



The Pakistan Credit Rating Agency Limited

## **SECTOR STUDY**

### **TEXTILE SECTOR – FY11**

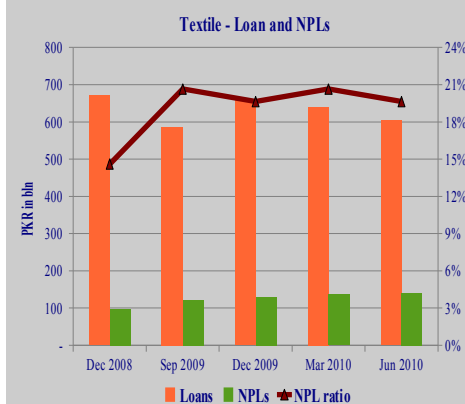
**MARCH 2011**

## RISK MATRIX



## HIGHLIGHTS

	FY10
Total Credit	PKR 604bln
Share in GDP	~9.5%
Total Exports	USD 10.2bln
Listed Companies	209



## SECTOR TRENDS

- ◆ **Rising Cotton Prices**  
*Expected to enhance working capital requirements*
- ◆ **Textile Policy 2009-14**  
*Announced, yet to be fully implemented*
- ◆ **EU Preferential Access**  
*Announced but challenged*
- ◆ **RGST on zero-rated sector**  
*Postponed till Jun'11; outcome uncertain*
- ◆ **Increased International Competition**  
*No plans devised yet*

## TEXTILE SECTOR - 2011

➔ Pakistan is the 4th largest producer of cotton (~12mln bales/yr), with the third largest spinning capacity in Asia after China and India, and contributes 5% to the global spinning capacity. Textile sector in Pakistan has gradually ventured into the production of fairly high quality counts and other value-added (hosiery, bedwear & garments) items. EU and US combined account for over 60% of Pakistani textile exports. The sector continues to be the mainstay of Pakistan's exports with highest contribution from value added segment. Moreover, the sector enjoys favorable policies from GoP.

### KEY RISKS

➔ Despite introduction of five-year Textile Policy, implementation remains to be seen. This implies high policy risk for the sector. However, due to the sector's high share in exports (~52%), it has strong bargaining power with the government, which has resulted in favorable domestic policy formulations. Moreover, efforts to achieve preferential access to EU market materialized, but the legislation has been challenged by competing EU countries. Rising cotton prices have pushed raw material costs substantially high, making it difficult for small players in the industry to survive.

➔ The industry structure is fragmented, offering limited economies of scale accompanied by a very low history of mergers and acquisitions. This limits the exit strategy for investors facing distress. The sector has found a niche in exporting coarse counts, while yarn and apparel products from finer cotton counts are vulnerable to international competition.

➔ Industry output is dominated by low-value added products, implying thin margins and low differentiation within product categories.

➔ Continuing shortage of power supply is exerting pressure on production costs, as companies have to meet their power requirements with internal generation at higher cost. Recent gas curtailment has added to the woes for the industry.

➔ Governance and management risk translates into weak internal policies and financial management at individual companies.

### CREDIT EXPECTATIONS

➔ Cotton prices touching an all time high, rising production costs owing to energy crises coupled with inflation, and the likely implementation of RGST under IMF guidance are expected to enhance credit requirements of the sector.

➔ Higher international prices of cotton and yarn drove the profitability in all the industry segments – specially in the spinning sector – as companies benefited from procuring the inventory at low cost, providing a cushion for debt-servicing during the year. However, with rising interest rates and higher input costs, the servicing capacity of the industry may come under pressure. Currently, the NPL to Advances ratio for the sector (20%) is higher than the overall country average (~13%).

## TEXTILE SECTOR - FY11

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1. PROFILE

- Mainstay of exports
- A long vertical and horizontal manufacturing chain
- Sector developed over years

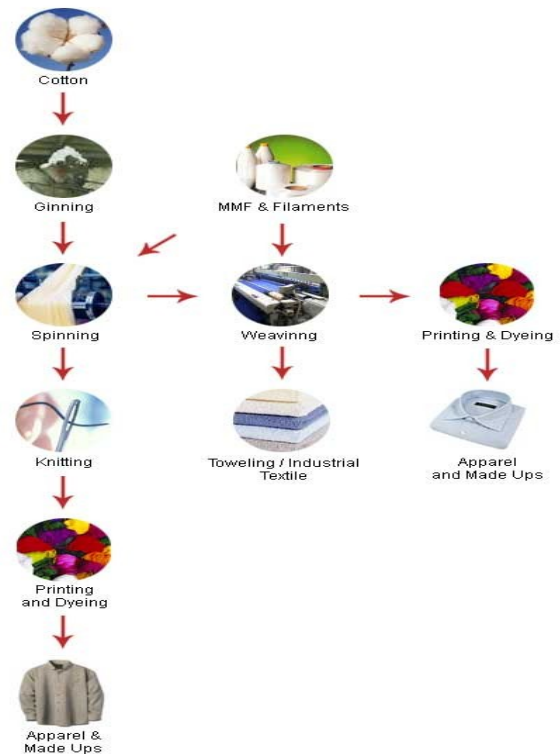
**1.1 Introduction:** Pakistan’s economy can be characterized as semi-industrialized. The country’s industrial sector constitutes ~24% of the gross domestic product (GDP). Pakistan has a total labor force of around 54mln (Labour Force Survey 2008-09 ). As Pakistan is one of the major producers of cotton, the country has a sound textile industry. Pakistan’s industrial sector experienced tremendous growth between 2004 and 2006. During the last decade, textile exports have doubled to USD10.2bln (2010) from USD 5.2bln (1999). Pakistan accounts for 3% of the United States textile imports. The textile sector continues to be the mainstay of Pakistan’s exports comprising ~52% of total exports and also represents the principal employment-generating avenue in the organized and large scale industrial segment<sup>1</sup>.

**1.1.1** Today, Pakistan is the 4th largest producer of cotton, and has the third largest spinning capacity (7.6% of total Asian capacity) in Asia after China and India and constitutes ~5% of the global spinning capacity. Pakistan’s textile sector has gradually ventured into the production of fairly high quality counts, hosiery, garments and other value-added items. During FY10, total textile exports accounted for ~9.5% of the GDP. FY07 was a historic year for the industry as it achieved highest ever exports of ~USD 11bln. Given the sector's significant contribution in the exports, the performance of this sector has a strong impact on the national economy.

**1.1.2** The word textile, originated from Latin – *texere*, which means "to weave", "to braid" or "to construct". Textiles process involves spinning of cotton and raw wool fiber on a spinning wheel to produce long strands – yarn. Yarn is further put through the steps of weaving, knitting, crocheting, knotting, or pressing fibres together to get the end product – cloth. As shown in the figure, Spinning is the first process in the cotton value chain that adds value by converting ginned cotton into a new product – cotton yarn. This yarn is further processed through weaving and knitting to produce fabric. The process of weaving collects two distinct sets of yarn – warp and weft in a way that warp threads run lengthways on the piece of cloth, and the weft threads are inserted over-and-under the warp threads to make a fabric. Where as knitting is the process of producing two dimensional fabric through one dimensional yarn. In contrast to weaving, knitting does not have straight, parallel running yarn, rather it follows a meandering path, forming symmetric loops

symmetrically above and below the mean path of the yarn. These loops are stretchable giving elasticity to the knitted fabric. Provided the type of yarn and the knitting pattern, knitted garments can be stretched as much as 500%. Therefore, knitted fabric is used in stretchable garments, such as socks and hosiery.

**Textile Value Chain**



**1.1.3 Origination of cotton cultivation in subcontinent:** The origination of cotton cultivation and production of textile products in the subcontinent<sup>2</sup> is traced back to the

<sup>1</sup>Employment to 40% of the country’s labor force

4th and 5th millennium B.C. in Indus valley civilization as the indigenous variety of cotton – Dessi (*Gossypium Arboreim* specie) Cotton – has been produced since that period. The residuals of actual textile and textile material, tools and instruments used in manufacturing textiles, all divulge presence of textile in the Valley. In the early 20<sup>th</sup> century, another variety of cotton – American Cotton – was introduced in this region by the British ruling at that time. Initially this variety was imported from the North American continent. However, in 1917, this was cross-bred with the Dessi cotton. The first test-cultivation of the new genetically modified seed (3F) was made in South Western Indian regions by a renowned cotton breeder, Dr. Mohammad Afzal. Biologically, cotton is perennial plant that grows in the forests, nevertheless, with the technological developments, its cultivation period turned seasonal generating higher productivity

**1.2 Textile sector in Pakistan – History and present:** In 1947, independence of subcontinent from the British rule and its division in two independent countries, Pakistan and India, opened new avenues for the textile sector. Pakistan then, comprised two areas, East Pakistan (now called Bangladesh) and West Pakistan. The West was the cotton producing area and East was renowned for jute production. At the time of partition, East Pakistan received only 90 cotton mills out of 389 mills of erstwhile undivided Bengal. Whereas, West Pakistan was left without any industrial setup and inherited mere two composite textile mills, Okara Textile Mills, Okara and Lyallpur Cotton Mill in Faisalabad [formerly Lyallpur]<sup>3</sup>.

**1.2.1** During the 1950s, with more area coming under cultivation, cotton production expanded rapidly. In the meantime, under the Open General Licensing (OGL) scheme, Pakistan’s business community imported textile plants and machinery. This led to the establishment of Star Textile Mills Limited, Gul Ahmed Textile Mills Limited in Karachi, Kohinoor at Rawalpindi, Nishat, Crescent Textile in Faisalabad and Colony Textiles Mills Limited in Multan. With the establishment of the Central Cotton Research Institute in Multan in 1970, cotton breeding process attained momentum in the country. Pakistan started exporting printed fabrics in the late 70s to Africa and by mid 80s made inroads to Europe for export of various the material.

**1.2.2** Today Pakistan has an integrated textile industry comprising cotton spinning (yarn), cotton weaving (cloth), cotton fabric, fabric processing, home textiles, towels, hosiery and knitwear and Apparels. These are manufactured both on large scale as well as in small & medium cottage units. A brief description of each segment is given below:

i) Cotton Spinning Sector: This segment is the most important segment in the hierarchy of textile production. At present, it comprises 521 textile units (50 composite units and 471 spinning units) with installed and operational capacity of ~12mln and 10.1mln spindles, respectively. In the recent years, Pakistan's spinning industry has created a niche in the international market, especially in coarse counts, on the back of closure of spinning mills in China and other parts of the world. Province wise overview of the installed spindles across the country is given below:

<sup>2</sup> Consists of Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka

<sup>3</sup> Source: All Pakistan Textile Mills Association

Year	SINDH		BALUCHISTAN		PUNJAB		A.KASHMIR		KHYBER PAKHTUNKHWA		TOTAL PAKISTAN	
	Units	Spindles 000	Units	Spindles 000	Units	Spindles 000	Units	Spindles 000	Units	Spindles 000	Units	Spindles 000
2004-05	118	2,512	10	99	307	6,998	6	93	17	781	458	10,483
2005-06	119	2,100	10	103	309	7,328	6	93	17	812	461	10,436
2006-07	119	2,132	10	127	309	7,349	6	94	17	812	461	10,514
2007-08	119	2,132	10	127	309	7,349	6	94	17	812	461	10,514
2008-09	119	2,132	10	127	309	7,349	6	94	17	813	461	10,515

Source: Textile Commissioner's Office

The spinning capacity utilization of standalone and composite units stands at 89% and 60%, respectively. Pakistan's textile industry enjoys several advantages over those of many other countries as far as the production of quality yarn is concerned. The country is a leading exporter of cotton yarn, including coarse, medium and fine varieties. Spinning is in the beginning of value chain since the effect of a sub-standard yarn production would go right across the entire value chain.

**ii) Weaving (Cloth) Sector:** There are two different sub-segments in weaving a) Mill segment (Integrated and Independent Weaving Units), and b) Non mill segment (Power Loom Units). The mills

Cloth Production		
Production (M.Sq.Mtrs.)	(July-Mar) 2008-2009	(July-Mar) 2009-2010
Mill Sector	763.38	762.42
Non Mill Sector	5,895.45	5,886.39
<b>Total</b>	<b>6,658.83</b>	<b>6,648.81</b>

segment captured momentum in the late fifties with the announcement of First Five-Year Textile Plan. At that time, Pakistan Industrial Development Corporation was established with an objective of industrial sector's development.

Source: Ministry of Textile

As a consequence, by mid sixties, the number of textile units undertaking bleaching, printing and processing reached to 180. Most of these units were situated in Karachi and a small number in Punjab. However, in 1968, due to sudden change in excise duty collection (from capacity to production), majority of the mills closed their weaving section. This greatly diminished the prospects of weaving mill segment in the country as the weaving capacity of Pakistan dropped down to an installed capacity of only 8,000 looms in 2008-09 from 26,000 looms in 1978-79. Whereas, the working capacity of these looms is only 50% as given in the adjacent table. As against the declining trend in the mill segment, the power loom segment, continued its growth pattern in terms of capacity and production. This was an outcome of joint catalysts in the form of market demand forces and favorable government policies (exemption of excise duty). Today, non-mill segment dominates by making a contribution of ~89% as evident by the following table. The major problems of this segment are poor technology, scarcity of quality yarn and limited production from the organized institutional network. Although the investment in this segment depicted a decline in import of textile weaving machines, the non-mill segment achieved significant progress. This was mainly owing to the mills outsourcing their

Year	Installed Capacity (Looms)	Working Capacity (Looms)
2004-05	9,000	5,000
2005-06	9,000	4,000
2006-07	8,000	4,000
2007-08	8,000	4,000
2008-09	8,000	4,000

Source: TCO

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Production of Cloth (Mln Sq. Meters)			
Year	Mill	Non Mill	Total
2004-05	925	6,192	7,117
2005-06	915	7,070	7,985
2006-07	1,013	7,683	8,696
2007-08	1,016	7,989	9,005
2008-09	1,018	7,998	9,016

Source: TCO

weaving operations to unutilized idle capacities in non-mill segment instead of internal expansions.

**iii) Textile Made-Up Sector:** Being value added segment, this comprises different sub groups namely A) Hosiery & Knitwear, B) Readymade Garments including Fashion Apparels, C) Towels D)Tents & Canvas E) Bed-Wear, and F) Cotton Bags. The segment accounts over 50% of textile exports.

**Hosiery & Knitwear Industry:** There are about 12,000 knitting machines spread all over the country. The capacity utilization is ~70%. Besides locally manufactured machinery, liberal import of machinery under different modes is also being made for the development of exports.

**Readymade Garment Industry:** This segment is distributed in small, medium and large scale units. The organized part of this segment is developing because of establishment of new large units. This industry, providing highest value addition in textile chain, enjoys the duty free import of machinery and income tax exemption for exports.

**Towel Industry:** There are about 7,500 towel looms in the country in both organized and unorganized sector. This segment is highly dependent on export outlets due to limited demand in the local market. In recent years, the trend has been to produce high quality towels for developed markets.

**Tents & Canvas:** The production capacity of this sector is more than 100 million sq. meters. As Pakistan is the cheapest source of supply of tents and canvas, therefore 60% of its production is exported while 40% is consumed locally by armed forces and food department.

**iv) Synthetic Fiber Manufacturing Sector:** This sector has made progress in line with the progress of the textile industry. Polyester Staple Fibre (PSF) has wide range of applications. Its main use is the production of blended yarns by the spinning industry, which in turn is used to produce cloth, garments and curtains etc. It is also now being used for wadding and non-woven applications like upholstery, tyre cord, filters and other rubber reinforcements etc. There are five main players in this industry in Pakistan with total production capacity of ~636,000 tons per annum. However, in the recent event of major plant closure – Dewan Salman Fibre Limited (260,000 tons per annum) – the segment has experienced a significant drop in its capacity. PSF industry lacks free market mechanism for determination of PSF pricing in Pakistan and enjoys protective policies such as import duty and anti-dumping duty leading to an oligopoly structure of the industry. International proportion of cotton to PSF to produce blended yarn is 50:50, whereas in Pakistan, this ratio stands at 70:30. This leaves a lot of room for the local manufacturers for potential enhancement and market exploration at domestic level. The basic raw materials used in the production of PSF are Purified Terephthalic Acid (PTA) and Mono Ethylene Glycol (MEG) (Zero-rated import duty in Pakistan). Both being derivative of crude oil, their prices fluctuate accordingly making PSF a price volatile product. Government of Pakistan (GoP) in federal budget 2008-09 reduced import duty on PSF from 6.5% to 4.5%, and later on also placed anti-dumping duty on PSF imports on companies from China (with exception of two companies), Indonesia, Thailand and South Korea mainly in order to protect the local PSF manufacturers. To protect local polyester-blended yarn manufacturers, a 10% customs duty is also in place on import of yarn containing 85% PSF.

Capacity of Synthetic Filament Yarn		
Type of Yarn	No of Units	Production Capacity (M.Tonnes)
Acetate Rayon Yarn	1	3,000
Polyester Filament Yarn	21	105,376
Nylon Filament Yarn	3	2,000

**v) Filament Yarn Manufacturing Industry:** The synthetic filament yarn

Source: Ministry of Textile

manufacturing industry gained ambition after the implementation of 5th Five Year Plan when private sector was allowed to enter in this segment owing to raising demand. Today three kinds of filament yarn, as mentioned in the table, are manufactured locally. Due to reduction of import duty on filament yarn resulting in large scale imports from China, the local manufacturing activity of polyester filament yarn has slowed down. There are six local units with operational capacity of 55,851Mtons. The estimated annual local production of ~60,337Mtons polyester filament yarn is significantly low as compared to 116,964 M Tons of imports recorded during the period July–March 2010 (July–March 2009: 89,362 M. Tons). Though it was beneficial for the synthetic weaving units, however, it negatively impacted the filament industry by resulting in the closure of 15 units. Recently, hosiery sector has started utilizing synthetic yarns for export quality knitted garments which would result not only in product diversification but in value addition as well.

**vi) *Art Silk and Synthetic Weaving Industry:*** Art Silk and Synthetic Weaving Industry mainly based on 8-10 cottage based power looms has developed over the time across the country. There are ~ 90,000 looms in operation, of which 30,000 looms are working on blended yarn and rest 60,000 looms on filament yarn. Apart from these, demand is also met through some mobile looms which become operational on need basis. Karachi, Faisalabad, Gujranwala, Jalalpur Jattan, Bara, Sawat, Khyber Agency and Waziristan are the main concentrated areas of this segment.

**vii) *Woolen Industry:*** The main products of the woolen industry are woolen yarn, acrylic yarn, woolen fabrics, woolen shawls, blanket, and carpets.

**viii) *Jute Industry:*** The main products of this industry – jute sakes and hessian cloth – are used for packing of food grains, wheat, and rice. The production of jute goods went upto 98,753 metric tones for the period of Jul-Mar 2009-10, observing a modest increase of 6.6% (Jul-Mar 2008-9: 92,666 metric tones).

**1.2.3** Pakistan produces around 12bln bales of cotton every year (with the highest ever achieved in 2004-2005 – 14.5bln bales), comprising % of total world production. Our total domestic cotton consumption is ~15bln bales per annum creating a short fall of around 20%. this gap is filled through impact of raw cotton mainly from India. Pakistan exports ~20% of its yarn and grey cloth production. Pakistan's leading buyers are Hong Kong, South Korea, China, USA, Bangladesh, Japan, Turkey, and Portugal<sup>4</sup>. Though, with the closing down of 12 million spindles in China this year – equivalent to the total installed capacity of Pakistan, there is a lot of opportunity for the spinning industry to tap in. However, with the increasing competitive pressure from Bangladesh, Vietnam and Turkey, there needs to be more strategic reformation in the policies at the industry level, which could help this segment in staying ahead of the competitors. The following table provides a snapshot of the textile exports during the last two years:

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<sup>4</sup> Pakistan Textile Journal

(Thousand US Dollar)

Textile Exports	2008-09	2009-10	2008-09	2009-10	%age Change
Raw & Processed Cotton	241,979	340,185	2.48%	3.34%	40.58%
Cotton Yarn	1,058,954	1,283,994	10.83%	12.62%	21.25%
Cotton Cloth	2,106,840	1,879,459	21.55%	18.47%	-10.79%
Knitwear	2,054,853	2,060,727	21.02%	20.25%	0.29%
Bed Wear	1,526,642	1,640,869	15.62%	16.12%	7.48%
Towels	546,591	602,867	5.59%	5.92%	10.30%
Ready-made Garments	983,443	962,481	10.06%	9.46%	-2.13%
Other Textile Materials	1,256,996	1,406,549	12.86%	13.82%	11.90%
<b>Total</b>	<b>9,776,297</b>	<b>10,177,131</b>	<b>100.00%</b>	<b>100.00%</b>	<b>4.10%</b>

**1.2.4** Over the years, there has been no consistent pattern in performance. Historically, the cyclical in performance – as measured by profitability and exports – has been primarily a function of the price of cotton, which in turn depends on the quantum of local cotton production. However, the sector experienced severe competition from other countries after abolition of trade barriers through WTO regime. The increase in cost of domestic utilities, coupled with a deteriorating security situation, has constrained growth prospects of the textile sector. Although cost side pressures likely to continue, market conditions in key importing countries are changing rapidly. With regional competitors shifting their focus to the value added sector, relative positioning of the domestic spinning segment has improved. This is expected to benefit vigilant entrepreneurs, alive to the changing dynamics of the industry.

**1.2.5** Pakistan's textile sector continued to savor revenue and profit growth, up 39%YoY and 183%YoY respectively, in 1HFY11. Spinning, weaving and composite all registered notable earnings performances, with the spinning sector turning out to be the star performer. Textile sector's sales were recorded as PKR 202.9bln in 1HFY11. The growth was driven by better product prices in export and local markets as the manufacturers successfully passed the higher cost of production to end consumers. The textile exports for the six month period (July- Dec 2010) were up 26%YoY at USD 6.3bln (FBS, Pakistan). Further, albeit rising cotton prices both in international and local markets to record levels, strong gross margins (16%) witnessed across the industry on the back of early cotton inventory procurement at lower prices (cotton prices up 36.4% in 1HFY11). The profitability growth in the sector was substantially led by the spinning sector. With cotton prices maintaining an upward trend, inventory procurement could become a problem for small and medium sized entities.

**1.2.6** The following table gives an overview of SWOT of the sector:

## Pakistan's Textile Industry... SWOT

### Strengths

- Access to indigenous raw material
- Established track record in export markets
- Large domestic market
- Favorable regulatory structure

### Weakness

- Negative country perception
- Fragmented industry structure; most producers with limited economies of scale
- Lack of marketing and selling initiatives
- Low value added, largely commodity products
- Low Price Image
- Limited use of modern technology
- Unskilled labor force

### Opportunities

- Better laid down factories on 'best practices'
- Potential of improving confidence in buyer by working directly & closely
- Improving product mix and a gradual move towards more value added products
- Demand for home furnishing from Pakistan is growing in developed countries
- Women's wear has a huge potential

### Threats

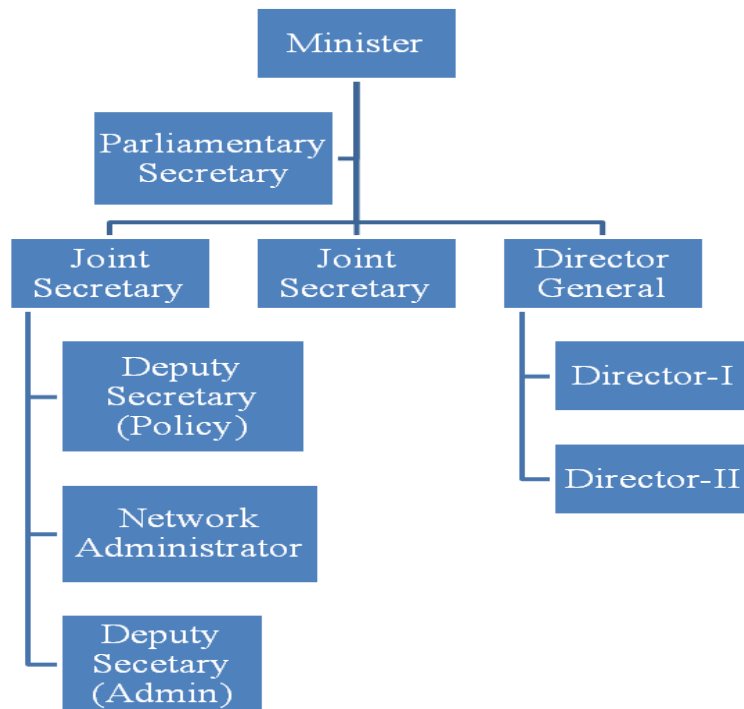
- Political instability and inconsistency in policy framework
- Rising cotton prices to push production costs for value added segment
- Increasing competitive pressures on product prices
- Natural calamities; disruptions in supply of raw material due to variable weather patterns
- Fashion life cycle
- Adverse changes in government policies

**1.2.7** GoP, being cognizant of the importance of the sector, has been adopting additional fiscal and non-fiscal measures to provide support to the sector. In this regard, it has been putting greater emphasis on the export of value-added products and increased domestic consumption of locally made textile products. Another step is the introduction of a five year Textile Policy 2009-2014 from Ministry of Textile Industry (MINTEX) – established in 2004 – which targets exports of USD 25bln by the end of policy tenor. One of the significant announcement of this policy was the establishment of Textiles Investment Support Fund and Technology Up-gradation Fund. The objective of these desired funds was to remove infrastructural bottlenecks by facilitating technology upgradation and new investments. However, the plan has not been materialized yet. Although, currently the sector enjoys specific concessions like zero rating tax facility on all textile products, reduction in export refinance rate, and long term financing for export oriented projects. However, SBP's stance to increase the borrowing cost going forward, and recent removal of sales tax exemption on domestic sales, would make the environment challenging for the textile players. Moreover, this would also dampen the probability to achieve the textile exports target of USD 25bln by end FY14. Nevertheless, the extent to which the Pakistan's textile industry succeed in sailing through increasingly tough operating environment remains to be seen.

**2. GOVERNANCE**

- **Governed by Ministry of Textile**
- **Large Number of Self Regulatory Organizations**

**2.1** In order to assess the feasibility and efficacy of an industry to achieve sustainable industrial development, it is critically important to examine the nature of governance system prevailing in that industry. GoP, keeping in view the strategic importance of textile sector, established a separate Ministry of Textile Industry (MINTEX) in September 2004, and appointed Mr. Mushtaq Ali Cheema, a renowned industrialist, as the first Federal Minister for textile Industry. The Federal Minister, appointed by the Prime Minister, is the functional head and is assisted by the Parliamentary secretary. The position remains subject to political shifts. The sitting minister is Mr. Mukhdoom Shabuddin. Mr. Shabuddin is a lawyer turned politician. Mr. Shahid Rashid – Secretary MINTEX – holds a Masters degree in Public Administration from Harvard University, Cambridge, USA.



The following table gives a brief overview of the ministry's functions:

Ministry	Functions
<p><b>Ministry of Textile Industry</b></p>	<ol style="list-style-type: none"> <li>1. Formulation of Textile policy</li> <li>2. To coordinate with Federal agencies/institutions, Provincial and local Government entities for facilitation and promotion of the textile sector</li> <li>3. To setup standards and monitoring and maintaining vigilance for strict compliance of the standards throughout production and value chain</li> <li>5. To conduct and concile textile related statistics, surveys, commercial intelligence, analysis and dissemination of information and reports on international demand patterns,market access etc</li> <li>6. To establish linkages with cotton and textile producing countries</li> <li>7. To provide training, skill development, research for quality improvement and productivity enhancement throughout the production/value chain</li> </ol>

	<p>8. To Manage textile quotas; and,</p> <p>7. Administrative control of:</p> <p>A) Federal Textile Board</p> <p>B) Textile Commissioner's Organization</p> <p>C) Synthetic Fiber Development and Application Center, Karachi</p> <p>D) Textile City Projects, Karachi/Faisalabad</p> <p>E) National Textile University, Faisalabad</p> <p>F) Directorate General of Textiles &amp; Quota Supervisory Council</p> <p>G) All textiles related EPB/EDF funded institutes concerned with skill development in various sub-sectors of textile industry</p> <p>H) Textile Testing Laboratory, Faisalabad</p> <p>I) Pakistan Cotton Standards Institute, Karachi</p>
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Apart from the above mentioned functions, MINTEX has introduced first ever **Textile policy 2009-2014**. Furthermore, recently a **Textile Law** has also been drafted and circulated among the textile stakeholders for their feed back. It was also agreed that Ministry of Commerce will consult MINTEX on textile trade negotiations and for the sector's trade promotion. Although, Textile Ministry will have representative on the Pakistan Central Cotton Committee, however, Ministry of Food, Agriculture & Livestock will have the administrative control.

**2.2** MINTEX has a consultation forum - Federal Textile Board (FTB), which is responsible to provide assistance to the ministry for the implementation of the recommendations contained in Textile Vision 2005. The following table gives an overview of the term of reference of this board:

Board	Term of Reference	Frequency of Meeting
<b>Federal Textile Board</b>	<ol style="list-style-type: none"> <li>1. To liaise with all stakeholders from cotton growers to textile exporters for removing any bottlenecks/problems in implementation of the recommendations</li> <li>2. To provide project financing for small and medium entrepreneurs in high value added textile segment</li> <li>3. To liaise with the Provincial Government to achieve the objective of value addition in the textile sector, from production of contamination-free cotton onwards</li> <li>4. To promote production of contamination-free cotton</li> <li>5. To take necessary steps to furnish inputs, e.g; certified seed, fertilizer, machine tools (ginning saws) and other raw materials to ensure supply chain movement towards value addition</li> <li>6. To review domestic and international prices of cotton and ensure a fair return to growers and maintain stability in domestic prices</li> <li>7. Human resource development for textile industry</li> <li>8. To take necessary measures to make Pakistan's textile products competitive internationally</li> </ol>	Monthly

**2.3** To facilitate coordination between the industry players and the government a special body - Textile Commissioners Organization (TCO) - also exists. TCO existed even prior to independence and was attached with different government departments at different intervals. After the creation of MINTEX, its administrative control was finally

transferred to this ministry. TCO advise government on technical matters relating to the Textile industry. It has also representative on different textile bodies. A brief description of its role is given below:

Body	Role	Representation
<b>Textile Commissioners Organization</b>	<ol style="list-style-type: none"> <li>1. To monitor the textile industry locally and internationally</li> <li>2. To gather statistical data</li> <li>3. To drafts and enforce execution of new rules and regulations; To develop appropriate policy measures to sloe the problems and difficulties of the industry</li> <li>4. To facilitate interaction within different sub-sectors of textile industry and evaluate the proposals made by them to draw up a consensus</li> </ol>	<ol style="list-style-type: none"> <li>1. Karachi Cotton Association</li> <li>2. Pakistan Central Cotton Committee</li> <li>3. National Textile University, Faisalabad</li> <li>4. Textile Machinery Company</li> <li>5. Pakistan Standard and Quality Control Authority</li> <li>6. Pakistan Textile City Company Limited/Garments City Company, Karachi</li> </ol>

**2.4** At present textile sector has following SROs, representing different textile segments.

- All Pakistan Textile Processing Mills Association (APTPMA)
- All Pakistan Textile Mills Association (APTMA)
- Pakistan Yarn Merchants Association (PYMA)
- All Pakistan Cotton Power Looms Association (APCPLA)
- All Pakistan Textile Exporters Association (PTEA)
- All Pakistan Bedsheets & Upholstery Manufacturers Association (APBUMA)
- Pakistan Knitwear & Sweaters Exporters Association (PAKSEA)
- Pakistan Art Silk Fabrics & Garments Exporters Association (APSF & GEA)
- Pakistan Bedwear Exporters Association (PBEA)
- Pakistan Commercial Exporters of Towel Association (PCETA)
- Pakistan Cotton Fashion Apparel Manufacturers & Exporters Association (PCFAM & EA)
- Pakistan Cloth Merchant Association (PCMA)
- Pakistan Canvas & Tents Manufacturers & Exporters Association (PCTMEA)
- Pakistan Gloves Manufacturers & Exporters Association (PGM & EA)
- Pakistan Hosiery Manufacturers Association (PHMA)
- Pakistan Readymade Garments Manufacturers & Exporters Association (PRGMEA)
- Pakistan Silk & Rayon Mills Association (PS & RMA)
- Pakistan Small Units Power Looms Association (PSUPA)
- Towel Manufacturers Association of Pakistan (TMA)
- Pakistan Denim Manufactures and Export Association (PDMEA)

Brief description of few SROs is discussed below:

**2.4.1 All Pakistan Textile Processing Mills Association (APTPMA):**

APTPMA, registered with Federal Ministry of Commerce under the Trade Organizations Ordinance 1961 and with Securities and Exchange Commission of Pakistan (SECP) under section 42 of the Companies Ordinance 1984, started functioning in July 1991. The association aims to protect and promote the interest of all

persons dealing in processing of textile dyeing, bleaching and printing. The association is mainly a joint platform of the unregistered organizations established for the above mentioned purpose. In June 2008, APTMA received a fresh license by the Federal Ministry of Commerce/Director General Trade Organizations under new Trade Organizations Ordinance 2007 as a Trade Organization. Currently, the organization operates in three zones – Karachi, Lahore/Gujranwala and Faisalabad – with its head office located in Faisalabad. APTMA currently has 475 member units. The current chairman is Mr. Maqsood Ahmed Butt, FCA, while the association has a twenty-six member Executive Committee.

#### **2.4.2 All Pakistan Textile Mills Association (APTMA):**

APTMA, founded in 1952, represents the organized sector of textile spinning, weaving, and composite mills. Currently its members' portfolio comprises 315 spinning units, 44 weaving, and 37 composite units. The registered installed capacity of these members is 9,661,366 spindles, 61,608 rotors, 10,452 shuttleless/airjet looms and 1,897 conventional looms. These members produce spun and open-end yarn, grey, printed dyed fabrics and bed linen. APTMA's head office is located in Karachi, while its two regional offices are in Lahore and Peshawar. To safeguard the interest of its members, APTMA coordinates with other national textile trade association. The administrative control of the head office is governed by the Chairman APTMA, Mr. Gohar Ijaz, and Central Executive Committee (CEC). The Central Executive Committee continuously reviews the policies and programs of the Association and establishes priorities accordingly. Apart from CEC – comprising 27 members, APTMA has following standing committees:

- I. Standing Committee on Raw Cotton
- II. Standing Committee on Man Made Fibre & Synthetic Textiles
- III. Standing Committee on Banking
- IV. Standing Committee on Energy
- V. Standing Committee on International Trade / WTO / ADI
- VI. Standing Committee on Research & Development
- VII. Standing Committee on Legal Affairs
- VIII. Standing Committee on Administration & Finance
- IX. Standing Committee on Image Building and Media Management
- X. Standing Committee on Islamabad Affairs
- XI. Standing Committee on Value Addition
- XII. Standing Committee on Export Price Check
- XIII. Standing Committee on Customs, Sales Tax & Industry
- XIV. Standing Committee on Taxation

**2.4.3 Pakistan Yarn Merchants Association (PYMA):** PYMA, established in 1960 under erstwhile Companies Act 1913 (now Companies Ordinance 1984), safeguards the interests of stakeholders involved in trading, manufacturing and sales of yarn. Its key objectives are.

- a) To protect and promote the interest of merchants and dealers in yarn of all grades, kinds and descriptions, and to take all necessary steps, for the protection and promotion of the trade in yarns generally.
- b) To communicate and consult with the public bodies and other associations in Pakistan and elsewhere for the promotion of interests of trade, commerce and industry

and/or persons engaged therein.

c) To create cohesiveness amongst the members of the association for the solution of all problems, relating to the yarn trade and to secure wherever possible, organized and/or concerned action on all subjects involving interests of the members.

d) Statistical data collection and circulation along with other information relating to the import, export or sale of yarns.

#### **2.4.4 All Pakistan Textile Exporters Association (PTEA):**

PTEA, established in 1985 by the name of All Pakistan Cloth Exporters Association, is headquartered in Faisalabad with a regional office in Karachi. The association with more than 300 permanent members is the first ISO-9001-2000 certified trade body of Pakistan. The association has an twenty four member Executive Committee.

#### **2.4.5 All Pakistan Bedsheets & Upholstery Manufacturers Association (APBUMA):**

APBUMA, commenced in 1983, aims in developing a synergy for creating a better environment in trade and industry. The association, having a fifteen member Executive Committee, has undertaken many projects for the betterment of the textile industry since its inception. The few worth mentioning projects include the establishment of College of Textile Engineering Multan, Multan Dry-port Trust Multan, Cluster Council for Bedsheets & Upholstery & Scientific Center. APBUMA, with a network of three zonal offices in Faisalabad, Lahore, Karachi and a head office in Multan and 318 members, has strong presence all over the country.

#### **2.4.6 Pakistan Knitwear & Sweaters Exporters Association (PAKSEA):**

PAKSEA representing the knitwear, sweater and fabric exporters of Pakistan was established in 1987. The main objective of the association is to promote and develop export of knitwear, sweater and fabrics. It also represents the knitwear industry at different official platforms to provide feedback regarding government policies, rules and regulations. PAKSEA, head quartered in Karachi, serves the members located in Sindh and Balochistan region, whereas its zonal office in Lahore caters the needs of its members of Punjab, Azad Kashmir and Khyber Pakhtoonkhwa. Moreover, PAKSEA has established Pakistan Knitwear Training Institute (PKTI), currently with two campuses, Karachi and Lahore. This institute provides technical training to the labour working in the knitwear and sweater industry. The association also has a seven member Executive Committee, who regularly monitors the affairs of the association. PAKSEA, having 125 members, not only collects and circulates important information about the knitwear and sweater industry to its members but also raises their concerns at the different regulatory forums.

#### **2.4.7 Pakistan Cotton Fashion Apparel Manufacturers & Exporters Association (PCFA):**

PCFA, employing ~ 200,000 human resource, represents the value added textile segment producing fine quality finished cotton apparel. Governed by a 13 member Executive Committee, PCFA not only updates its 250 members through statistical data but also promotes the interest of its members regarding various trades, taxation and manpower related matters. Moreover, PCFA also helps its members in getting access to international markets by carrying out marketing campaigns.

#### **2.4.8 Pakistan Hosiery Manufacturers Association (PHMA):**

PHMA, one of the old associations of Pakistan, was incorporated in 1960 under the Companies Act of 1913. Its founding members were leading players of hosiery and knitwear industry. The association aims to develop, promote, and protect the hosiery, knitwear industry. PHMA's Executive Committee comprises 23 members having representation from Central, South and North zones.

### 2.4.9 Pakistan Readymade Garments Manufacturers & Exporters Association (PRGMEA):

PRGMEA, since its inception in 1981, has been protecting and promoting the rights and interests of its members. The association through its Management Board consisting of 3 committees – one Central Committee and two Zonal Managing Committees – is serving 283 members across the country. Moreover, the association has also been magnificent in establishing Pakistan Readymade Garment Technical Training Institute (PRGTTI). The institute, established in 1997, provides different training programs for the development of readymade garment industry of Pakistan.

### 2.4.10 Towel Manufacturers Association of Pakistan (TMA):

As against the other segments of the textile processing, towel manufacturing started in Pakistan at a very small scale after 1965. In 1976, the towel manufacturing group was affiliated with the Federation of Pakistan Chamber of Commerce & Industry as an all Pakistan Association. During the same year, the association received Certificate of Incorporation by the assistant registrar Joint Stock Companies, Sindh. TMA with its two circles, Northern (Punjab & Khyber Pakhtoonkhwa) and Southern (Sind & Baluchistan), is providing assistance to its 176 members. The affairs of TMA are governed by 12 member Central Executive Committee.

### 2.4.11 Pakistan Denim Manufactures and Export Association (PDMEA)

As compared to other textile fabric, denim fabric is a recent development. PDMEA, representing the country's denim manufacturers and exporters, was established in 2006. Currently, there are 40 denim mills operation in Pakistan and all are the member of PDMEA. The association, through its registered office in Karachi and two regional offices in Lahore and Faisalabad each, is administered by a 10 member Managing Committee. PDMEA, with a three years work plan, aims to achieve competitive pricing of Pakistani denim products in the international markets.

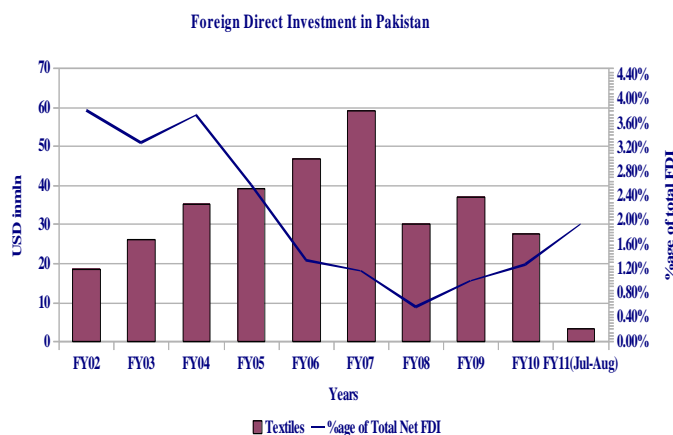
**2.5** Textile sector, due to its strategic importance and political clout, enjoys bargaining power. Sector representatives, through SROs and other forums, remain actively engaged with various government bodies to safeguard their interests. Issues like gas allocation, energy shortages and foavorable policy formulation are regularly taken up with MINTEX and concerned government bodies. Most recently, industry has negotiated with GoP to maintain zero rating facility for export oriented units and lessen the sales tax rate for domestic sales.

## 3. OWNERSHIP

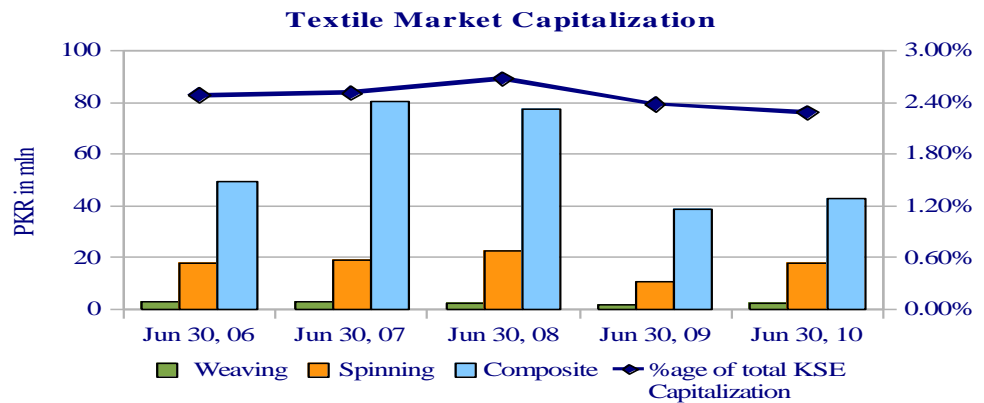
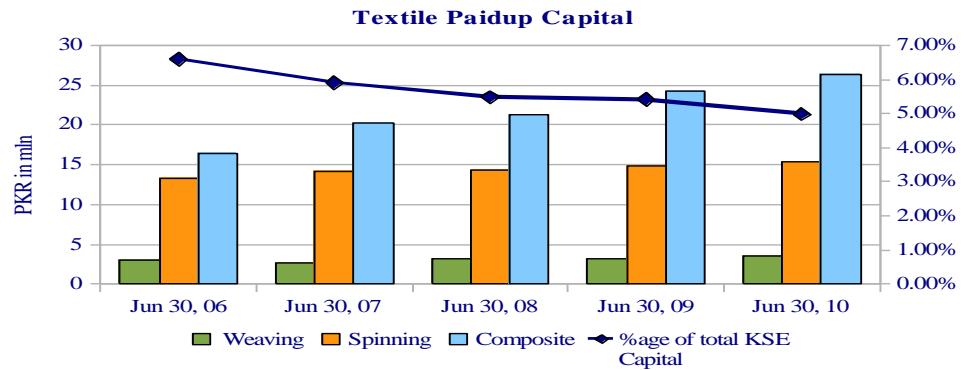
- Few listed companies
- Majority owned by Individuals
- Larger groups moving towards formalized structures

**3.1** The textile products are being manufactured both in the large scale organized sector as well as in unorganized

cottage/medium & small units. From 2000 to 2009, with the combined efforts of private and public sector, the textile industry made a rapid development. Total investment made in textile industry during 1999-2009 is estimated to be USD 7.5bln that has led to improvement in productivity – both in terms of quality and quantity. Textile sector is completely deregulated



and no government sponsored entities participate in this sector. The listed textile companies are divided in the three groups: A) Spinning, B) Weaving, and C) Composite. The following graphs provide YoY status of the paid up capital, market capitalization of listed textile companies and their respective share in KSE:



**3.1.1 Spinning:** This is the largest textile segment in terms of number of listed units. There are 106 listed companies on KSE - 23% of the total spinning population. Most of these companies are owned by business families or group of individuals.

**3.1.2 Weaving:** Weaving has two different sub-sectors: A) mill and B) non-mill (power loom sector). At present there are 18 weaving companies listed on KSE.

**3.1.3 Composite:** These integrated units, also known as value added segment, have complete finishing facilities that includes spinning, weaving, processing, bleaching, dyeing and finishing, and stitching. This segment, with its 62 listed participants, contributes above 50% of the total listed textile companies' paid up capital and more than 65% of the market capitalization.

**3.2 Ownership in textile industry rests with private sector.** Textile units are owned by individuals and business families. Established after independence in 1947, most of the businesses are family owned and managed. Currently the ownership resides with the second/third generation of the original entrepreneurs. This also highlights the importance of succession planning as succession statistics show that only about 30% of family businesses survive into the second generation, 12% are still viable into the third generation, and only about 3% of all family businesses operate into the fourth generation or beyond. Since majority of units are small to medium size, succession does not cause much problem. While large groups are working on group holding structures, the adaption of a corporate culture with separation of ownership and management is at an early stage. A brief profile and ownership structure of the few textile players of

Pakistan is discussed below:

**3.2.1** Nishat Mills Limited (NML), established in 1951, is the single largest textile composite unit in Pakistan. The company is a leading exporter of textile products in the country. Overall, NML has 17 manufacturing units each specializing in a specific product range located at Faisalabad Sheikhpura Ferozewatwan and Lahore. NML's diverse product range includes various varieties of yarn, grey fabric, processed fabrics, garments made-ups.

NML is the flagship company of the Nishat Group which is one of the country's leading conglomerates with interests in textile, cement, energy, power and financial sectors. Nishat Group, through family members (Mansha family) and associated concerns – mainly D.G. Khan Cement Company Limited – owns majority (~51%) holding in the company.

**3.2.2** Sapphire Fibers Limited (SFL), incorporated in 1979 and listed on all three bourses of the country, is one of the largest specialized yarn manufacturing and marketing company in Pakistan. Apart from producing a range of finer quality yarn, the company is also engaged in weaving, dyeing and finishing, and stitching. SFL is an export oriented company with two third of its turnover comprising exports to the USA, Europe and the Middle East. The company has three manufacturing facilities: two are located in Sheikhpura (Kharianwala and Feroze watwan) and the other is located in Lahore.

Sapphire Group (SG) owns 79% stake in SFL through direct and indirect shareholding. Mr. Mohammad Abdullah, the chairman of the group, founded SG when he migrated to Pakistan after the partition. The group is mainly concentrated in the textile industry. Within the industry, it has significant presence in spinning, weaving and other value added segments. SG has recently diversified into power sector based on its experience with the captive power plants. Mr. Mohammad Abdullah has four sons. Each of them has been entrusted with the responsibility of specific group companies. The entities constituting Sapphire Group include Sapphire Rextile mills Limited, Reliance Cotton Spinning Mills Limited, Diamond Fabrics Limited, Amer Cotton Mills (Pvt.) Limited, Sapphire Power Generation Limited, Sapphire Finishing Mills Limited, and Sapphire Electric Company Limited.

**3.2.3** Nagina Cotton Mills Limited (NCML), established in 1967, and listed on Karachi and Lahore Stock Exchanges, is engaged in the production and marketing of different types of yarn. NCML, with its registered office at Karachi and plant located at Kotri Industrial Trading Estate, Sindh, is a medium sized spinning unit having a capacity of 46,428 spindles.

NCML is majority (91%) owned by Nagina Group (NG), through group companies and key sponsoring individuals. NG comprises three publicly limited companies and five private limited companies and employs over 3,500 employees. The public limited companies are listed on both major bourses in Pakistan, and include NCML, Prosperity Weaving Mills Limited (PWML), and Ellcot Spinning Mills Limited (ESML). The private limited companies include Monell (Pvt.) Limited (MPL), Icaro (Pvt.) Limited (IPL), Haroon Omer (Pvt.) Limited (HOPL), Ellahi International (Pvt.) Limited (EIPL), and ARH (Pvt.) Limited (APL). Currently, NCML and ESML collectively operate 100,956 spindles. PWML, comprising 324 looms of various widths, produces fabric of over 55,000,000 (fifty five million) linear meters annually. Of the five private companies, HOPL, MPL and IPL have been set up independently by three key sponsoring individuals<sup>1</sup>; the objective is to use these companies as a vehicle to hold

<sup>1</sup> Three brothers; namely 1) Mr Shaukat Ellahi Shaikh(MPL), 2) Mr. Shafqat Ellahi Shaikh (IPL), and 3) Mr. Shahzada Ellahi Shaikh (HOPL)

their individual investments in the listed companies and/or to manage their personal equity investment portfolios. On the other hand, EIPL and APL represent joint family ownership and, in addition to having proprietary investments, maintain holdings in the three listed group companies.

**3.2.4** Fazal Cloth Mills Limited (FCML), incorporated in 1966 and listed on Karachi and Lahore Stock Exchanges, is engaged in the manufacturing and marketing of different varieties of yarn. FCML started its business in 1972 with a small scale spinning unit. The company now operates four spinning units (141,816 spindles), three in Muzaffargarh and one in Multan.

Fazal Group (FaG) and Fatima Group (FG) own 45% and 41% stake in FCML, respectively. Late Mr. Sheikh Fazal-ur-Rehman, the predecessor of the Fazal Group and Fatima Group, started his journey in 1936 by setting up a vegetable oil and ghee unit. His son, Mr. Sheikh Naseem Ahmed, played a leading role in the establishment of Fazal group. The group is engaged in the business of cotton ginning, ring spinning, and greige fabric manufacturing. Another son of Late Mr. Sheikh Fazal-ur-Rehman, Mr. Sheikh Ahmad Mukhtar, was instrumental in establishing Fatima Group. FG is now one of the leading corporate groups in Pakistan with interests in sugar, textiles, fertilizer and foreign trade. The group has close to seven decades of experience in textile business with over 50 years of experience of dealing in export markets such as the US, Japan, Hong Kong and various European countries.

**3.3** The presence of strong business families in the textile business assures a strong affiliation between the owners and the entities. The families are carrying their businesses with the same name for decades and have very strong willingness to keep it operational. The strength of the large businesses groups adds to their ability to manage any possible crises. This holds true with many small to medium players in the industry as well where the willingness is very high while they may lack in ability to certain extent.

#### 4. MANAGEMENT AND SYSTEMS & CONTROL

- Control vested with Owners
- Poor Quality Standards

##### Management:

The management of the textile industry is mainly vested with its owners, majority of whom belong to second or third generation. Nevertheless, with the changing global market requirements and increasing competition, the industry is in the transition phase and gradually inducting professional management. The top management – the owners – are supported by teams of professionals with relevant experience in the textile industry. The organizational structure of the industry is mainly divided into three functional areas: (1) Production (2) Finance and (3) Marketing. To meet the need of technical expertise, the country has two textile teaching universities, offering requisite technical education. Moreover, with the sufficient supply of labour, this industry never faced human resource shortage. The players of the textile industry also manage their macro level issues through Self Regulatory Organizations (SROs). All these associations are affiliated with the Federation of Pakistan Chamber of Commerce & Industry.

##### 4.2 Systems and Control:

Despite being the 4<sup>th</sup> largest producer and 3<sup>rd</sup> largest user of cotton, Pakistan still stands 9<sup>th</sup> in the international trade. Following are few factors which are causing lag in the production of our textile products.

##### 4.2.1 Research & Development (R&D):

Although cotton is one of the major crops of the country, there has not been any significant research and development to increase the quality and quantity of this crop. Pakistan's cotton crop yield is lower due to many factors including shortage of good quality and different varieties of seed, pest attacks, rising costs of agricultural input –

seeds, fertilizers and pesticides – lack of awareness of the farmers about technology advancement and agri profession. However, with the recent developments in genetically modified seeds – BT cotton – per acre yield is expected to increase as the crop is protected from certain damages.

**4.2.2 Technological advancement:**

Pakistan's textile sector is equipped with poor mechanical infrastructure, which results in higher cost of production as compared to other regional countries like India, Bangladesh and China. This also affects the Pakistani textile products' competitiveness in the international markets. Moreover, most of the textile units import old and cheap machinery from China, India, Korea, and Taiwan. This poor technological framework produces lower quality products which does not comply with the international quality standards.

On the MIS front, majority of the players employ people-based control mechanisms. However, the trend is changing in larger export oriented textile units which are working on improving their control through Information Systems. There are two major reasons to upgrade to MIS, 1) the units opting for IS have grown to an extent where they require centralized monitoring, often over more than one location. 2) the international buyers recommend improving control systems at par with international standards when entering into long term relationship. Hence, number of players are in process of implementing fully integrated ERP systems.

The capacities have remained uniform over a long time. However, increasing international demand has pushed some large export oriented players to undertake expansion projects.

**4.2.3 Human resource development:**

Another problem faced by Pakistani textile units is the lower productivity of labour. According to a survey conducted by the Financial Advisor on Textile, average time consumed by Pakistani labour to produce a piece of cloth is 133 minutes as compared to 75 minutes taken by our regional competitors. Although there is an ample supply of labor but most of them are unskilled. This demands the provision of training for efficient execution.

**4.2.4 Supply chain management:**

Another drag on the performance of our textile sector is the absence of efficient supply chain management and centralized framework. Many economic and political factors limit the ability of the exporters to meet their commitment timely and may also result in losing business in future.

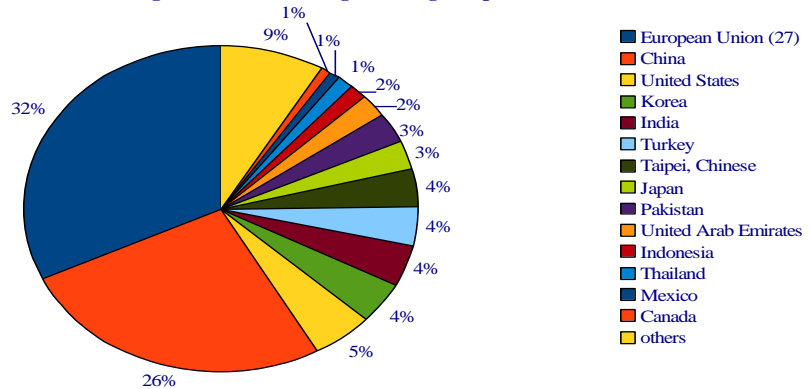
**5. BUSINESS RISK**

- **Slow World Trade Growth**
- **Post Quota Abolition Challenges**
- **Tough Working Environment**
- **Draft Textile Industry Act**

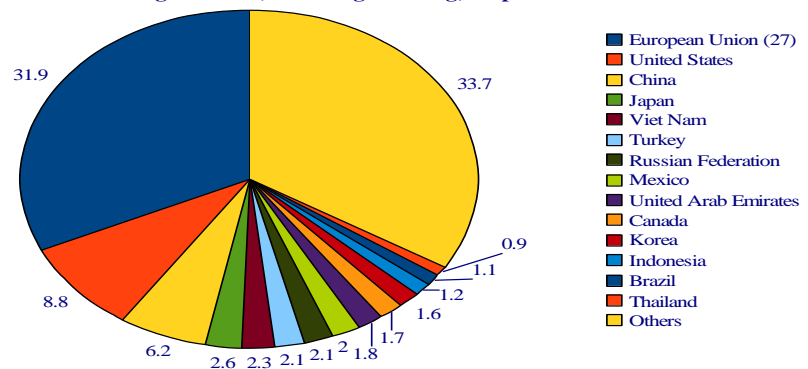
**5.1** World textile and clothing trade reached to USD 612bln in 2008, almost doubled from USD 355bln in 2000 with clothing growing at a faster pace. Nevertheless, the 2007-08 increase of 4.4% represents slower growth compared with the previous few years. This depicts the reduction in demand from the developed countries suffering from 2007 economic crises, which, dropped the world trade volume by 12%, more than the prediction of the global economists. However, most of the world economies are in recovery phase. For the year 2010, WTO is estimating a volume growth of 9.5% in the global exports.

**5.2** During 2008, the world's biggest textile exporter (USD 80bln) and importer (~ USD 84bln) was the EU27. Whereas in clothing, China (USD 120bln) was the world's leading exporter for the third consecutive year followed by the EU27 (USD 112bln). For clothing imports, EU (USD 177bln) again took lead by utilizing 47% of the world total, with the USA (USD 82bln) catching 22%, Japan (~USD 25bln) - 7% and Russia (USD 21bln) – 6%. Also in the recent times there has been a shift in demand pattern as demand for medium and low-end products is growing at a relatively faster pace.

**Leading Textile (excluding clothing) Exporters-2008**



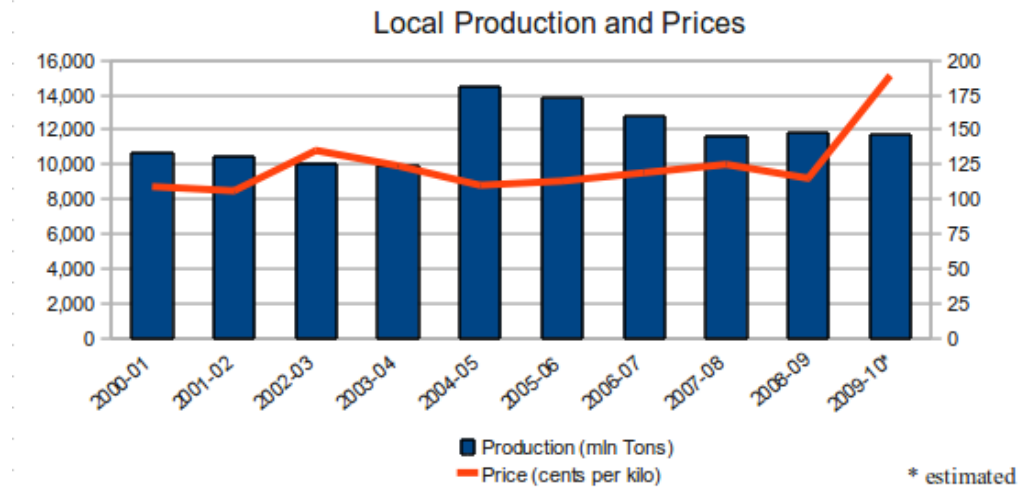
**Leading Textile (excluding clothing) importers - 2008**



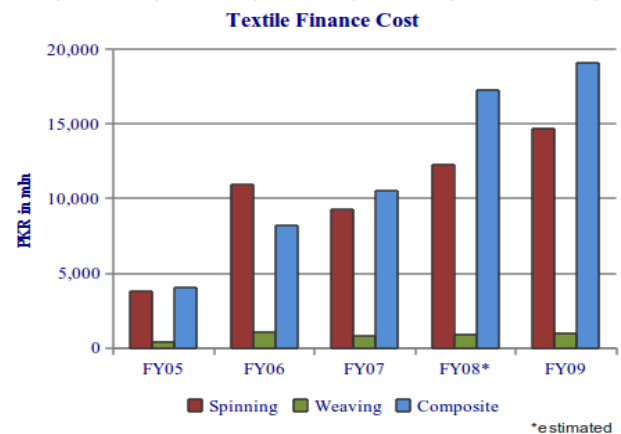
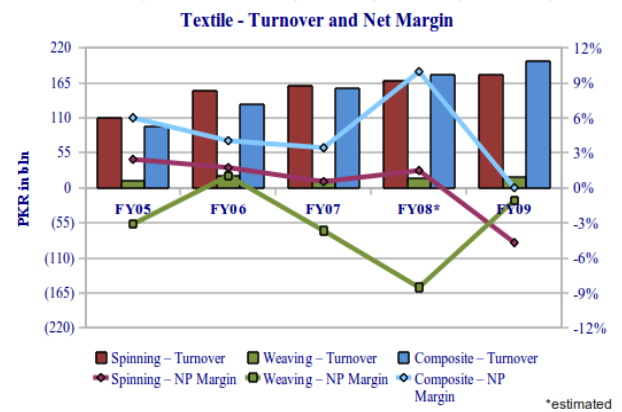
**Raw Material:** Cotton production in Pakistan has largely remained flat over the last decade (Avg. ~ 11.5mln bales/annum) with a major jump in 2004 (14.5mln bales). However, the yield of cotton crops has not improved and Pakistan continues to lag behind other major producers. This is due to old farming techniques being followed and the use of non-modified breed of cotton plants. In contrast, the world has moved on to genetically modified varieties which help farmers in increasing their yields per acre. The use of genetically modified seeds (BT Cotton) is gradually picking up in Pakistan. This is expected to have a positive impact on yields, going forward.

Annual consumption of cotton by the local industry averages around 16mln bales of which almost 75% is met through local production. The rest is imported from China and Egypt. The price of cotton had fluctuated between 100-130 cents per kilo up until 2010, when it saw an almost 75% increase. The increase was fueled by speculation of low production in Pakistan and damage to the Chinese cotton crop during the year. Moreover, activity in the commodities as a hedge against devaluation of major currencies of the developed world has also contributed towards this spike. This trend is likely to continue, with various sectors in the value-chain passing on the price increase to the consumer. Meanwhile, manufacturers are also upbeat about the demand volume remaining high, as consumption of textile products is directly proportional to population

growth and rising purchasing power of consumers in the developing world.



**5.3 Performance:** Pakistani exports over the years have been dominated by textile sector contributing ~53% during FY10<sup>2</sup> to total exports (FY09: 49%). Accordingly, the performance of the sector has a significant impact on the country's overall economy. Pakistani textile sector had to face challenging environment after the abolition of quota regime due to competitiveness of other regional players - China, India and Bangladesh. Few segments of textile industry - cotton yarn, cotton cloth; bed-wear, garment and knitwear - were impacted from the new trade development. Although, textile sector witnessed growth in the turnover during next two years, this growth could not be transferred to bottom-line due to higher finance cost. FY08 was a disappointing year as production of major components of textile industry dropped, resulting in a decline of 2.5% in exports for the period. Weaving segment could not transfer rising input costs to consumers resulting in major decrease in margins. Although the international prices were rising on demand pull trend, Pakistani textile manufacturers were not able to reap full benefits from this opportunity. Higher cost of production owing to relative increase in domestic cotton prices and stifling power shortages coupled with deteriorating law and order



<sup>2</sup>

State Bank of Pakistan

situation in the country resulted in export order losses to other countries. During 2009, Pakistan experienced rising domestic interest rates causing further deterioration in the liquidity position of the industry. All these factors adversely affected the exports during the period. Moreover, global economic crisis and recession in the USA – largest buyer of Pakistan's textile export – also hampered textile exports' performance. In FY09, Pakistani textile exports while taking the dual advantage of better pricing and rupee devaluation, registered a substantial growth on YoY basis. However, again, this growth could not support the bottom-line, hence margins, owing to hefty finance cost on back of high interest rates.

**5.3.1 Spinning:** FY10 turned out to be tremendous year for Pakistan's spinning segment as China, the largest producer of yarn, stopped production of 12 million spindles – equivalent to Pakistan's total installed capacity. This phenomenon, while improving the supply/demand equilibrium in the world yarn market, provided an added export avenue to local spinners. This led to a sizable increase in the turnover of the spinning segment. Most of the players enjoyed healthy gross margins attributable to Pakistani rupee devaluation and better pricing of their product locally as well as internationally. Pakistani spinning sector has been able to develop a niche in high course count market. Moreover, better inventory management also supported the margin as the cotton prices jumped up record high in the later half of the year. Additionally, reduction in lending rates also benefited the bottom-line of the debt holders. However, going forward, these substantial gains may not sustain considering the relative stability of domestic currency and increasing cost of production with reforms in the energy sector and tax regime. Since the sector remains highly dependent on domestic supply of cotton due to competitive pricing and ease of procurement, the recent floods have added to issues already faced by the industry. These, coupled with a negative country perception owing to the precarious security situation, all undermine the competitiveness of Pakistani textile products in the global market.

**5.3.2 Weaving:** During FY10, despite a moderate increase in the turnover of the segment, the gross margins remained stagnant due to significant rise in the input cost – raw materials and energy – which could not be completely passed on to the customers due to global economic crisis. Moreover, Pakistani cloth exports also dropped down by 10% in the review period. However, reduced financial cost and improved other income helped the sector's bottom-line turn black.

**5.3.3 Composite:** The composite segment experienced a significant jump of ~25% in its top-line emanating from higher product pricing and rupee dollar exchange rate parity. Among the composite segment's products, home textile component was the main export driver as against the readymade garments, which dropped slightly. Nevertheless, comparative increase in the cost of production could not help in translating the same into gross margins. Interestingly, it was better pricing of yarn and improved volumetric sale of the home textiles which helped the players in retaining their margins. Given the reduction in the borrowing cost, most of the players posted better profitability hence improved net margins.

**5.4 Investment risk:** Textile industry has a small investment book as evident by few of its major players' investment portfolio - Nishat Mills Limited, Nagina Group, Sapphire Group, and Fazal Group. This comprises equity stakes mainly in group companies and real estate investments. Given the strategic nature of most of these investments, the players generally enjoy significant unrecognized gain on these investments. However, divestment of this portfolio remains unlikely given its strategic nature.

**5.5** Companies which have come to terms with the changing scenario, have put in place the requisite infrastructure and identified an appropriate product range and mix that would enhance their competitive position in exports. Thus, within the entire textile

landscape, the attributes of potential winners and laggards are clearly identifiable. In the absence of redressing the fundamental structural issues, Pakistan’s bulk of textile exports would remain confined to the lower end of the international market. Given the strategic importance of the sector to the economy, the GoP is also extending requisite support to the sector. In this regard, a draft Textile Industry Act for the development, promotion and standards of the industry, has been circulated among the SROs, soliciting their feedback. This law highlights government's intent to promote textile sector by taking requisite measures such as discounted interest rates through Export Refinance Facility (ERF), lower cost of financing for BMR, establishment of training institutes and infrastructure advancement. Moreover, the government also plans to i) promote and develop Pakistani textile products' markets abroad, ii) provide budgetary support, iii) regulate trade, iv) compile data and, v) establish Federal Textiles Board. The law is expected to be approved by National Assembly, nevertheless, the extent to which this law manages to address the concerns of textile industry players successfully, remains to be seen.

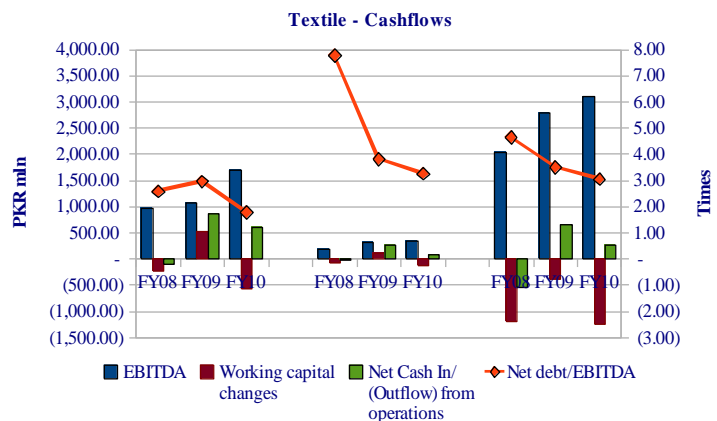
**5.6** The industry is currently enjoying healthy margins with the cotton prices continuing on a rising trend. Although the industry has been facing energy supply shortages, it has managed to pass on the cost increase to the consumers. Recently, strong bargaining power of SROs has enabled the sector to negotiate with the GoP and continue receiving the zero rating facility on exports while reducing the tax rates for domestic sales.

**6. FINANCIAL RISK**

- **Low to Moderately Leveraged Capital Structure**
- **Increasing Cost of Borrowing**
- **Pressure Times Ahead**

**6.1** Textile<sup>1</sup> is relatively a capital intensive industry. The cost of establishing a textile unit – spinning, weaving, or composite – varies and depends on the type of machinery and technological framework. However, the sector offers the opportunity of scaling up from a small production base over time and most of the businesses have used this strategy. The benefit being that start-up cost are lowered and growth is financed from debt and retained earnings. This industry enjoyed a period of heavy investment from 2003 till 2007. Almost half of the capital expenditure was made in the spinning industry. This investment boom until 2007 was due to the phase out of traditional quota regime under WTO – Agreement on Textile and clothing and China’s integration into WTO structure. The following graph presents the pattern of foreign direct investment in textile sector over last ten years.

**6.2** Textile industry’s working capital requirements are mainly a function of its inventories and for this it avails short term credit lines from banks. Furthermore, previously to encourage exports, the State Bank of Pakistan (SBP) has also been providing financing under the Export Finance Scheme (EFS) at significantly lower rates. However, during the current year, SBP has revised its rates repeatedly, taking it to 10% p.a. while planning to make it equivalent to six months Treasury Bills rates (13%). The graph depicts the cashflow pattern of the three major segments of the textile industry during the last few years. The operating cashflows of the textile companies have been a function of its working capital requirement and finance cost. The players of the industry have witnessed a rising trend



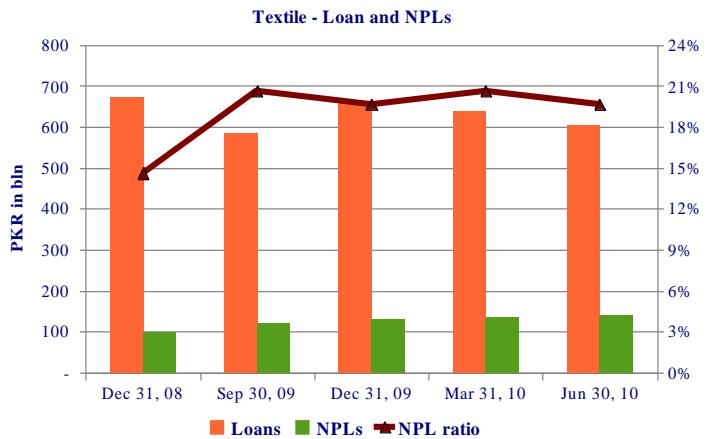
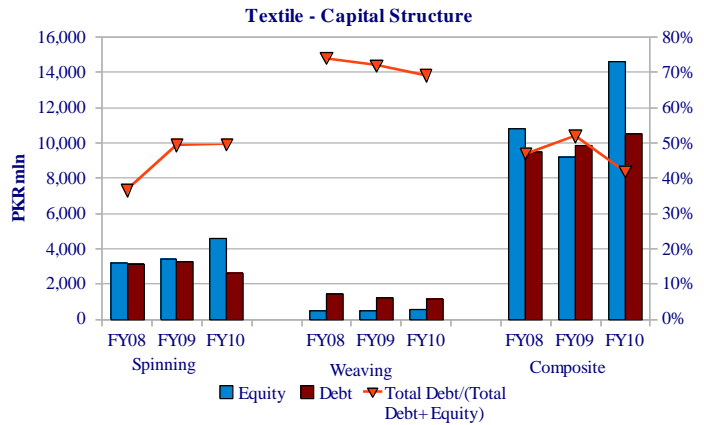
in EBITDA with better profitability over the years. Hence coverage also experienced improvement as evident by the better net debt\EBITDA.

**6.3** Apart from short term borrowings, the spinning and composite segments are low leveraged (sample average total debt/(total debt+ equity): spinning: 49%; composite: 42% at end-Jun10) as against the weaving segment which is relatively highly leveraged (69%). Textile sector

has been enjoying subsidized borrowing cost by availing Long Term Financing Facility (LTFF) from SBP for its balancing, modernizing and replacement activities. Nevertheless, these rates have also been revised up to maximum of 11%-11.2% depending on the period of financing. It is

pertinent to mention here that currently textile sector has the largest proportion in the advances' portfolio of the banking sector (end-Dec09: 18%; end-Dec08: 20%).

**6.4** Given rising cost of production and squeezing margins – aborting the sector's repayment capacity, its NPL/Total Advances ratio (end-Jun10: 20%; end-Dec09: 20%) is higher than the overall country's average of ~13%. Keeping in view the cost of financing, this ratio may go up. The adjacent graph shows the textile banking loan book and the NPL trend during the last few quarters.



<sup>i</sup> The financial risk of the textile sector has been discussed on the sample basis. The sample companies are  
A. Spinning (60 % market capitalization): Fazal Textile Mills Limited, Gadoon Textile Mills Limited, Din Textile Mills Limited, Indus Dyeing Manufacturing Company Limited, Ibrahim Fibre Limited, and Rupali Polyester Limited.  
B. Weaving (74% market capitalization): Prosperity Weaving Mills Limited, Shahtaj Textile Mills Limited, and Zephyr Textile Limited.  
C. Composite (60% market capitalization): Azgard Nine Limited, Nishat (Chunian) Limited, Nishat Mills Limited and Crescent Textile Mills Limited.