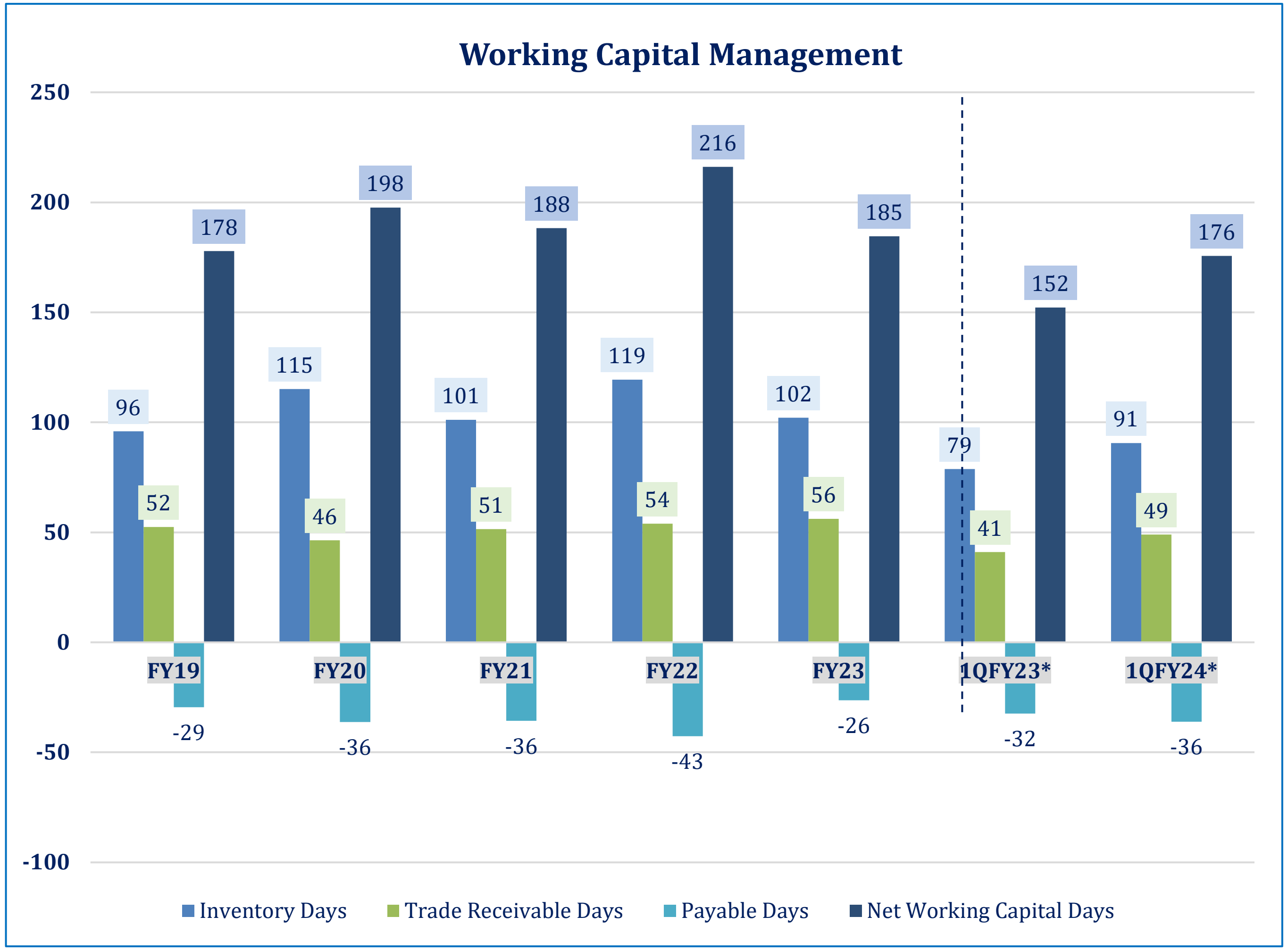
*Due to limited availability of data, margins for 1QFY23 and 1QFY24 reflects listed players' financial data

Source: PACRA Database, PSX

Composite and Garments

Financial Risk | Working Capital Management

- The Sector's working capital is largely a function of inventory and trade receivables. Inventory is the most significant component and majorly includes raw material and finished goods, with work-in-process making the smallest contribution.
- The average working capital cycle for the industry during the last six years (FY18-23) recorded at ~190 days, a relatively larger period due to the fact that composite units encompass multiple processes within the textile value chain, with FY22 having the highest inventory days of ~216 days.
- The net working capital days in FY23 were lower by ~31 days compared to SPLY. In FY22, there was an excessive build-up of cotton inventory by spinners as cotton prices fell globally.
- Inventory days have been observed to be higher in the first quarters of each fiscal year and this is owing to arrival of cotton into the warehouses of spinners from fields and the build-up of inventory for resale in the warehouses of other segments of the value chain. This can also be observed in 1QFY24 ~91 days which is just ~11 days lower than FY23.



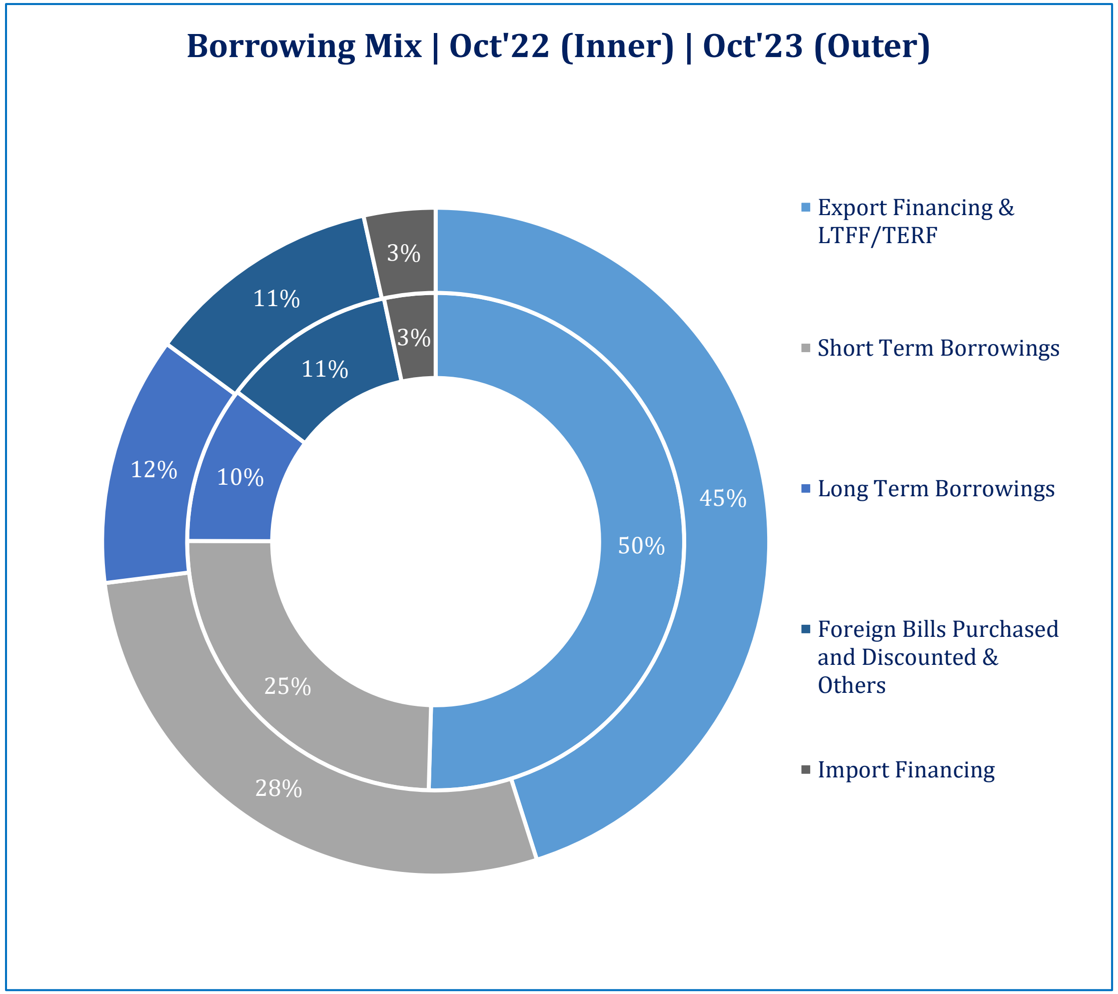
As per availability of data, working capital for 1QFY23 and 1QFY24 reflects 32 listed players' financial data

Source: PACRA Database, PSX

Composite and Garments

Financial Risk | Borrowing Mix

- The total borrowing for the Textile sector in Oct’23 stood at PKR~2,093bln as compared to PKR~1,928bln in Oct’22, depicting a growth of ~8.6% YoY.
- In Oct’23, the largest component within the borrowing of textile sector comprised discounted borrowing, amounting to ~45% of the total borrowing. This includes Export Finance Scheme (EFS) at rate of 10.0% till Dec’22 and at a rate of ~19% till date, as well as Long Term Finance Facility (LTFF) and Temporary Economic Refinance Facility (TERF) also at rate of 10.0% till Dec’22 and ~19% till date.
- Total discounted borrowing amounted to PKR~943bln as at End-Oct’23 (EFS: PKR~598bln, LTFF/TERF: PKR~345bln).
- The Sector’s short term borrowing at normal rates accounts for ~28% of total borrowing and stood at PKR~584bln as at the end of Oct’23.
- The average leverage for the Composite Sector in FY23 was moderate and stood at ~49%. However, this climbed to ~50% in the 1QFY24 period (SPLY: ~50%).
- As of Sep’23, the total non-performing loans (NPLs) of the textile industry stood at PKR~168bln while in terms of infection ratio were recorded around ~8.3% (Jun’23: ~8.6%). Textile NPLs continue to remain above the total infection ratio of ~7.7% of the private sector banking credit indicating higher level of financial risk.



Note: *Average leveraging is reflective of 59 listed/rated players. 1QFY23 and 1QFY24 leverage figures reflect 32 listed players*

Source: SBP

Composite and Garments

Financial Risk | Borrowing Mix

Textile Segments	Total Borrowings		YoY Change (%)	Short-term Borrowing			Long-term Borrowing		Foreign Bills Discounted
	Oct'22	Oct'23		Import Financing	EFS	Other Short-term	LTFF	Other Long-term	
Knitwear	57,952	61,380	5.9%	524	37,134	6,376	5,877	6,843	4,626
Readymade Garments	156,752	152,897	-2.5%	1,231	62,050	29,018	26,383	15,907	18,308
Bedwear	57,469	59,207	3.0%	1,708	17,179	3,020	14,755	2,648	19,897
Cotton Cloth/ Spinning	552,137	665,825	20.6%	37,831	114,623	293,410	89,509	93,927	36,525
Cotton Yarn/Weaving	345,019	387,883	12.4%	11,865	109,180	90,920	77,300	56,339	42,279
Towels	230,364	220,957	-4.1%	2,737	92,440	34,272	40,043	19,595	31,870
Other	528,772	544,942	3.1%	16,800	165,136	179,978	92,250	64,119	26,659
Industry	**1,928,465**	**2,093,093**	**8.5%**	**72,696**	**597,742**	**636,994**	**346,117**	**259,378**	**180,166**

Source: SBP

Regulatory Framework

- With respect to Income Tax, the composite sector is under the Normal Tax Regime (NTR). Further, the sector is also subject to Minimum Tax @ 1.25% of turnover, if tax liability under NTR is lower than minimum tax. However, the additional tax paid under minimum tax is adjustable against future tax liabilities for the next 5 years.
- In FY22 finance bill, a super tax was introduced and will be imposed at a rate of 10% on textile manufacturers whose income exceeds PKR~300bln.
- In addition, sales tax of 18% is applicable on both the raw material, i.e. cotton and finished goods, i.e. yarn. In addition to Sales Tax, there is Advance Tax of 1% applicable on the import of these products. However, the amount of Advance Tax is adjustable against final income tax liability.
- The sector receives discounted financing from SBP under the Export Finance Scheme (EFS) and the Long Term Financing Facility (LTFF). In Dec'22, SBP announced that the mark-up rates for the two aforementioned rates will be linked to the policy rate such that the difference between the former two, on the one hand, and the latter, on the other, is equal to 3%. This gap is subject to revisions in future economic activity.
- In response to the COVID-19 pandemic, SBP introduced several measures intended to provide relief to the industries. These measures included loan extension and refinancing, loan for payment of employee salaries and wages and facilitation of new investment, expansion and BMR activities through the Temporary Economic Refinance Facility (TERF) with a ten-year maturity loan facility. While the TERF scheme has been withdrawn by the SBP w.e.f. Apr'21, corporate loans under this facility have not yet matured and continue to be reported on the financial statements of sector players.
- In FY23, the policy rate has been hiked upwards five times, it stood at 15.00% in Jul'22 and by a further 100 basis points (to 16.00%) in November-22. The consistent upward revision in rates has served to increase sector borrowing costs and linked EFS and LTFF markup rates.
- All Pakistan Textile Mill Association (APTMA) acts as the national trade association of textile cluster in the country. On May 01, 2023, the GoP withdrew the Regionally Competitive Energy Tariff (RCET) that was granted to five export-oriented sectors including textiles , resulting in an increase in the RLNG cost from USD~9/MMBTU to the full rate of USD~13.5/MMBTU.

Source: SBP

Composite and Garments

Duty Structure

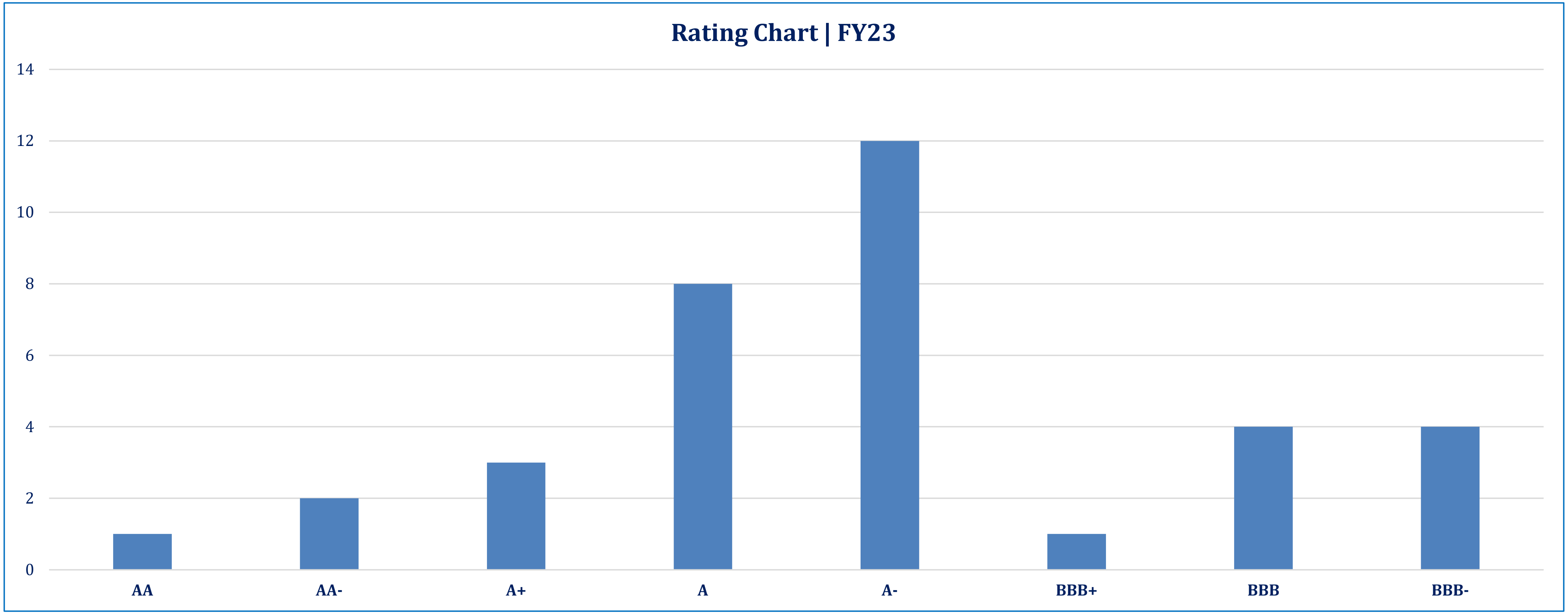
PCT Code	Description	Custom Duty		Additional Custom Duty		Regulatory Duty		Total	
		FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
52.01	Cotton, not carded or combed	0%	0%	0%	2%	0%	0%	**0%**	**2%**
52.03	Cotton, carded or combed	0%	0%	0%	2%	0%	0%	**0%**	**2%**
52.04	Cotton sewing thread, whether or not put up for retail sale	16-20%	16%	0%	4%	0%	0%	**16-20%**	**20%**
52.05	Cotton yarn (other than sewing thread), containing 85% or more by weight of cotton, not put up for retail sale	11%	11%	0%	2%	0%	0%	**11%**	**13%**
52.06	Cotton yarn (other than sewing thread), containing less than 85% by weight of cotton, not put up for retail sale	11%	11%	0%	2%	0%	0%	**11%**	**13%**
52.07	Cotton Yarn (other than sewing thread) put up for retail sale	11%	11%	0%	2%	0%	0%	**11%**	**13%**
52.08	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing not more than 200g/m2	11%	11%	0%	2%	2%	0%	**13%**	**13%**
52.09	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing more than 200g/m2	11%	11%	0%	2%	2%	0%	**13%**	**13%**
52.10	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with mand-made fibres, weighting not more than 200g/m2	11%	11%	0%	2%	2%	0%	**13%**	**13%**
52.11	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with mand-made fibres, weighting more than 200g/m2	11%	11%	0%	2%	10%	0%	**21%**	**13%**
52.12	Other woven fabrics of cotton	16%	16%	0%	4%	0%	0%	**16%**	**20%**
61.01-61.17	Knitted or crocheted clothing articles and accessories	20%	20%	0%	6%	10%	10%	**30%**	**36%**
62.01-62.17	Clothing articles and accessories (other than knitted and crocheted)	20%	20%	0%	6%	10%	10%	**30%**	**36%**
63.01-63.07	Other made up articles (including blankets, bedsheets, towels etc.)	3-20%	20%	0%	6%	10%	10%	**0-30%**	**36%**

Source: FBR

Composite and Garments

Rating Curve

PACRA rates 35 textile composite players with a long-term rating bandwidth ranging from BBB- to AA.



Source: PACRA Database

Composite and Garments

SWOT Analysis

- Low cost labor
- Mature and long-standing textile sector
- Strong sector association resulting in high lobbying power

- Imported machinery
- Low BMR resulting in technological obsolescence
- Dollar based input costs leads to thin margins as a result of inefficiencies
- Interdependency on demand from developed markets
- Exposure to economic cycle shifts

- Geographical export concentration
- Intense competition from regional players in international market
- Strong bargaining power of buyers
- Withdrawal of tax credits for expansion and replacement has hindered new investments
- Declining/low quality local cotton production resulting from climate-induced natural disasters and pests.
- Rising borrowing costs (EFS, LTFF and KIBOR) as well as local and global inflation increase the cost of doing business.

- Forward and horizontal integration can be used to produce value added and differentiated products
- Opportunity to increase efficiency through technological upgrade
- Special Economic Zones provide incentives to sector
- Isolation of Chinese manufacturers by US and European retailers and the pursuit of alternative regional sources to meet order demand.

Composite and Garments

Outlook | Stable

- Pakistan's economy posted a real GDP contraction of ~0.17% in FY23 (FY22: ~6.1%), while the LSM declined by ~10.3% (FY22: ~11.8%), owing majorly to supply-chain disruptions which resulted from SBP-imposed import restrictions, along with the flash floods of Aug'22, and consequent sluggish demand across major industrial sectors of the country. The local Textile sector is classified as a Large Scale Manufacturing (LSM) industrial component within the industrial sector. In FY23, the textile industry's weight in the QIM was recorded at ~18.2%.
- In FY23, despite a ~10.7% YoY increase in cultivation area, cotton yield declined by ~45.9% due to floods in Aug'22, resulting in ~41% YoY decrease in cotton production to ~4.9mln bales. FY24 target for cotton production is set at ~12.7mln bales, while the GoP announced an incentive in the form of minimum Support Price (MSP) of PKR~8,500/40kg bag for the FY24 cotton crop.
- In FY23, Textile Group contributed ~3.0% to the country's GDP, reaching a market size of PKR~2,585bln, up ~8.0% YoY. However, Textile exports were down ~14.6% in FY23, constituting ~59% of the country's total exports. Similarly, Textile imports during the year declined ~21.8%, attributable to import restrictions imposed by the SBP during May'22-Jun'23 on the import of raw materials and machinery. The Sector is dominated by ~59 organized composite units, with ~32 listed on the PSX.
- The FY23 dip in gross profit margin resulted from increase in cost of sales (~20% YoY) offsetting the increase in sales. Similarly, operating margins remained at ~13% in FY23 (FY22: ~13%),owing to the increase in operating costs (especially the energy costs) which nullified the increase in gross profit. Similarly, net margins dipped to ~7% from ~9% in FY22, owing to higher finance costs which grew by ~127% YoY owing to the increase in policy rates during the year.
- As per IMF's directives, the GoP withdrew the Regionally Competitive Energy Tariff (RCET) for export-oriented sectors in May'23. Moreover, gas prices were revised upwards as of Nov'23 lowering the competitiveness of Pakistan's export prices. The local textile industry has the highest gas tariff USD~10.3/MMBTU as of Nov'23 amongst regional countries, with high finance costs.
- However, during 4MFY24, export receipts for raw cotton and cotton yarn surged ~137.0% and ~42.8% YoY, respectively. On the other hand, export value of knitwear declined by ~13.4%, while in volumetric terms registered an uptick of ~38.4%. In 1QFY24, the gross, operating and net margins stood at ~16%, ~13% and ~5% respectively, during this period.
- Going forward, while the removal of subsidies under the IMF directives is likely to render exports non-competitive in the international market, Sector's margins are expected to rangebound, owing to domestic factors like higher expected cotton production during FY24, stable interest rates and consistent demand, both locally as well as globally, with global economic activity to rebound. However, the recent gas tariff hikes of Nov'23 are likely to adversely affect Sector's margins, complete impact of which is yet to unfold.

Together. Creating Value.

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