



# Garments Sector

## An Overview

# TABLE OF CONTENTS

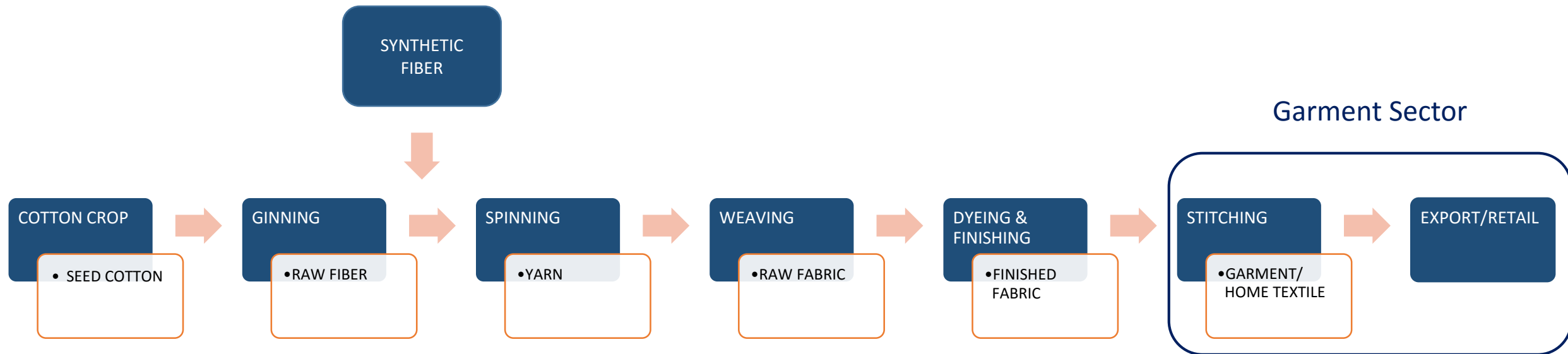


Contents	Page No.	Contents	Page No.
Introduction	1	Duty Structure	11
Global Industry   Overview	2	Working Capital Management	12
Local Industry   Overview	3	Financial Risk	13
Raw Material	4	Rating Curve	14
Exports	5	COVID-19   Impact & Relief Measures	15
Business Risk	7	SWOT Analysis	16
Margins & Cost Structure	8	Outlook & Future Prospects	17
Regional Cost Comparison	9	Bibliography	18
Regulatory Environment	10		

---

# GARMENTS | INTRODUCTION

- Textile cluster has one of the largest value chains in the manufacturing universe in Pakistan.
- The production of garments is the last value adding process within the textile chain. The finished goods consist of a wide variety of products such as denim and knitwear. These products are then sold in both the local and export markets.
- The following flow chart depicts the major processes along with the output of every process of the textile cluster’s value chain.



*Note: Many garment manufacturers are also involved with the dyeing and finishing process for fabrics.*



## Overview

- **Size:** The size of the global garments industry was estimated to be USD~672bln in CY19 as compared to USD~640bln in CY18. The industry exhibited an estimated CAGR of ~7% in a four year period till CY19. However, it is estimated to contract by ~1.9% in CY20 in the aftermath of the COVID-19 crisis with an estimated size of USD~659bln in CY20.
- **Demand Drivers:** The growth of garment industry in pre-pandemic years is attributable to increasing demand in developing countries. Moreover, the rapid pace of urbanization and rising disposable incomes have also historically contributed to the growth.
- **Region Wise Textile Market:** The Asia-Pacific region has largest market share (sales) and accounts for ~32% of global consumption. This is largely because of growing populations alongside increase in disposable incomes. In addition to consumption, the region is also a textile producing hub. It includes countries such as India, China and Bangladesh who are amongst the top producers and exporters of textile finished goods due to easy access to raw material (cotton and yarn) and availability of relatively cheap labor. They cater to both growing local demand and export demand from other regions.
- The second largest region is Western Europe with ~28% market share. In addition, the EU and United States are two of the largest importers of textile finished goods such as garments and apparel. The United States contributes ~18% to global consumption.
- **Demand Trend:** As a result of the COVID-19 pandemic, demand for the garment manufacturing industry was hampered due to lockdown restrictions and higher unemployment that reduced disposable income of consumers. In the first quarter of CY20, global trade of textiles and garments declined by ~12%.
- Since then there had been a gradual recovery in demand and production levels as Covid-19 restrictions began to ease. However, a second wave of the pandemic, which has caused further lockdowns or restrictions in the UK and across Europe may result in slowdown of demand.

## Overview

- **Structure:** The garment manufacturing sector is the last value adding stage within the textile value chain. Finished goods produced by the sector are sold in both local and export markets. Many garment manufacturers have implemented backwards integration in order to increase efficiencies, improve margins and achieve economies of scale. There are ~20 garment manufacturers listed on the Pakistan Stock Exchange and several private players operating in this segment.
- **Size & Significance:** The approximate market size of the garment manufacturing industry (including knitwear) was PKR~1,561bln in FY20 as compared to PKR~1,406bln in FY19. In FY20, the export contribution was of PKR~841bln (54% of market) and grew by ~11% from PKR~757bln (54%) in FY19. This increase was solely attributable to depreciation of currency in the period as there was a decline in exports in both USD and quantitative terms. Meanwhile, the local market size also increased from PKR~649bln in FY19 to PKR~720bln in FY20 due to higher prices of finished goods as a result of inflation.
- **Product Range:** The finished goods produced by the industry fall under two main categories: readymade garments and knitwear. There is large product differentiation as the industry has to cater to a wide range of styles and rapidly changing fashion trends.
- **Demand Drivers:** Demand for garments emanates from both the local and export markets. During FY20, Pakistan's total ready made garments and knitwear exports stood at USD~5,347mln (PKR~841bln) and accounted for ~43% of the country's total textile exports and ~25% of total country exports. The demand for ready made garment and knitwear exports is concentrated towards USA and Europe.

## Raw Material

- The major raw material for the garment manufacturing sector is cotton fabric. Pakistan's annual production of fabric has remained relatively stable in past few years. However, there was a ~11% YoY decline in the production of fabric during FY20 as a result of the COVID-19 pandemic and its fallout in 4QFY20.
- Production of grey cloth has the greatest share in overall cloth production. Meanwhile, dyed and printed cloth also has a significant share in total cloth production.

Production of Cloth (000 Sq. M)	FY16	FY17	FY18	FY19	FY20*
Grey	571,393	584,532	582,812	583,374	521,211
Bleached	87,852	75,801	111,110	114,156	101,992
Dyed & Printed	302,781	299,519	269,082	267,397	238,904
Blended	77,157	83,488	80,736	81,073	72,434
<b>Total</b>	<b>1,039,183</b>	<b>1,043,340</b>	<b>1,043,740</b>	<b>1,046,000</b>	<b>934,540</b>

\*FY20 figures are prorated

# GARMENTS | LOCAL INDUSTRY

## Garment Exports

- Pakistan’s textile exports contribute ~59% to the country’s total exports and this figure has remained relatively consistent in recent years.
- Among textile exports, the largest share is occupied by knitwear and readymade garments that contribute ~22% and ~20%, respectively to total textile exports.
- Prior to FY20, there was an increasing trend in the exports of the garments sector. However, the exports remained largely stagnated in dollar terms but increased in rupee terms due to depreciation of local currency.
- In FY20, there was an overall decline in ready made garment exports (-4%) and clocked in at USD~2,552mIn as compared to USD~2,653mIn in FY19. Meanwhile, exports of knitwear also declined by ~4% and stood at USD~2,792mIn in FY20 as compared to USD~2,900mIn in FY19.
- During 4MFY21, the exports of readymade garments grew ~5% and stood at USD~947mIn as compared to USD~905mIn in 4MFY20. Moreover, the knitwear exports also grew by ~12% and clocked in at USD~1,184mIn during 4MFY21 as compared to USD~1,054mIn in 4MFY20.
- The average price of knitwear products has increased from USD~21,017 per Th. Doz in FY16 to USD~26,414 per Th. Doz in FY20. However, average price of ready made garment products decreased from USD~66,978 per Th. Doz in FY16 to USD~50,981 per Th. Doz in FY20.

Garment Exports (USD mIn)	FY16		FY17		FY18		FY19		FY20		4MFY21	
	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value
Knitwear (Th. Doz)	112,459	2,364	104,091	2,361	108,503	2,720	117,673	2,900	105,777	2,794	48,425	1,184
Ready Made Garments (Th. Doz)	32,775	2,195	35,158	2,319	40,149	2,579	55,665	2,653	50,058	2,552	11,378	947
<b>Total Textile</b>		<b>12,447</b>		<b>12,451</b>		<b>13,530</b>		<b>13,328</b>		<b>12,527</b>		<b>4,760</b>

Note: Th. Doz stands for Thousand Dozens.

## Garment Exports

- The adjacent tables show major export destinations of ready-made garments and knitwear.
- Exports of ready made garments are concentrated towards the USA with ~24% share. Other export destinations include European countries such as Spain, UK, Germany and Netherlands.
- Meanwhile, in the knitwear category, exports to USA constitute ~36% of total exports. Other major export destinations are mainly European countries such as UK, Germany, Netherlands and Spain.
- Pakistan gains access to the European Union market through its GSP+ status. Approximately 80% of Pakistan's textile exports enter the EU at preferential tariff rates. The status is periodically reviewed and was recently extended till 2022.

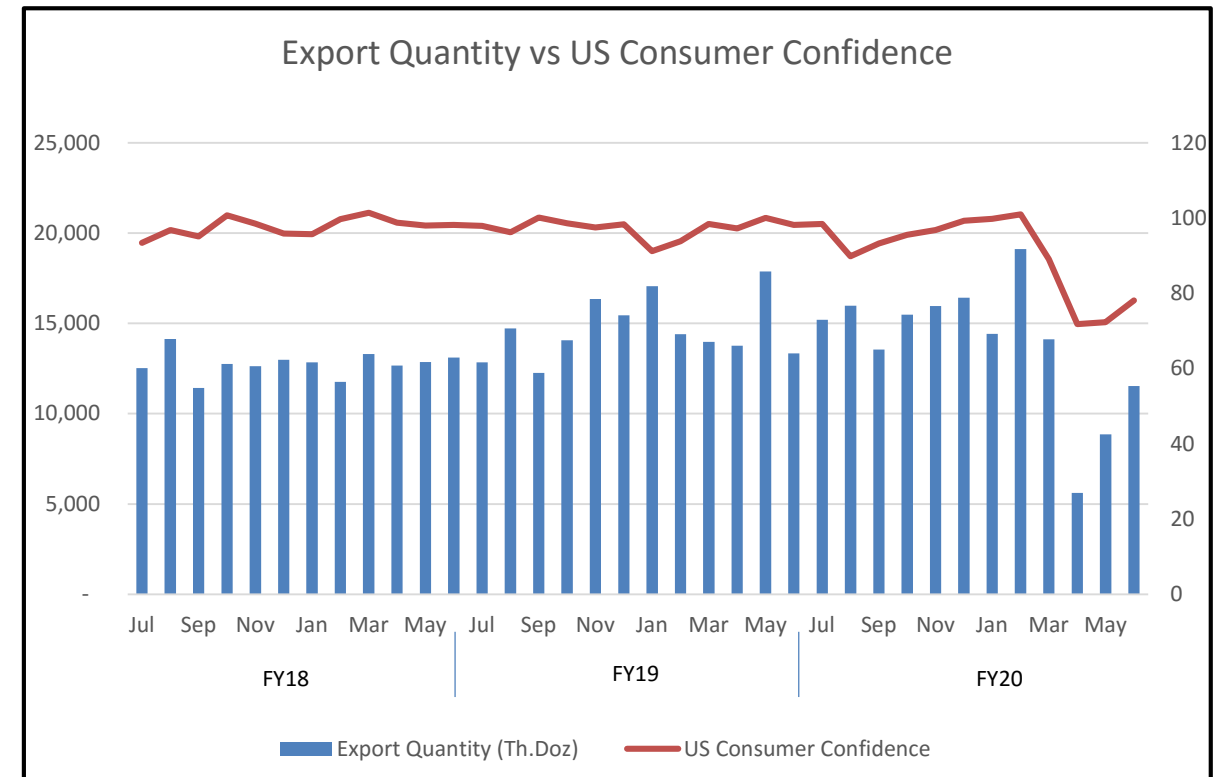
Ready Made Garments	FY18		FY19		FY20	
	Amount (USD 000)	%	Amount (USD 000)	%	Amount (USD 000)	%
USA	552,627	21%	622,272	23%	604,261	24%
Spain	348,204	14%	344,528	13%	291,210	11%
UK	327,256	13%	295,845	11%	288,062	11%
Germany	324,659	13%	286,967	11%	278,997	11%
Netherlands	142,321	6%	200,653	8%	240,259	9%
Other	882,151	34%	903,455	34%	849,797	33%
<b>Total</b>	<b>2,577,218</b>	<b>100%</b>	<b>2,653,720</b>	<b>100%</b>	<b>2,552,586</b>	<b>100%</b>

Knitwear	FY18		FY19		FY20	
	Amount (USD 000)	%	Amount (USD 000)	%	Amount (USD 000)	%
USA	963,797	36%	1,083,225	37%	999,633	36%
UK	427,183	16%	418,940	14%	397,438	14%
Germany	218,624	8%	224,263	8%	253,117	9%
Netherlands	197,378	7%	234,612	8%	242,388	9%
Spain	202,811	7%	221,320	8%	191,508	7%
Other	701,408	26%	717,517	25%	710,439	25%
<b>Total</b>	<b>2,719,201</b>	<b>100%</b>	<b>2,899,877</b>	<b>100%</b>	<b>2,794,523</b>	<b>100%</b>



## Business Risk

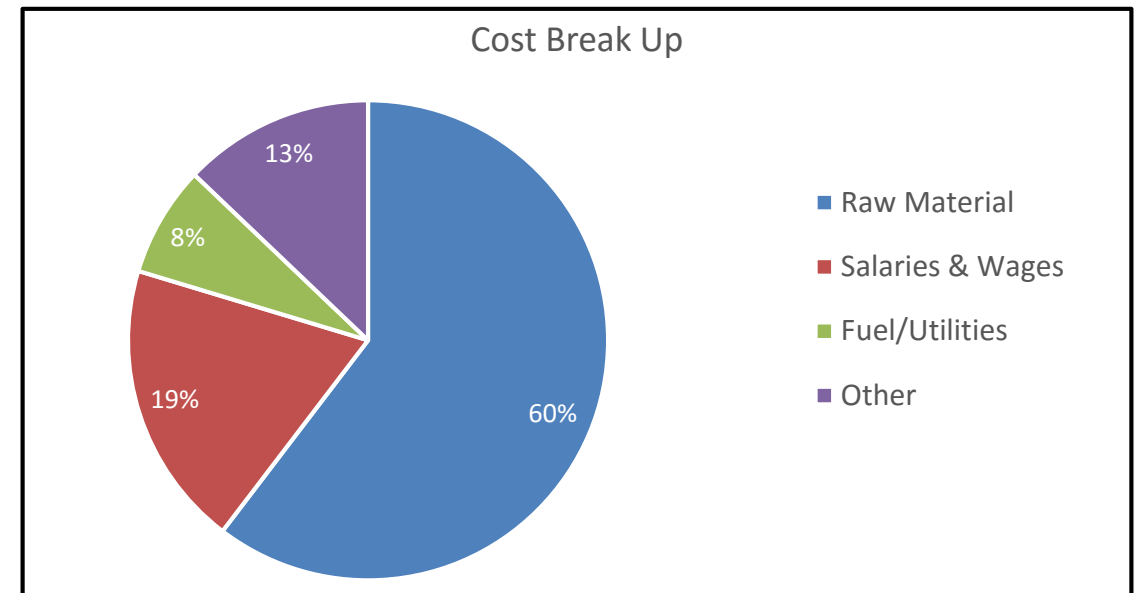
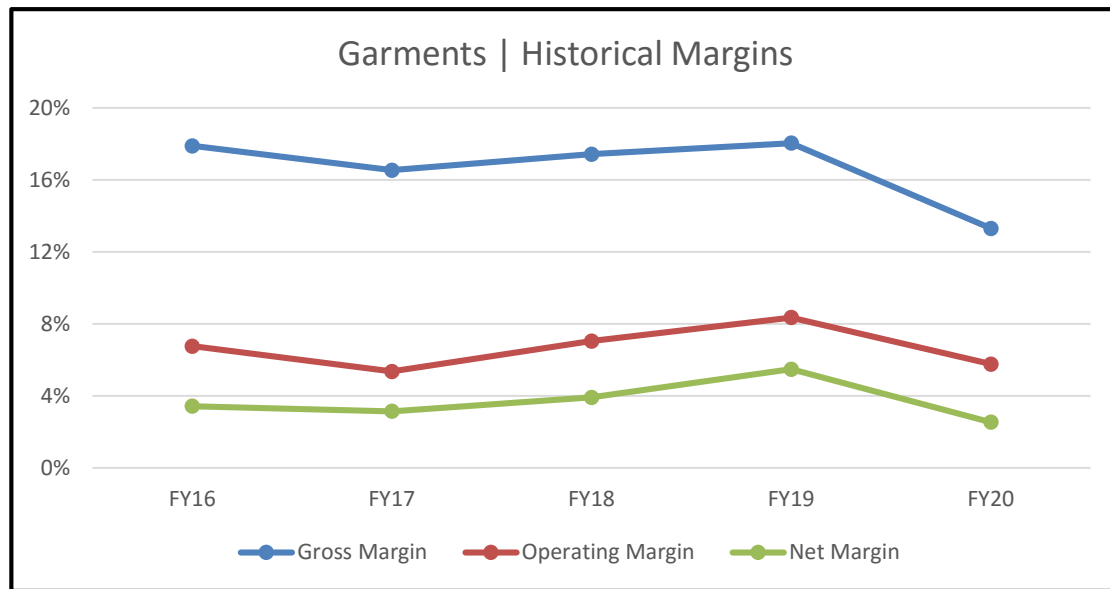
- A significant portion of demand for the garment sector is derived from exports to international clothing brands based in Europe and North America. The adjacent graph shows positive correlation between monthly export of garments and knitwear with US consumer confidence index.
- The COVID-19 pandemic caused a decline in demand both in export and local market as export orders were cancelled or delayed and local consumers faced reduced purchasing power in adverse economic conditions. Moreover, manufacturing operations were also briefly suspended during the lockdown.
- In recent months, the sector has significantly recovered and is in a better position than some regional competitors who are still dealing with COVID-19 crisis. As a result, some international orders are shifting towards Pakistan. However, a second wave of COVID-19 has caused renewed lockdowns and restrictions in Europe and this may hamper recovery as demand may remain low.
- During 1QFY21, the textile industry has witnessed a recovery and according to the Large Scale Manufacturing index, grew by ~2.08% as compared to same period last year.



# GARMENTS | LOCAL INDUSTRY

## Margins & Cost Structure

- Prior to FY20, the garment manufacturing sector’s margins had remained relatively stable, with slight increase in net margins from ~3% in FY16 to ~5% in FY19.
- However, in FY20 margins declined significantly with average net margin clocking in at ~3% (FY19: ~5%) and average gross margin clocking in at ~13% (FY19: ~18%). The decline in margins occurred mostly due to the rising cost of raw material and slight increases in interest costs and salaries and wages.
- The largest component within direct costs is raw material comprising ~60% of the total manufacturing cost. The raw material for the sector, cotton fabric, has been impacted by the declining local cotton production and rising cotton prices, both locally and internationally, in the aftermath of COVID-19 pandemic.

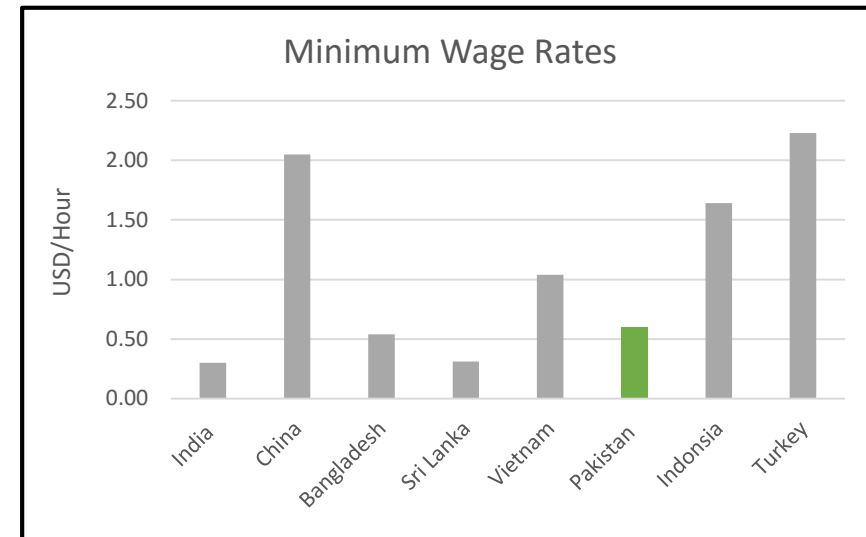
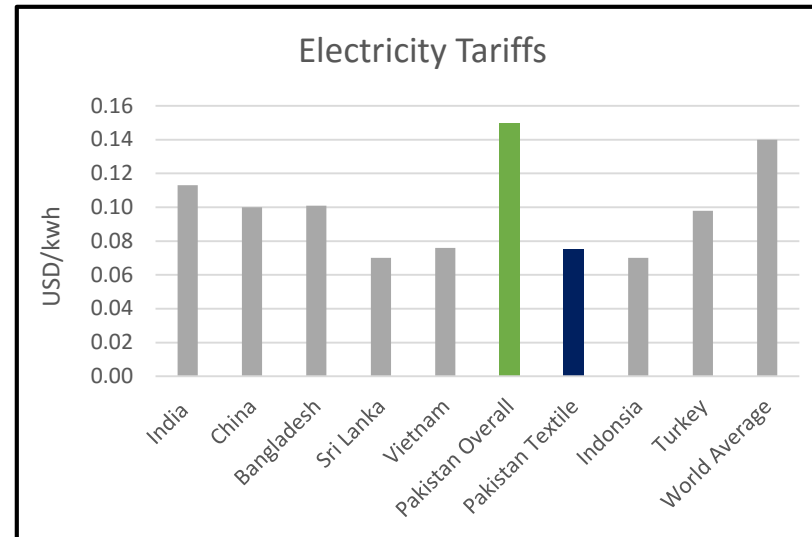
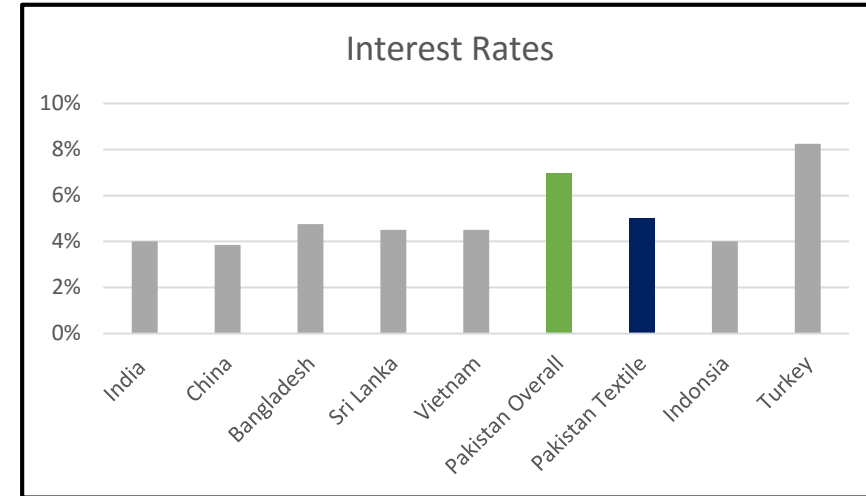


Note: Average margins and cost structure is reflective of ~10 listed/rated players

# GARMENTS | LOCAL INDUSTRY

## Regional Cost Comparison

- Pakistan has the second highest interest rate in the region behind Turkey. The high cost of borrowing acts as a barrier to investments in various sectors. Garments, on the contrary, falls in the ambit of export sector which has access to subsidized financing facilities from the SBP in the form of short term Export Refinance Facility (ERF) and Long Term Financing Facility (LTFF). On regional level, China has the lowest borrowing rate.
- The Pakistani businesses face competitive disadvantage due to the high electricity tariffs it incurs which exceed all regional players. However, the government provides subsidized electricity and gas at internationally competitive prices to the textile cluster. In contrast, Sri Lanka and Indonesia have access to the lowest electricity tariffs in the region.
- Pakistan's minimum wage translates to 0.6 USD per hour which is higher than countries such as Sri Lanka, Bangladesh and India. However, we maintain competitive advantage of low labor cost over regional players China, Vietnam, Indonesia and Turkey.



## Regulatory Environment

- With respect to Income Tax, the garment sector is under the Normal Tax Regime (NTR). Further, the sector is also subject to Minimum Tax @ 1.5% 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.
- The sector receives subsidized financing from SBP under the following schemes;
  - Long Term Financing Facility (LTFF) up to PKR 5bln for installation of new plant & machinery @ ~34%.
- Govt. provides subsidized electricity at USD 7.5 cents/kwh and gas at USD 6.5/mmbtu in order to increase export competitiveness in international markets.
- Duty structure of the sector provides protection to the local players.
- Govt. also provides Drawback of Local Taxes and Levies (DLTL) at the rate of 2% on eligible product line of processed fabric (2% additional drawback is also allowable for exports to non-traditional markets).
- In addition, sales tax of 17% is applicable on finished goods of the garments sector. However, retailers integrated with FBR have an applicable sales tax of 14%.
- All Pakistan Textile Mill Association (APTMA) acts as the national trade association of textile cluster in the country. It represent 396 textile mills which fall under spinning, weaving and composite categories.

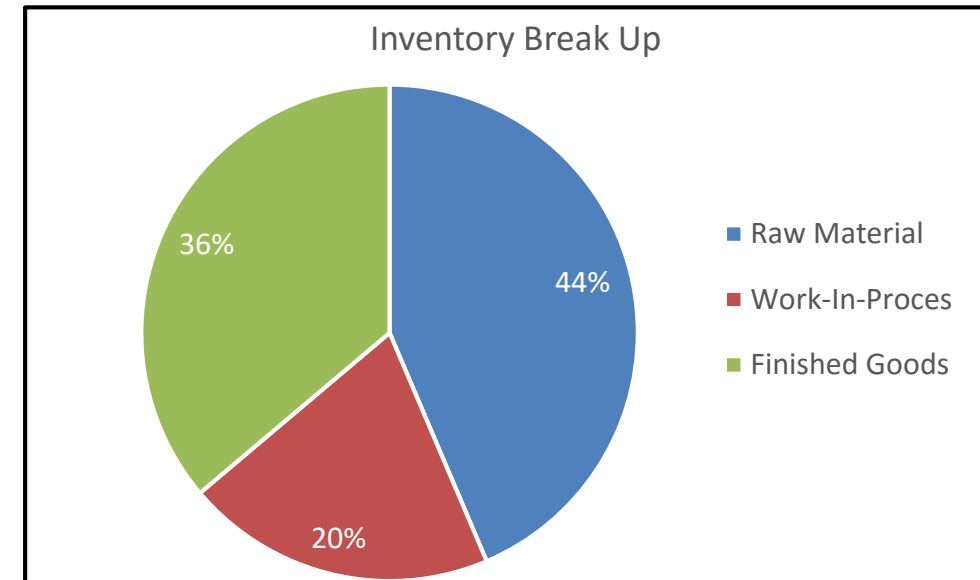
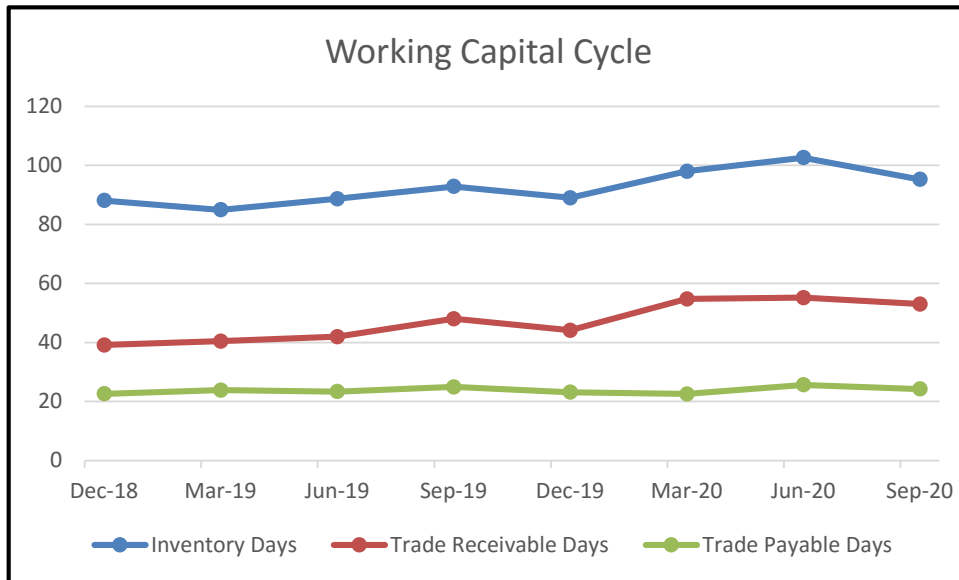
## Duty Structure

PCT Code	Description	Additional Custom Duty		Custom Duty		Regulatory Duty		Total	
		FY20	FY19	FY20	FY19	FY20	FY19	FY20	FY19
52.08	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing not more than 200g/m <sup>2</sup>	7%	0%	20%	20%	10%	10%	37%	30%
52.09	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing more than 200g/m <sup>2</sup>	7%	0%	20%	20%	10%	10%	37%	30%
52.10	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with man-made fibres, weighing not more than 200g/m <sup>2</sup>	4%	0%	16%	16%	10%	10%	30%	26%
52.11	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with man-made fibres, weighing more than 200g/m <sup>2</sup>	4%	0%	16%	16%	10%	10%	30%	26%
52.12	Other woven fabrics of cotton	7%	0%	20%	20%	10%	10%	37%	30%
61.01-61.17	Knitted or crocheted clothing articles and accessories	7%	0%	20%	20%	10%	0%	37%	20%
62.01-62.17	Clothing articles and accessories (other than knitted and crocheted)	7%	0%	20%	20%	10%	5%	37%	25%

# GARMENTS | LOCAL INDUSTRY

## Financial Risk | Working Capital Management

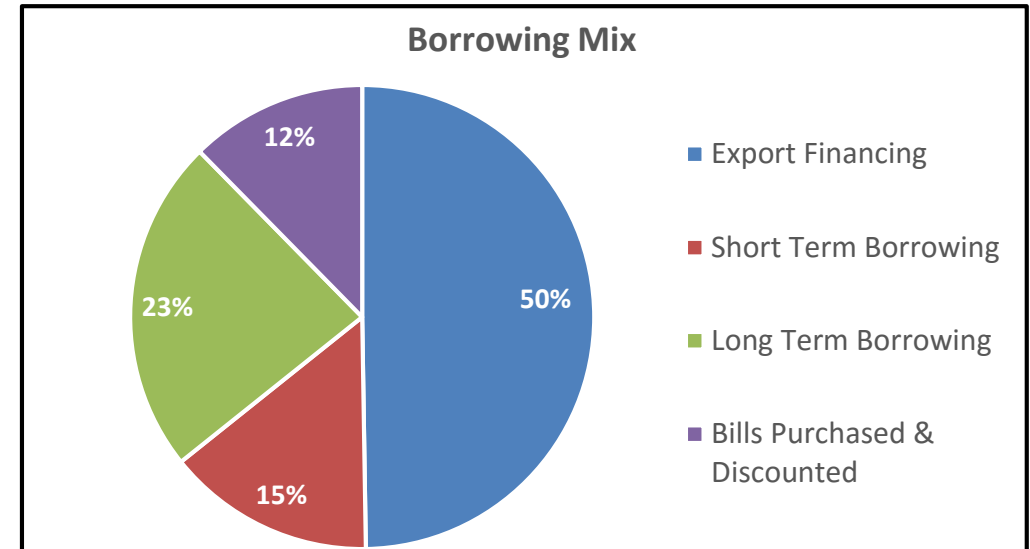
- The garment sector’s working capital needs are largely a function of inventory and trade receivables.
- The average working capital cycle for the industry is ~110-115 days. There has been an overall increase in the sector’s working capital cycle with net working capital days clocking in at 132 days at the end of FY20 as compared to 107 days at the end of FY19. As seen in the graph, the greatest increase was in inventory and trade receivable days while trade payable days remained relatively stable.
- This is due to the COVID-19 pandemic which caused a significant decline in demand which resulted in cancelled or delayed orders. However, there was also suspension of operations during lockdown period which prevented further increase in inventory build up.



*Note: Average working capital cycle and inventory breakup is reflective of ~10 listed/rated players*

## Financial Risk | Borrowings

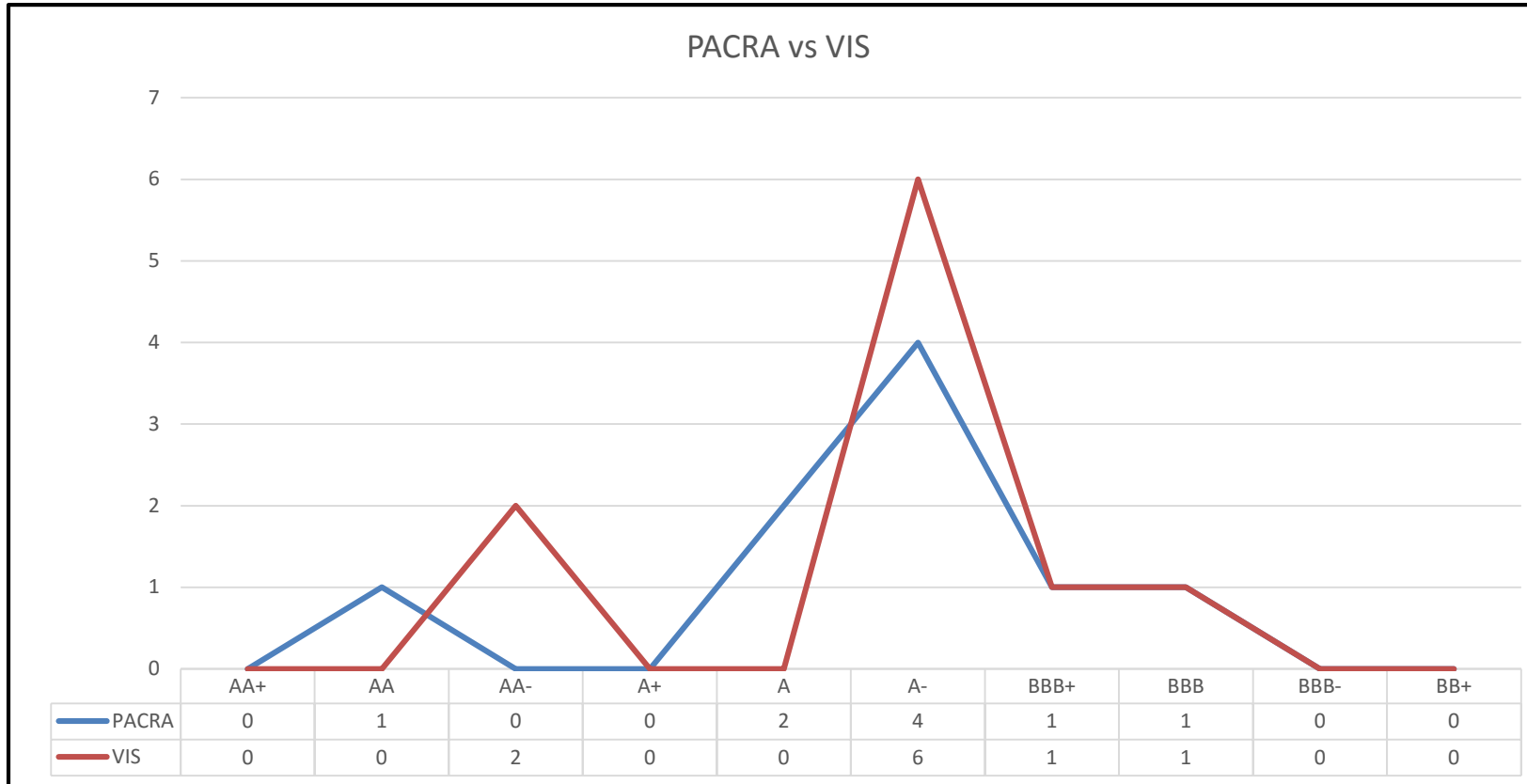
- The total borrowing for garment sector in October 2020 stood at PKR~154bln as compared to PKR~126bln in October 2019.
- The largest component within the borrowing of garment manufacturing sector is export refinance which stands at PKR~76bln and contributes ~50% to total borrowings. Other short-term borrowings contribute ~15% and stands at PKR~22bln.
- Meanwhile, long-term borrowing contributes ~23% and stands at PKR~36bln of which PKR~21bln consists of LTFF borrowing.
- The average leveraging of the garment sector is moderate at ~50%.



*Note: Average leveraging is reflective of ~10 listed/rated players*



## Rating Curve



Total Market Capitalization:  
PKR~192bln



Rated Capitalization:  
PKR~104bln



Market Capitalization  
Rated by PACRA:  
PKR~69bln

Note: Capitalization figures include textile composite units with garment manufacturing segments.



## COVID-19 | Impact & Relief Measures

- The demand for exports is highly dependent on demand from European & North American markets. Since the spread of COVID-19 and subsequent impositions of countrywide lockdowns, major brands in USA and Europe had shut down retail operations resulting in orders on hold or cancellation.
- Local demand was also impacted negatively during 4QFY20 on the back of countrywide lockdowns. The businesses missed peak demand seasons of Eid, which represent a significant share of total local demand.
- The lockdown impacted supply chain for raw materials such as cotton, synthetic fibers and dyes. However, businesses maintained sufficient inventory of 2-3 months, which provided time to re-establish supply chains.
- The garment sector had to suspend operations for a brief time period before being granted exemption from lockdown by the government. Despite this, capacity utilization remained low and demand was significantly reduced.
- In order to relieve liquidity pressure on the sector, the SBP allowed to defer principal repayments for one year to the corporate sector. Further, the SBP also allowed to restructure loans up to 30th June 2020.
- The SBP also reduced benchmark rate by 625bps to 7%. This is expected to reduce finance costs of the industry by PKR~3,967mln and improve bottom-line.
- The SBP also relaxed certain requirements of the Export Finance Scheme in order to provide relief to exporters. These relaxations included six month extension in shipping period for those availing EFS Part I loan and reduction of export performance requirement from 2 times to 1.5 times for those availing EFS Part II facility.
- While the impact of COVID-19 was significant, the sector along with the overall economy have started to experience a recovery during 1QFY21.



# GARMENTS | LOCAL INDUSTRY

## SWOT Analysis

- Availability of local raw material
- Strong support from government and SBP
- Mature and long-standing textile sector
- GSP+ status from European Union
- Strong sector association resulting in high lobbying power
- Recent PKR depreciation leading to improved international competitiveness

- Imported machinery
- Low BMR resulting in technological obsolescence
- Low quality of local raw material
- Declining local cotton production



- Geographical export concentration
- Intense competition from regional players in international market
- Strong bargaining power of buyers
- Interdependency on demand from developed markets
- Withdrawal of tax credits for expansion and replacement has hindered new investments
- Bankruptcy in retail chains worldwide

- Horizontal integration can be used to produce value added and differentiated product
- Increase efficiency through technological upgrade
- Special Economic Zones provide incentives to sector
- Subsidized cost & financing structure provides competitive advantage.

## Outlook: Stable

- Despite significant challenges faced due to the COVID-19 pandemic the garment industry has been making a recovery in recent months as restrictions both in Pakistan and abroad have eased allowing the industry to resume operations and resulting in gradual increase in demand.
- Pakistan has also attracted additional export orders as regional competitors such as India and Bangladesh were unable to control COVID-19 crisis and thus not able to meet export orders in a timely manner. Imports from India and Bangladesh fell by ~41% and ~32%, respectively during the 2HFY20 as compared to the same period in previous year.
- As a result, readymade garment exports grew by ~5% YoY in 1QFY21 and clocked in at USD~701mln (PKR~117bln) as compared to USD~667mln (PKR~105bln) in 1QFY20. Moreover, knitwear exports grew by ~11% YoY in 1QFY21 and stood at USD~861mln (PKR~14bln) as compared to USD~779mln (PKR~123bln) in 1QFY20.
- As the industry is a major contributor to GDP and total exports, it also receives significant support from the government in the form of subsidized borrowings and subsidized energy prices. Although there were recent news of increase in electricity tariff from 7.5 cents/kWh to 9 cents/kWh, the rate is expected to remain the same for the next two months.
- On the contrary, export demand can still decline again as a result of second wave of COVID-19 pandemic due to which there has been a reintroduction of greater restrictions and lockdowns in UK and other European countries.
- The reduction in benchmark rate by 625bps is expected to reduce the garment industry's finance costs by PKR~3,967mln and thus improve profitability.
- Moreover, the exchange rate is expected to remain stable in the near future thus reducing risk associated with the import of raw material.

- Pakistan Bureau of Statistics (PBS)
- Pakistan Stock Exchange (PSX)
- State Bank of Pakistan (SBP)
- Federal Board of Revenue (FBR)
- Textile Commissioner's Organization (TCO)
- Trade Development Authority of Pakistan (TDAP)
- All Pakistan Textile Mills Association (APTMA)
- Investing.com
- Statista
- UNCTAD
- International Labor Organization
- Business Recorder
- University of Michigan
- PACRA database
- <https://ec.europa.eu/trade/policy/countries-and-regions/countries/pakistan/>
- <https://www.prnewswire.com/news-releases/global-apparel-market-to-experience-a-1-9-yoy-growth-decline-during-2019-2020-due-to-covid-19--301080256.html>

<b>Research Team</b>	<b>Saniya Tauseef</b> <i>Asst. Manager</i> <a href="mailto:saniya.tauseef@pacra.com">saniya.tauseef@pacra.com</a>	<b>Insia Raza</b> <i>Associate Analyst</i> <a href="mailto:insia.raza@pacra.com">insia.raza@pacra.com</a>
<b>Contact Number: +92 323 8457222</b>		

## DISCLAIMER

PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. The information in this document may be copied or otherwise reproduced, in whole or in part, provided the source is duly acknowledged. The presentation should not be relied upon as professional advice.