



Towels Sector

Sector Study

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Introduction

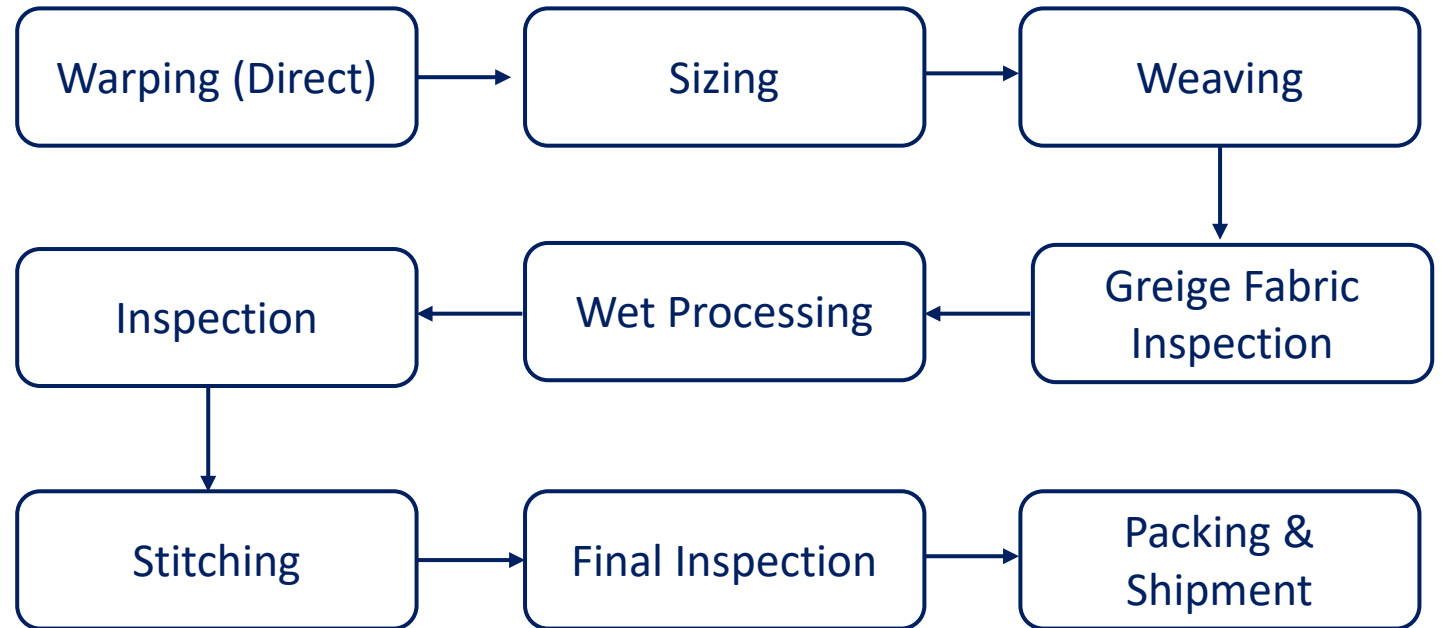
- Terry towels, more commonly known simply as towels, are thick, absorbent cloths used for drying or wiping moisture.
- They are made of pile loops on one or both sides of the fabric, covering the entire surface. The loops are often formed into strips, checks or other decorative patterns. Length of loop determines fluid absorption ability, therefore, longer loops absorb a larger amount of water.
- Cotton is the most common fiber used for the production of towels due to its natural qualities which include:
 - Absorbency
 - Wet Strength
 - Hypoallergenic
- Other fibers sometimes used in towel production include polyester, nylon, flax and bamboo.
- There are several varieties of towels, categorized either by their usage or dimensions. The most commonly used types of towels are beach towels, bath towels, hand towels and wash cloths.





Manufacturing Process

- The adjacent flow chart shows various processes involved in the production of towels
- Terry towel is type of woven fabrics where two 2 beams are used to weave this fabric. One beam for ground fabrication and other beam for loop formation.
- Wet processing involves multiple stages including scouring, bleaching, dyeing and finishing.
- Finishing can be done through chemical process such as antimicrobial treatment or mechanical process such as tumble drying which increases softness.





Overview | Global Industry

- The global towels market is largely segmented into kitchen and bath towels. The combined size of both the market is estimated to stand at USD~13.8bln in CY22 as compared to USD~8.2bln in CY21. Growth is expected to slow down for at least the first half of CY23, at a minimum, as global economies suffer from recession and the resulting weak global demand.
- The global kitchen towel market is estimated to have a value of USD~2.6bln in CY23 growing ~4.8% from a market size of USD~2.4bln in CY22. The Russian-Ukraine war dampened expectations of success after economies recovered from economic slowdown during the Covid-19 era. The war between the two countries led to economic sanctions which precipitated a surge in commodity prices, supply chain disruptions, and inflation in the prices of goods and services.
- Meanwhile, the market value of bath towel segment reached USD~11.2bln in CY22, with an expected cumulative average growth between CY23 to CY27. The hospitality sector is a key driver of the growth in the bath towels sector.
- Prior to 2020, the growth in towel market was spurred by rapid urbanization and growing income levels, which led to improved standards of living and increased spending on home care products. Growth was hampered during CY20 due to the pandemic, however, the towel market has exhibited healthy growth during CY21 as demand recovered and major retail outlets were able to reopen.
- Some of the prominent players in towel manufacturing include Welspun, Trident Group, 1888 Mills, Loftex, Noman Group, Alok Industries and American Textile Systems.
- On the consumption side, major retail outlets such as Kohl's, Walmart, Asda and Home Depot play a significant role as they cater to household and individual demand.



Top 5 Importers of Terry Toweling

USD mln	CY17	CY18	CY19	CY20	CY21
USA	2,115	2,111	2,064	1,867	2,612
Japan	538	543	550	459	500
Germany	309	312	289	283	329
UK	253	242	248	197	215
France	225	231	205	173	227
Other	2,117	2,245	2,183	1,885	4,978
Total	5,333	5,453	5,335	4,691	6,025

Top 5 Exporters of Terry Toweling

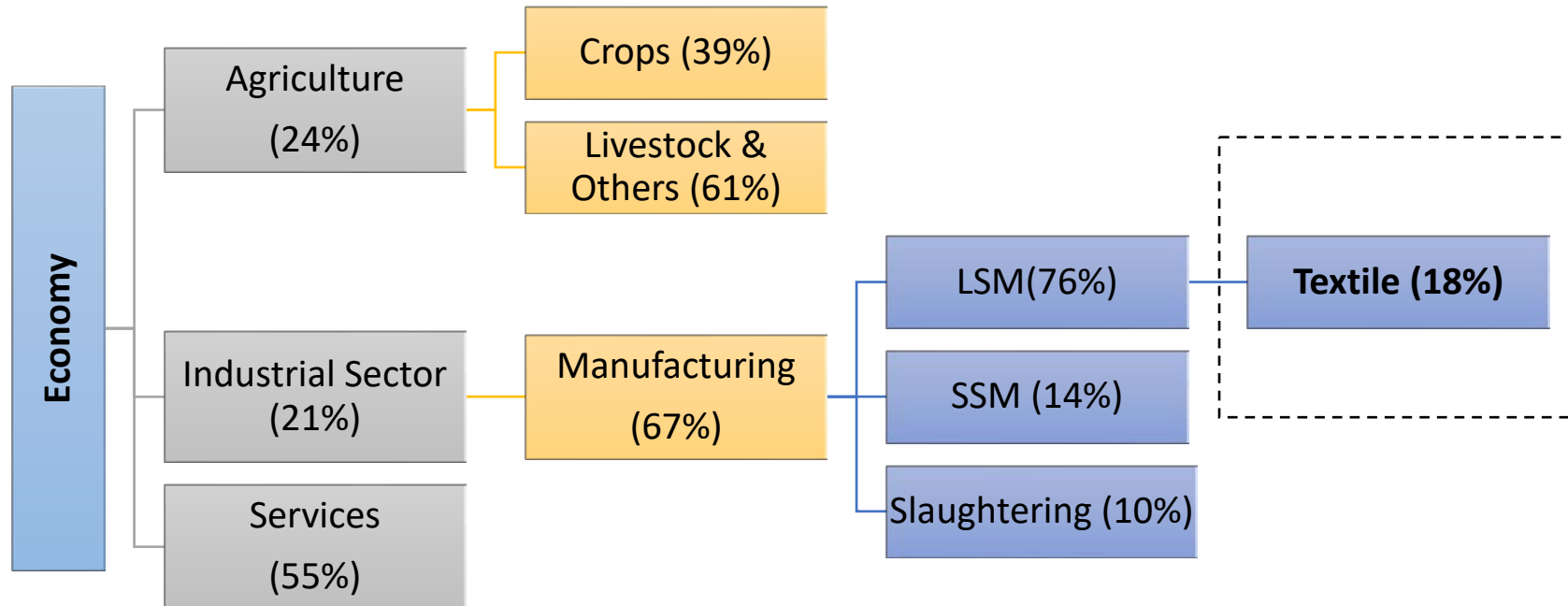
USD mln	CY17	CY18	CY19	CY20	CY21
China	2,759	2,873	2,383	2,032	2,456
Pakistan	805	786	785	777	1,017
India	1,031	1,055	1,082	1,009	1,014
Turkey	608	599	568	531	689
Portugal	216	258	209	186	248
Other	1,051	1,137	1,132	997	1,217
Total	6,470	6,710	6,159	5,332	6,643

- In CY21, global trade rebounded following CY20 wherein trade activity was depressed. In CY21, towel exports increased by ~20% compared to the SPLY owing to an increase in demand as global economies resumed economic activity after Covid-19.
- From CY17-CY21, USA remained the largest importer of towels with imports of just over USD~2bln from CY17 to CY19 and CY21. During CY21, USA's imports stood at USD~2.6bln. Meanwhile, in regional terms Europe is also a major importer with countries such as Germany, UK and France having significant towel imports.
- Similar to other textile segments, the supply or export of towels is concentrated in the Asian continent. This is due to the easy access to raw material and cheap labor.
- The top 5 exporters consist of China, India, Pakistan, Turkey and Portugal and together they account for approximately ~82% of the total export market.

Composite and Garments

Local Economy and Textile Industry | An Overview

- In FY22 Pakistan’s GDP (nominal) stood at PKR~66.9trln (FY21: PKR~55.8trln) and posted a growth in real terms of ~6.0% (FY21: ~5.7%). Industrial activities in FY22 represented ~19% share in the GDP while manufacturing activities represent a ~76% value addition in industrial activities.
- Large Scale Manufacturing (LSM) in Pakistan is essential for economic growth considering its linkages with other sectors, as it represents ~76% value of all manufacturing activities in FY22. The LSM grew by ~11.7% in FY22 (FY21: ~11.3%) but declined by ~0.4% in the 3MFY23 period.
- The textile sector is classified as a Large Scale Manufacturing (LSM) industrial component within the industrial sector. In FY21 and FY22, the textile industry’s weight in the QIM was ~18.2%. Towels has a 0.59% in the textile category of the QIM.



Overview | Local Industry

- In Pakistan, there are approximately 10,000 towel looms, including shuttle and shuttle less looms operating in both organized and unorganized segments of the towel manufacturing sector.
- The towel sector is predominantly export oriented. During FY22, exports clocked in at PKR~198bln (USD~1,111mln) as compared to PKR~150bln (USD~938mln) in FY21. The ~32.1% increase in FY22's export revenue (in PKR terms) was attributable to a ~4% volumetric increase while the remainder ~28% is a combination of an increase in export price of ~18% and depreciation of the PKR/USD value of ~13%.
- During the 5MFY23 period, towel exports stood at PKR~91bln (USD~410mln) as compared to PKR~78bln (USD~429mln) in 5MFY22. This reflects a growth of ~27% in PKR terms. Meanwhile, there was ~16% decline in quantitative terms. This decline was mainly due to global recessionary conditions putting downward pressure on export orders.
- During FY22 and 5MFY23, the towel sector's contribution to overall textile exports was ~6%. Meanwhile, contribution to total country exports was ~3%.
- The sector is represented by both the All Pakistan Textile Mills Association (APTMA) and the Towel Manufacturers Association of Pakistan (TMA). Currently there are approximately 197 towel manufacturing players registered as members of TMA. These players are largely concentrated in the South region. There are only four players listed on the Pakistan Stock Exchange and they have a combined free market capitalization of PKR~26,983mln as at 13th January, 2023.

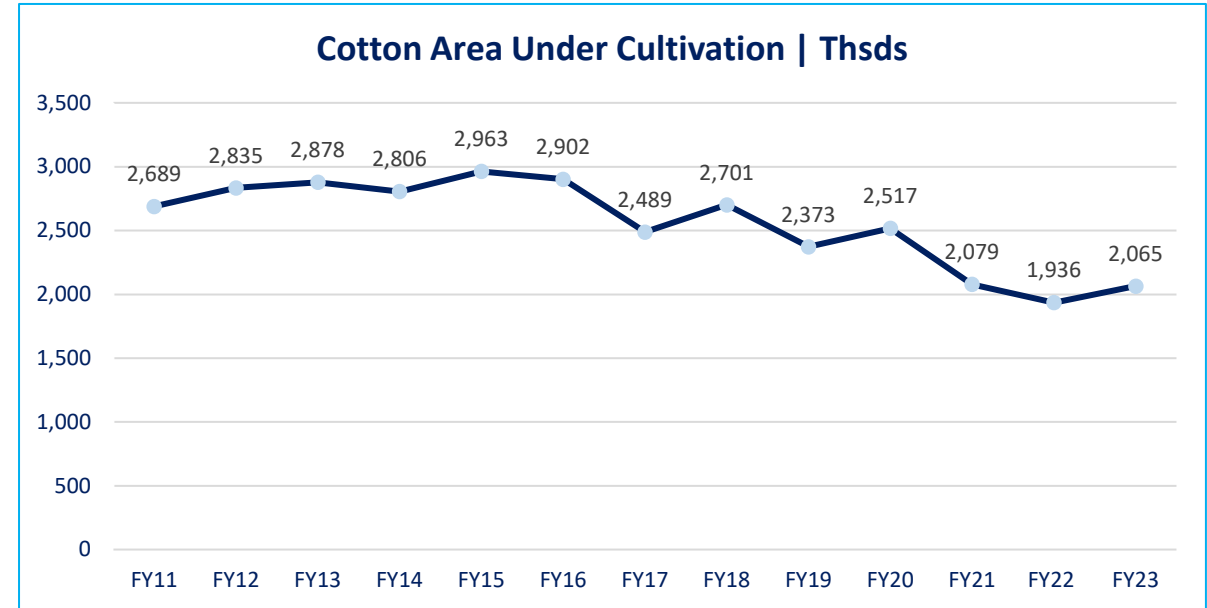
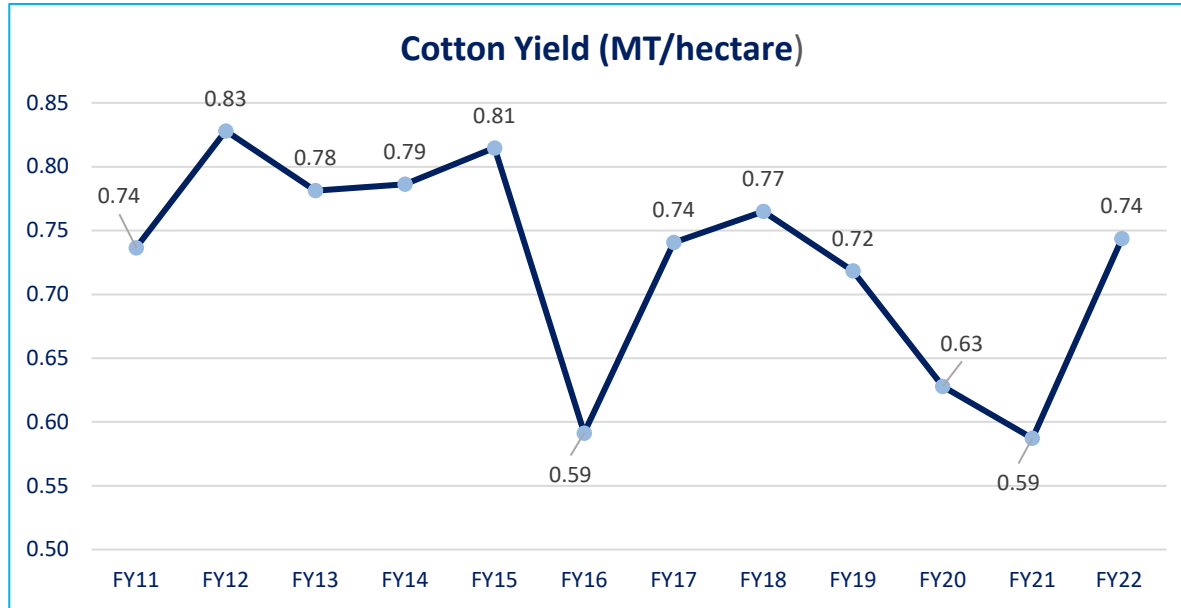
Sector Overview	FY20	FY21	FY22	5MFY22	5MFY23
Towel Exports Value (PKR bln)	112	150	198	72	91
Share of Total Textile Exports	6%	6%	6%	6%	6%
Share of Total Country Exports	3%	4%	3%	3%	3%
Towel Exports Quantity (000 MT)	173	212	221	93	79
No of Players	~197 Players				
Industry Association	Towel Manufacturers Association (TMA)				

Local Industry | Cotton Dynamics | Pre-floods

Pakistan's Cotton Supply (Bales 000s)							
	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Opening Stock	550	-	440	681	821	1,652	1,648
Production	9,917	10,671	11,946	9,861	9,148	7,064	8,328
Imports	2,453	2,976	3,251	2,439	2,777	5,037	4,562
Total supply	12,920	13,647	15,637	12,981	12,746	13,753	14,538*
Local consumption	12,633	13,060	14,749	12,085	11,019	12,102	13,995
Exports	287	147	207	75	75	3	16
Closing stock	-	440	681	821	1,652	1,648	526

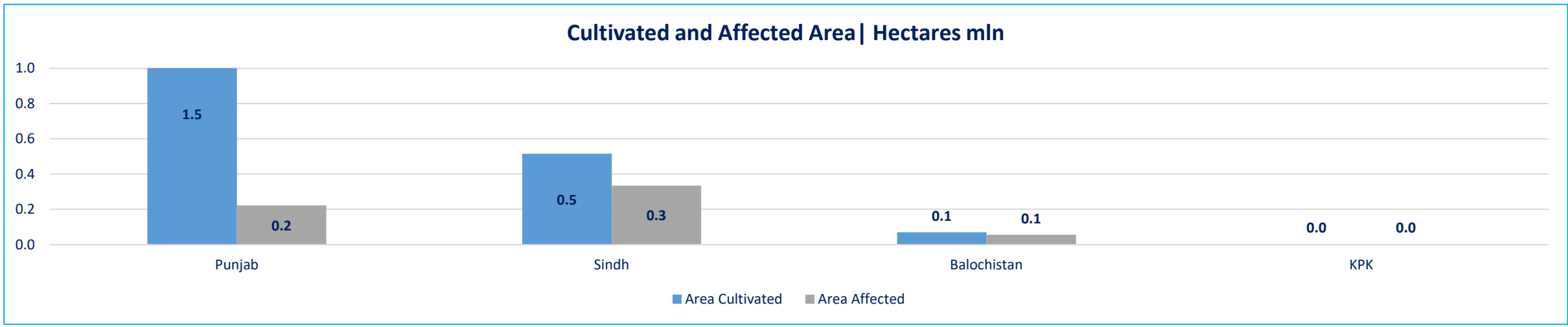
- The majority of Pakistan's crop is grown in Punjab (~71.9%) and Sindh (~25.3%) while KPK and Balochistan share a relatively smaller segment of the total growing area. Pakistan's cotton production increased by ~8.9% in FY22 (FY21: ~-22.8%) due to an improvement in yield by ~25.4% (FY21: ~-6.3%), conducive weather conditions, smooth input supplies, and better crop management practices.
- Despite these promising results, Pakistan missed its cotton production target for 2021-22 of ~10.5mln bales (SPLY: ~10.9mln) owing to drought, high temperatures and dry weather at the start of the season, achieving a production of ~8.3mln bales (SPLY: ~7.1mln). In FY23 a production target of ~11 mln bales was hoped to be achieved, a figure which will be significantly revised following the monsoon flash floods (as discussed in the report) .
- FY22 was the first year Pakistan's net imports of raw cotton declined after previously dipping in FY19. Prior to FY22, cotton imports rose by ~78.1% over the FY17-FY21 period. The ~9.5% decline in FY22 imports can be attributable to the significant currency depreciation serving to increased import prices as well as a ~18% YoY increase in local production.
- Prior to the monsoon (Aug-22) flash floods, the proposed cotton crop target for the 2022-23 season was ~11.03mln bales) of which ~59.8% had been budgeted for Punjab and ~36.3% for Sindh and the remainder for KPK and Balochistan.

Cotton Dynamics | Cultivation Area and Yield | Before the Flash Floods



- The improvement in cotton yield came despite the fact that the area under cultivation decreased by ~6.9% in FY22 (FY21 decrease: ~-17.4%). The area under cultivation in FY23 Kharif season has been recorded at ~2.1mln hectares, a ~6.7% increase from FY22 when the area under cultivation was ~1.94mln hectares.
- Climate change related factors - heat wave and unprecedented water shortages at sowing time, March-22 onwards, and replacement of cotton by other crops, such as sugarcane and maize, explain the decline in area under cultivation in FY22.
- For FY23 (pre-floods), the sowing of the cotton crop for the 2022-23 season has been complete in Punjab and is in its final stages in Sindh. The cultivated area of cotton in Punjab is ~1.5mln hectares (~81.5% of the FY23 target), ~16.1% higher than previous year but ~18.5% lower than the target set, while sowing area in Sindh was registered at ~0.5mln hectares (~80.5% of the target), ~13.0% and ~19.5% lower than the previous year and FY23 target, respectively. The shift in crop preference has a reason to play for this decline in sowing area.

Cotton Dynamics | Monsoon-22 Flashfloods



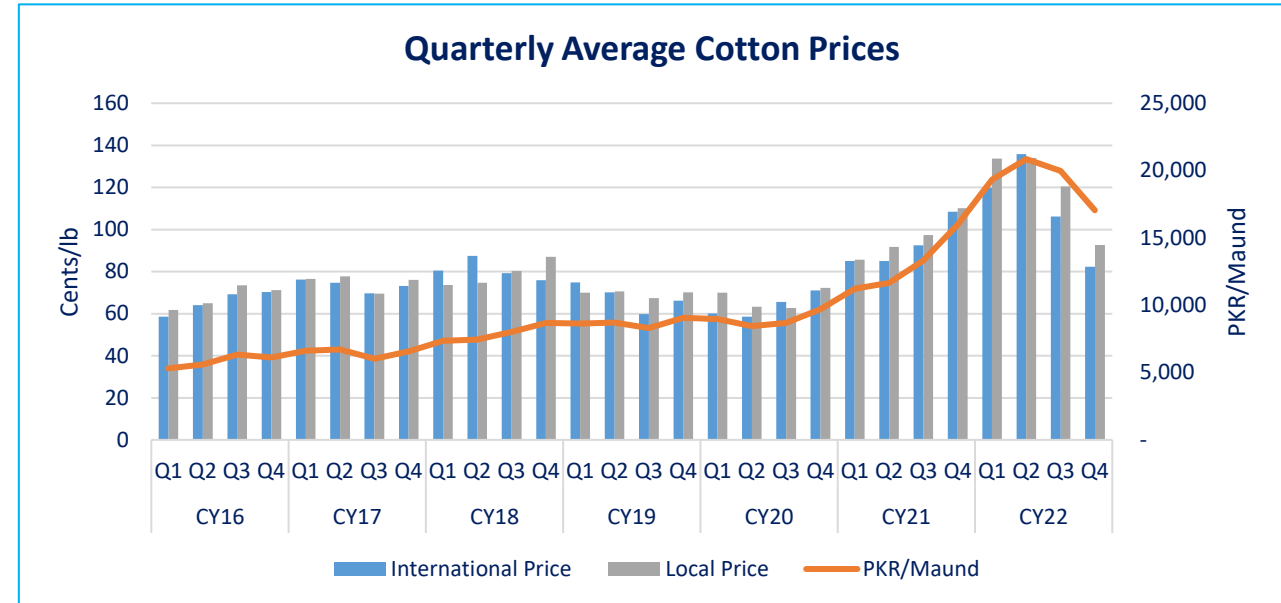
- The Aug-22 flashfloods were perceptuated by unprecedented rainfalls which surpassed Pakistan’s 30 years average rainfall spells of ~136.5mm by ~186.2%. Nearly one-third of Pakistan’s geographical area was submerged under flood waters. Loss in GDP is projected at ~2.2% of FY22 GDP while the agriculture sector is projected to contract the most, by ~0.9% of GDP.
- The natural disaster has had a significant impact to standing crops including the Kharif cotton crop. While Balochistan’s area under cultivation has been the most severely hit – nearly ~80% affected – the greatest damage, in terms of cultivated area has been in Sindh followed by Punjab where ~1.5mln and ~0.5mln hectares were cultivated, respectively, and out of which ~0.3mln and ~0.2mln, respectively have been destroyed (~65% and ~15%, respectively).
- It is pertinent to note that the FY23 production target was ~11.0mln bales. However, after the floods, the estimated production figure has now been revised downwards to ~4.8mln bales which amounts to a loss of ~7.0mln bales (or ~60%).
- The estimated yield lost will now need to be imported. With an average local demand of ~12.0mln bales and import demand of ~4.8mln bales, Pakistan’s projected import demand could amount to ~12.0mln bales. With an international cotton price of USD~421.35/bale in the 6MFY23 period, Pakistan’s import bill can rise by an estimated USD~5bln if the projected quantity is imported.
- In addition, any harvested cotton may be of inferior quality and if used to produce output, will reduce the quality and competitiveness of output.

Note: Cotton price is based on the 6MFY23 average price

Source: Economic Survey, 2021-22, PCCC’s November-22 Daily and Monthly Cotton Price Review, NDMA, PACRA Internal Database, World Bank Pink Sheer, USDA

Cotton Dynamics | Prices

- International cotton futures prices peaked until Apr-22 touching 138 cents/lb in the international market and 135 cents/lb in the local market.
- International prices have exhibited a downward trend post 2QCY22 falling from an average of 136 cents/lb in 1QCY22 to a price of 82 cents/lb in 4QCY22. In the recent past, prices were this low in Jan-21 and the latter was in the COVID-19 era when global demand was significantly suppressed.
- Globally, the CY22 dip in cotton prices is primarily attributable to a weakening in demand forces amidst a global economic slowdown.
- Another variable influencing global cotton prices in the sluggish import demand from China, the world's largest importer, which has built significant stockpiles within the country in the recent past.
- However, global cotton prices have experienced significant volatility in CY22 and this is attributable to speculators betting on global supply and demand forces. Prices jumped by ~13% between 1QCY22 and 2QCY22 before dropping by ~22% in both 3QCY22 and 4QCY22.
- Local average cotton prices (in PKR/maund) in the 6MFY23 period continue to remain high compared to the SPLY, when prices were ~23% lower, despite a drop in the local price in cents/lb. This is because of the ~13% depreciation of the PKR/USD rate in the 6MFY23 period compared to the SPLY.
- However, local cotton prices in Dec-22 have eased from the PKR~23,000 per maund level observed at Aug-22 end.



Average Cotton Prices	FY18	FY19	FY20	FY21	FY22	6MFY23	Cotton Unit Conversion	
	Unit	Conversion						
International (Cents/lb)	78	76	62	76	114	92	1 Maund	37.3kg
Local (Cents/lb)	74	78	68	78	123	102	1 Bale	170kg
Local (PKR/maund)	6,888	8,604	8,742	10,290	13,476	17,992	1 Bale	4.6 Maund

Yarn Supply | Local Industry

Production of Yarn (MT)	FY18	FY19	FY20	FY21	FY22*	4MFY23*
Coarse	787,376	790,223	704,702	792,594	896,253	272,943
Medium	826,399	823,784	734,631	826,256	934,318	284,535
Fine	393,126	395,655	352,835	396,841	97,197	29,600
Super Fine	88,406	85,799	76,425	85,957	85,797	26,128
Synthetic/Blended	1,334,743	1,335,929	1,191,349	1,339,937	1,514,310	461,164
Total	3,430,050	3,431,390	3,059,942	3,441,585	3,527,874	1,074,370

- Pakistan’s annual production of yarn has remained relatively stable in the past few years. During FY21, the production of yarn grew by ~12% as there was recovery from the COVID-19 pandemic which had slowed down production in the previous year.
- Synthetic or blended yarn has the largest share of total yarn production. Moreover, there is greater production of coarse and medium type yarn as compared to fine cotton yarn.
- In the 4MFY23 period production of yarn has declined to ~1.07mln MT compared to ~1.15mln MT in the 4MFY22 period. This ~6.75% decline in production is due to reduced global as well as local demand for yarn owing to high inflation and recessionary conditions.

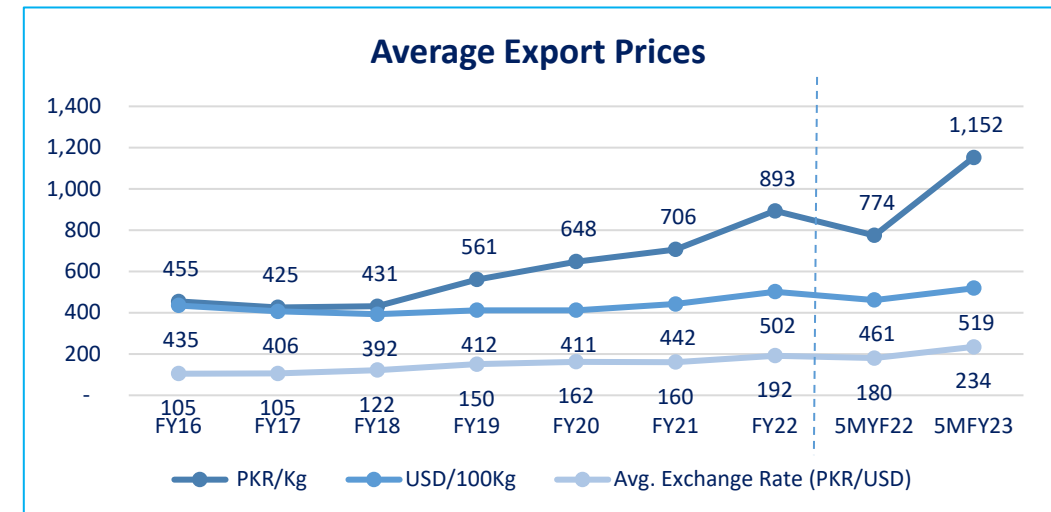
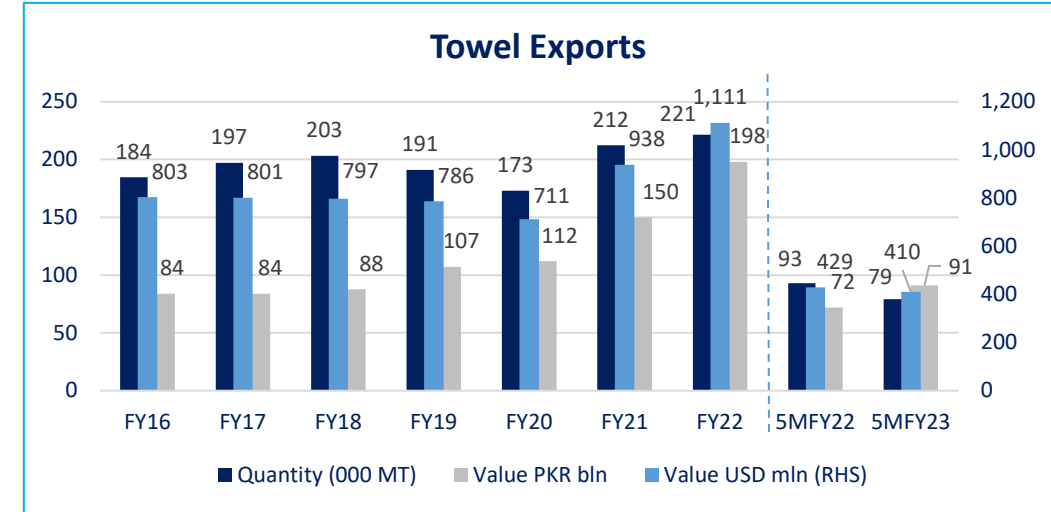
*Production figures for individual yarn categories is estimated using actual total production figures for the two respective years and FY21 ratio of product wise yarn production to total production

Textile Exports | Local Industry

Pakistan Textile Exports (PKR bln)	FY19		FY20		FY21		FY22		5MFY22		5MFY23	
	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value
Knitwear (Th. Doz)	117,673	395	106,027	0	179,365	610	167,630	912	59,542	346	78,487	471
Readymade Garments (Th Doz)	55,665	362	48,588	401	37,418	485	55,657	696	-	249	31,457	337
Bedwear (MT)	414,845	307	405,184	339	460,143	443	516,042	585	234,253	236	178,046	272
Cotton Cloth (Th. Sqm)	2,827,064	286	2,365,874	288	992,145	307	444,537	434	197,263	158	154,209	201
Cotton Yarn (MT)	433,978	153	412,559	155	390,090	162	335,647	214	155,187	84	98,867	73
Towels (MT)	190,855	107	172,903	112	212,163	150	221,489	198	93,262	72	78,554	91
Raw Cotton (MT)	12,992	3	12,776	3	594	0	2,752	1	0	0	6,737	2
Other		201		674		304		400		155		192
Total Textile		1,813		1,972		2,461		3,439		1,300		1,640
Total Country Exports		3,128		3,370		4,042		5,663		2,072		2,661
Towel % of Textile Exports		6%		6%		6%		6%		6%		6%
Towel % of Total Country Exports		3%		3%		4%		3%		3%		3%

Exports | Local Industry

- Pakistan’s towel exports increased from PKR~84bln in FY17 to PKR~198bln in FY22, exhibiting a CAGR of ~19% during the period.
- During FY22, towel exports grew to PKR~198bln as compared to PKR~150bln in FY21. In dollar terms, the exports stood at USD~1,111mln in FY22 as compared to USD~938mln during FY21, a growth of ~19%. The FY22 growth in export revenues from the SPLY (~32%) occurred largely on the back of currency depreciation (~20% between FY21-FY22) and increase in export price (~26%) as quantitatively, exports increased by a small ~4% to stand at 221,489 MT.
- During 5MFY23, towel exports stood at PKR~91bln an increase of ~26% from PKR~72bln during 5MFY22. The growth came on the back of greater increase in export price, which increased by ~49% during the period, in addition to currency depreciation of ~13%. There was a marked decline in the quantity of towels exported during this period of ~15%; exports fell from 93,262 MT in 5MFY22 to 78,554 MT in 5MFY23. The decline in global demand is largely due to inflationary and recessionary pressures dominating global economies.
- The average export price of towels has increased significantly in the last five years. In previous years, price increase occurred largely due to currency depreciation. However, supply constraints and increase in prices of raw materials have also contributed to significant price increase since FY20, both in PKR and USD terms. During 5MFY23, the average price stood at PKR~1,152/kg, an increase of ~12% from PKR~706/kg in FY22.



Export Destinations | Local Industry

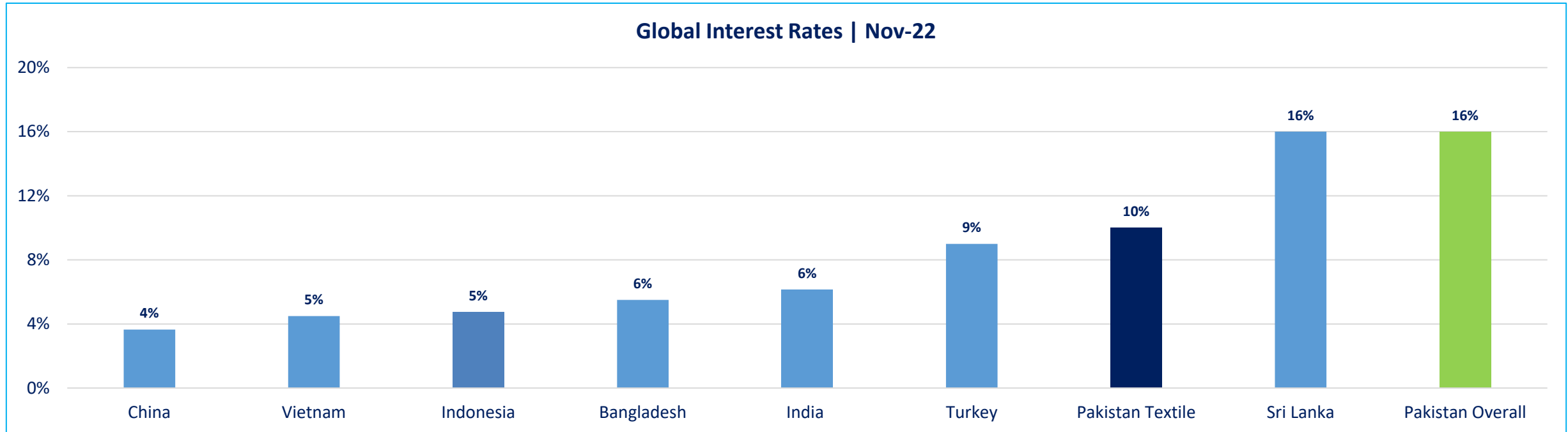
Export Destinations	FY19		FY20		FY21		FY22	
	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%
USA	345	44%	299	42%	430	46%	395	41%
UK	78	10%	66	9%	94	10%	88	9%
Netherlands	49	6%	56	8%	69	7%	84	9%
Germany	39	5%	37	5%	47	5%	42	4%
Italy	38	5%	29	4%	36	4%	46	5%
Spain	32	4%	29	4%	29	3%	42	4%
Other	204	26%	195	27%	234	25%	261	27%
Total	786	100%	711	100%	938	100%	958	100%

- Pakistan’s towel exports are largely concentrated towards the United States with the country accounting for ~41% of total towel exports in FY22.
- The remaining top exporting export destinations consist of European countries such as UK, Netherlands, Germany, Italy and Spain.
- The top six export destinations combined accounted for approximately ~73% of Pakistan’s total towel exports.

Business Risk

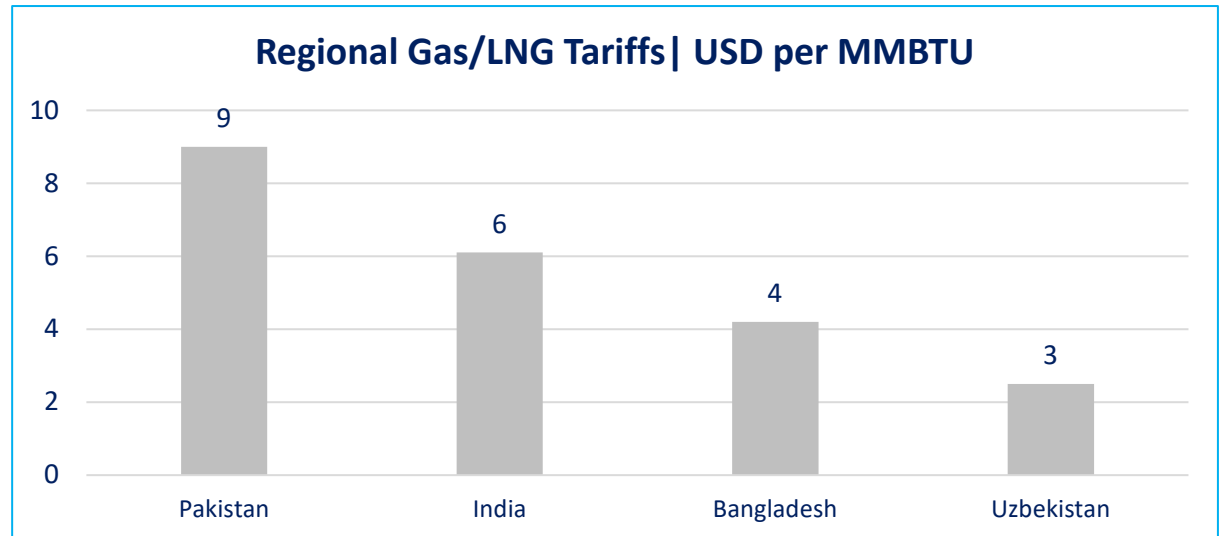
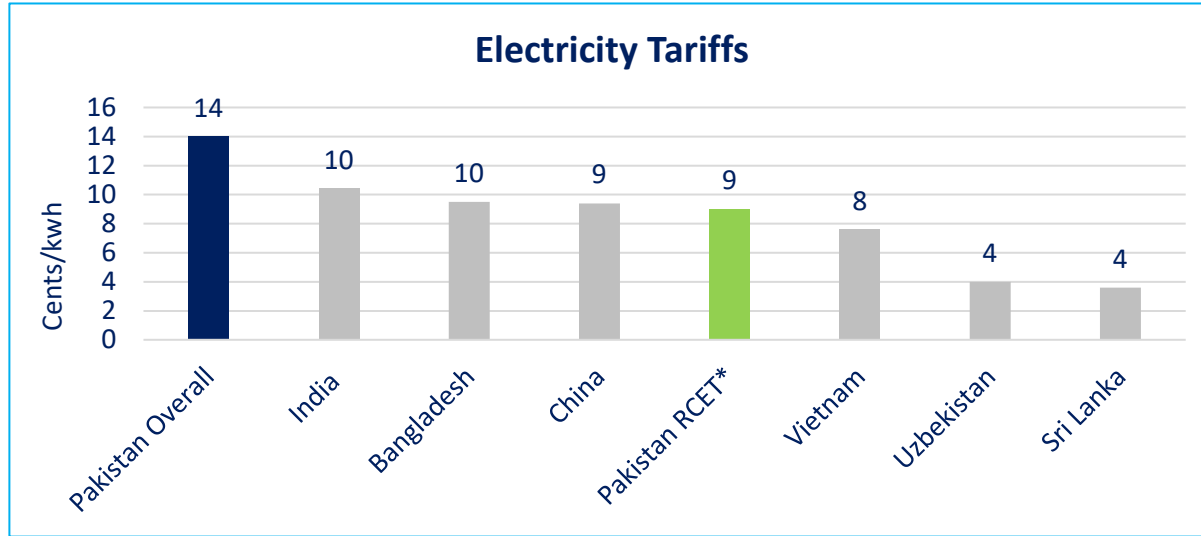
- **Decline in local cotton production:** In FY23~60% of Pakistan's cotton crop was destroyed following the Aug-22 monsoon flash floods. Total white lint production dropped to ~4.8mln bales. This is the most significant risk to impact the textile sector as damage to local crop will mean more cotton will need to be imported and with the presently high PKR/USD exchange rate, sourcing raw material from overseas will hurt the bottom lines of industry players. In addition, as at the end of Oct-22, mill arrivals were 29% lower compared to the same period last year which is as a result of the production decline.
- **Dependency on cotton imports:** The estimated ~64% crop damage resulting from the monsoon flash floods increases the dependency on imports. Raw material constitutes ~71% of the sector's direct costs and thus the sector remains vulnerable to fluctuations in the price of the raw material which is at a low level. Profitability depends on the players' ability to continue to pass on the increased price impact.
- **Low level of value addition:** Although, the increased demand in FY22 has increased the overall profitability of the sector, it remains a low value addition sector with historically narrow margins. Moving forward, subdued global and local demand coupled with elevated interest rates and high inflation will pose a significant challenge to the sector.
- **High Energy Costs:** Although the government provides the textile industry with subsidized RLNG at USD~9.0 per mmbtu, which increased from USD~6.5 per mmbtu on August 1, 2022, this rate is above the regional average for countries such as India, Bangladesh and Vietnam which reduced the competitiveness of Pakistan's yarn exports. Furthermore the withdrawal of the RCET and imposition of a fixed power tariff of Rs. 20/kWh has forced smaller mill owners to close down business. In Oct-22 APTMA reports ~1,600 mills have been forced to shut down as a result due to the rising power tariff.
- **Disruption in electricity and gas supply:** The towels sector depends on an uninterrupted supply of electricity and gas. Interruptions in energy supply and curtailment of gas supply meant that the industry
- **High level of regional competition:** Pakistan's textile exporters have traditionally faced a high level of competition from regional players such as Bangladesh and Vietnam which has driven down the average export prices and margins in previous years. Although, many regional players were severely impacted by the COVID-19 pandemic which benefited Pakistan, the regional competition continues post the pandemic.

Local Industry | Regional Interest Rate Comparison



- With the recent hike in policy rate (15% to 16% in Nov-22), Pakistan has the highest interest rate in the region in line with Sri Lanka. The high cost of borrowing acts as a barrier to investments in various sectors.
- Prior to FY22, the textile sector was a beneficiary of subsidized financing facilities from the SBP in the form of short term Export Refinance Facility (ERF) and Long Term Financing Facility (LTFF). In July-22 the SBP announced that any subsequent revisions in the LTFF and EFR rates will be linked to policy rate revisions such that the difference between the former two rates and the latter is maintained at 5%; this difference was reduced to 3% in Dec-22.
- The LTFF and EFS rates were revised to 10% in Jul-22, 11% in Nov-22, and ~13% in Dec-22. This serves to increase the cost of borrowing for the sector which has already experienced a jump in borrowing costs OF ~79% in the 3MFY23 period.

Electricity and Gas Tariffs | Local Issues and a Regional Comparison

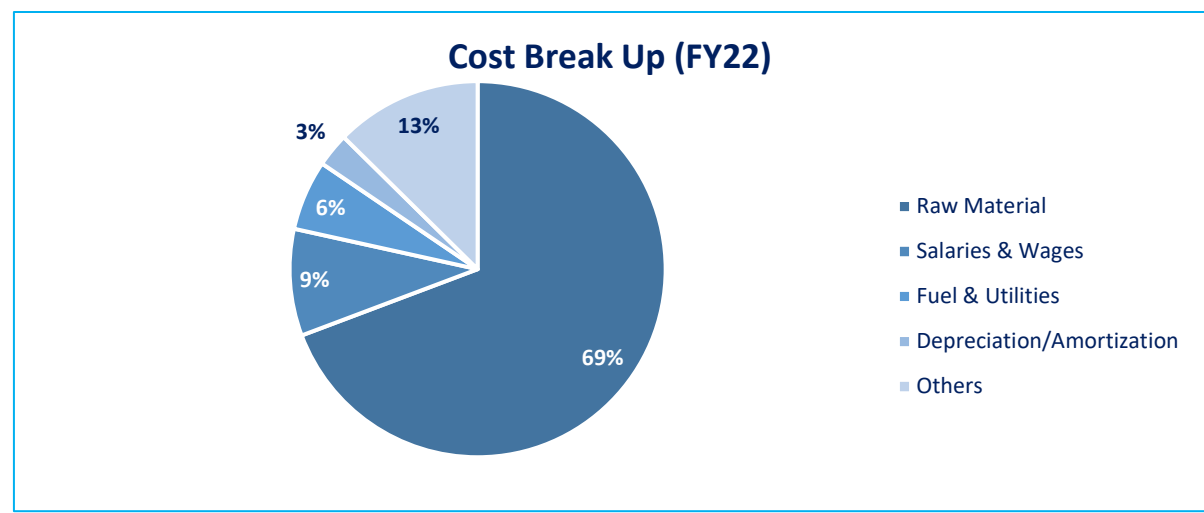
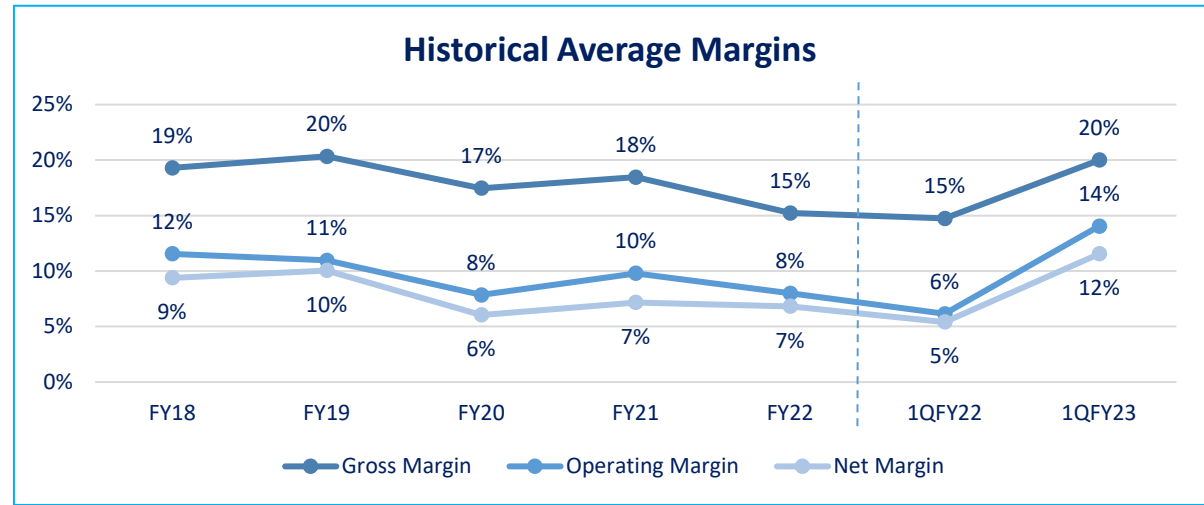


- Pakistan’s businesses face a competitive disadvantage when it comes to comparing national and regional electricity tariffs. Energy costs have a significant share in the final conversion costs of textile mills and these costs cannot be ignored for achieving a competitive edge.
- The government provides gas at internationally competitive prices or at regionally competitive energy tariffs* (RCET) to the five export-oriented sectors of the economy including the textile cluster. However, these RCETs are still higher when compared to tariffs in Vietnam, Uzbekistan and Sri Lanka. Disruptions in the supply of electricity 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. Furthermore, the onset of winter means the little gas provided to the sector will also be curtailed.
- Effective October 1, 2022 to June 3, 2023, electricity is now being provided at an all-inclusive subsidized rate of Rs. 20 per kWh. In Aug-22, gas rates have been increased to USD~9.0 from USD~6.5 per mmbtu in light of higher import prices for RLNG which will be sold at a retail price of USD~13.80 per MMBTU Jan-23 until further price revision.
- Gas remains the major or only source of energy to ~75% of the textile industry which consumes only ~8% of the national gas supply. Therefore, any disconnection of gas has severe consequences for the local textile industry and export orders. In FY21, total gas supply was 4,300 MMCFD out of which 368 MMCFD was consumed by the textile industry. Compared to regional al players, the local textile industry’s gas/LNG tariff is significantly higher.

*Pakistan’s RCET figures are based on latest figures while other energy tariffs are based on CY21 figures

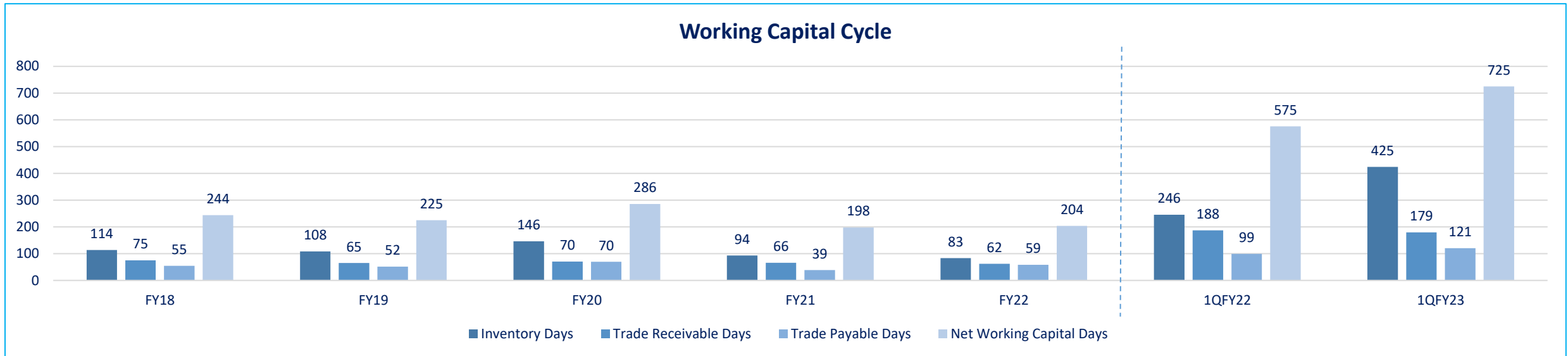
Margins & Cost Structure | Local Industry

- Over the last five years (FY16-FY21), the average gross margins for the towel manufacturing sector* have stood at ~18.9% while average net margins during the period have stood at ~8.2%. The towels sector has relatively higher margins due to significant value addition. Moreover, margins have remained relatively stable in recent years.
- During FY22, the average gross margin fell from ~18.0% in FY21 to ~15.0% in FY22 while net margin remained stable at 7.0%. Rising cost of raw material owing to depreciation of the PKR relative to the USD, albeit lower international cotton prices, as well as higher international freight rates (global freight index increased by ~% in FY22 compared to FY21 rates) increased cost of sales by ~39% compared to the SPLY. On The contrary, net sales increased by ~22% which resulted in the increase in the cost of sales offsetting the former.
- In the 1QFY23** period there was an increase in gross, operating and net profit margins by ~5%, ~8%, and ~7% compared to the SPLY. While volumetric sales fell over this period as did the PKR value of sales, the latter by a marginal ~-1%, the increase in gross profit margins was driven by a ~52% drop in cost of sales due to lower raw material purchases; a drop in export orders meant lower purchase of raw materials.
- The depreciation of the PKR relative to the USD helped boost 1QFY23 net margins as other operating income/other income of the players* increased by ~597% with exchange rate gains on foreign currency transactions being one factor, alongside others, for this increase.
- Raw materials constitute the largest component within direct costs at ~65%. Prices of cotton have been on a continuous increasing trend since the COVID-19 pandemic in part due to lower global production along with supply constraints.



Note: *Historical margins and cost break-up is estimated from ~8 Listed/Rated Players

**Analysis pertains to four listed players and one unlisted PACRA-rated client.



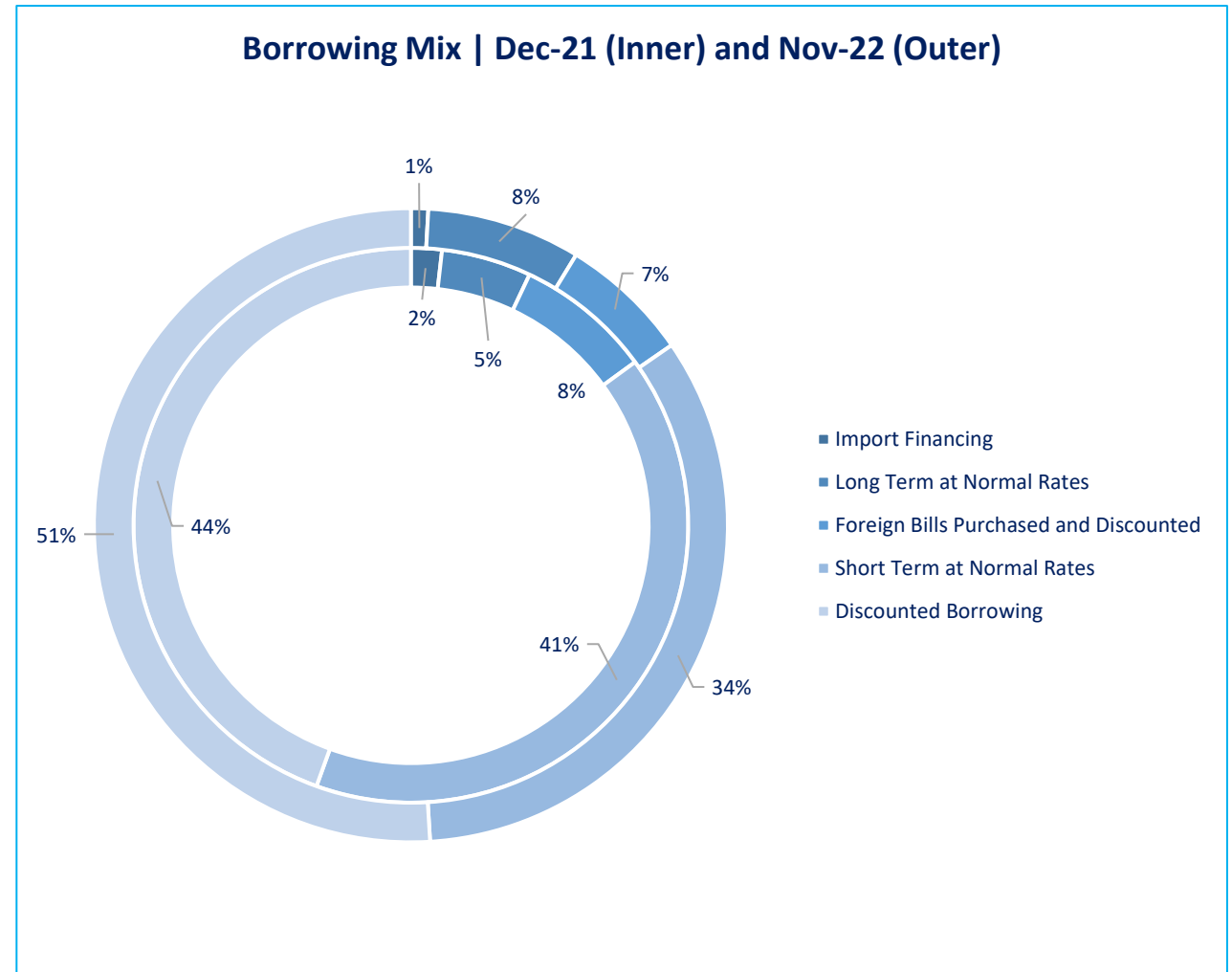
- The towel sector’s average working capital cycle* stands at around ~231 days. Inventory is the largest contributor to working capital of which finished goods inventory has the highest share of ~41% while raw material and work-in-process inventory occupy ~28% and ~31% shares, respectively.
- There was a marginal in the sector’s average working capital cycle* with net working capital days clocking in at ~204 days in FY22 as compared to ~198 days in FY21.
- Most notable is the significant increase in working capital days** in 1QFY23 compared to the 1QFY22 period of ~150 days. Decline in local and export sales is the strongest possible reason for the increase and justifies i) the increase in closing inventory balance at the end of the 1QFY23 period, which increased by ~18% compared to the 1QFY22 and ii) the ~52% decrease in cost of sales over the same period. Two major contributing factors to the latter’s decrease were lower manufacturing expenses and raw materials consumed, which directly indicates low manufacturing activity.
- In addition, the receivable days** increased during the 1QFY23 period (versus 1QFY22) by ~179 days as both domestic and foreign customers slowed down their outstanding payments owing to weakening macroeconomic factors.

Note: *Historical margins and cost break-up is estimated from ~8 Listed/Rated Players

**Analysis pertains to four listed players and one unlisted PACRA-rated client.

Financial Risk | Borrowing Mix | Local Industry

- The total borrowing for towel sector in Nov-22 stood at PKR~172bln as compared to PKR~167bln in Dec-21
- In Nov-22 the largest component within the borrowing of towel sector comprised discounted borrowing, amounting to ~51% of the total borrowing. This includes Export Finance Scheme (EFS) at rate of 13.0%, as well as Long Term Finance Facility (LTFF) and Temporary Economic Refinance Facility (TERF) at rate of 13.0%. It is pertinent to note that these two rates have been revised upwards to 13.0%, in Dec-22, from their respective rates of 11.0%.
- Total discounted borrowing amounted to PKR~87bln as at End-Nov'22 (EFS: PKR~60bln, LTFF/TERF: PKR~28bln).
- The sector's short term borrowing at normal rates accounts for ~34% of total borrowing and stood at PKR~58bln as at the end of Nov-22.
- The average leveraging for the towel sector* in FY22 was moderate and stood at ~36%. However, this declined by a minor ~1% to ~35% in the 1QFY23 period (1QFY22: ~34%).
- As of September-22, the total non-performing loans (NPLs) of the textile industry stood at PKR~161bln while in terms of ratio were recorded around ~8.4% (June-22: ~8.3%). Textile NPLs continue to remain above the total infection ratio of ~7.6% of the private sector banking credit indicating higher level of financial risk.



*Note: Average leveraging is estimated from ~4 Listed/Rated Players and 1 unlisted PACRA-rated client

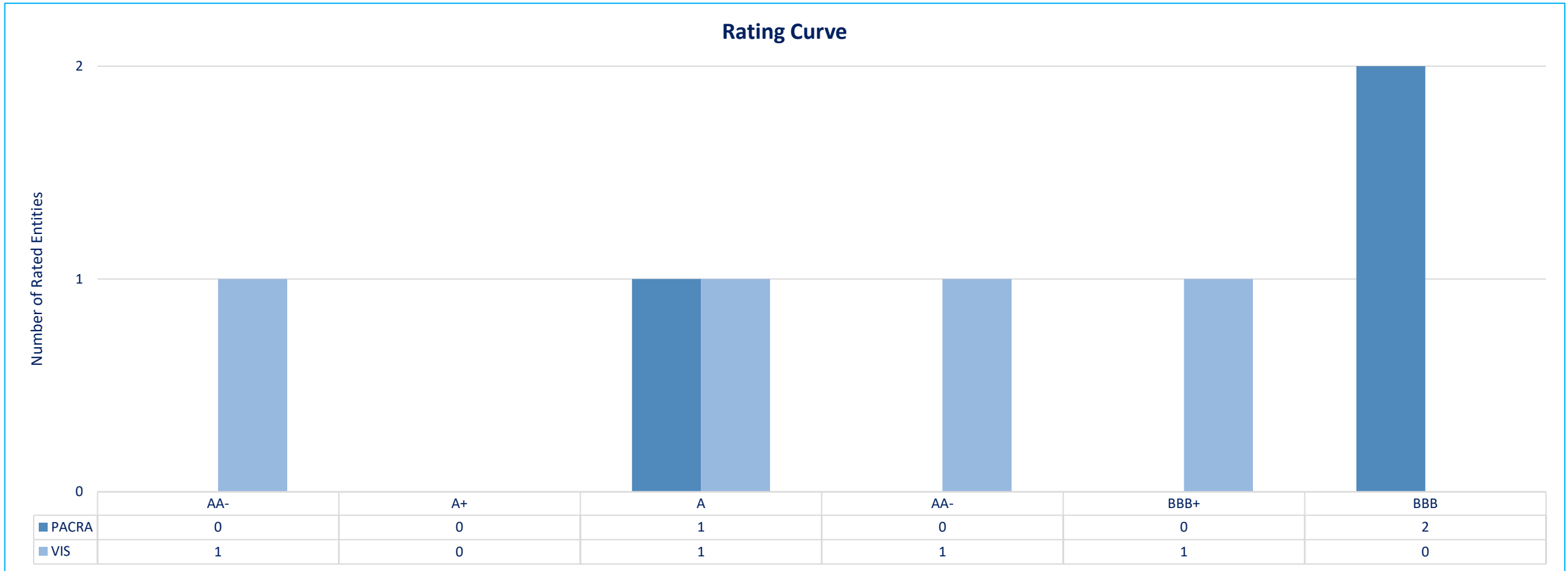
Regulatory Framework

- With respect to Income Tax, the textile industry, including the towel 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.
- 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 17% 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 July-22, the SBP announced that the two 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 5%. This gap was reduced to 3% in Dec-22 and 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, corporate loans under this facility have not yet matured and continue to be reported on the financial statements of sector players.
- The SBP increased the monetary policy rate by 250 bps to 12.25% in April-22 and a further 150 basis points to 13.25% in May-22. In FY23, the policy rate has been hiked upwards twice: to 15.00% in July-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.

Custom Duty Structure | Local Industry

PCT Code	Description	Custom Duty		Additional Custom Duty		Regulatory Duty		Total	
		FY23	FY22	FY23	FY22	FY23	FY22	FY23	FY22
52.01	Cotton, not carded or combed	0%	0%	0%	0%	0%	0%	0%	0%
52.03	Cotton, carded or combed	0%	0%	0%	0%	0%	0%	0%	0%
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%
58.02	Terry towelling and similar woven terry fabrics	11%	2%	0%	11%	0%	0%	21%	13%
63.02	Table, bed and kitchen linen (including towels)	20%	20%	0%	6%	10%	10%	30%	36%

Rating Curve



- PACRA rates three entities in the towels sector with a long term rating bandwidth ranging from BBB to A.



SWOT Analysis



Outlook: Watch

- The textile industry is a significant contributor to Pakistan's PKR~67trln GDP (~8.5%) and has a significant share (~18.2%) in the Large Scale Manufacturing (LSM) Index. The industry is vital to Pakistan's economy providing employment to ~40% of the national labor force.
- Within this vital industry operates the towel industry which, in FY22, garnered USD~1.1bln (SPLY: USD~1.0bln) in export revenue for Pakistan contributing ~5.7% to national textile exports. During this fiscal year towel exports grew by ~3.9% in volumetric terms to 221,489 MT.
- The sector's FY22 performance could not be replicated in the 5MFY23 period wherein exports declined by ~15.7% in volumetric terms and ~4.5% in USD terms. We forecast export performance to be lackluster for the remaining of FY23 owing to low demand forces prevailing in a local and global economy characterized by recession and high inflation.
- Declining export orders and weakened global economic conditions have significantly affected the sector's working capital which has significantly increased in the 5MFY23 period by ~ 150 days and this was largely due to a(n) i) an accumulation of inventory and ii) lower manufacturing activity.
- While being a forward segment of the textile value chain, the towel sector is linked backward to the agriculture sector given its high dependence on the quality of cotton crop. Any climate-related event which impacts the cotton crop therefore has a direct influence on the quality of local and/or demand for imported cotton. This fact has been established by the devastating monsoon flashfloods of Aug-22 which has wiped out an estimated~60% of the FY22 crop; this will increase the cost of importing cotton at a time when the average exchange rate has depreciated in value (FY22 vs. FY21 PKR/USD depreciation: ~13%; 5MFY23 depreciation: ~29%) and international cotton prices stand at USD~421.35/bale.
- Adding to the textile industry's woes is energy supply and quality, ~75% of the industry relies on gas-based electricity as supply from national grid is uneven. Furthermore, with the winter season gas shortages and curtailments will serve as an additional challenge to mill operators particularly those of a smaller scale, which have been forced to halt operations. ~6% of the towel industry's cost of sales comprise fuel and utility costs.
- Technology upgradation is another necessity for the towel sector to realize its true potential. However, the recent revision of the LTFF rate to 13% and reduction in gap between this rate and the policy rate implies that replacing machinery with more modern units will prove to be a costly exercise.
- While the towel sector is a value-added segment of the textile value chain thereby allowing any cost increases to be passed on to customers in the form of higher prices, performance greatly depends on sustainable export demand, secure energy supply, and technological upgradation in order to continue to retain its position as the third largest exporter and to thrive in the global environment.

- Pakistan Bureau of Statistics (PBS)
- Pakistan Stock Exchange (PSX)
- State Bank of Pakistan (SBP)
- Federal Board of Revenue (FBR)
- Towel Manufacturers Association of Pakistan (TMA)
- PACRA Database
- Pakistan Cotton Ginners Association (PCGA)
- Pakistan Central Cotton Committee (PCCC)
- Trading Economics
- Business Recorder
- UN Comtrade
- World Bank Pink Sheet
- Business Wire – Kitchen Towels
(<https://www.businesswire.com/news/home/20211006005553/en/Kitchen-Towel-Global-Market-Report-2021---ResearchAndMarkets.com>)
- Business Wire – Bath Towels
(<https://www.businesswire.com/news/home/20211117005868/en/Global-Bath-Towel-Market-2021-to-2028---by-Product-Application-and-Geography---ResearchAndMarkets.com>)

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