Spinning

Sector Study

September 2021

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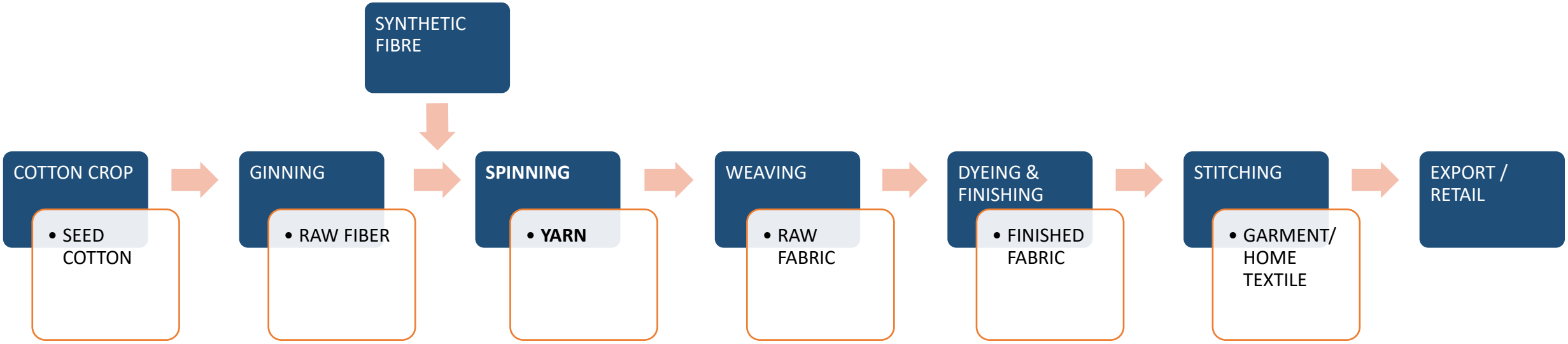
Textile Value Chain

- Textile cluster has a relatively large value chain with multiple distinct sectors.
- The following flow chart depicts the major processes along with the output of textile value chain
- The spinning sector, which processes cotton into yarn, falls towards the beginning of the value chain, also referred to upstream sector in the textile chain. However, there is limited value addition in this segment.



Spinning | Introduction

Production Process

Blow Room: the compressed bales are opened, cleaned and blended/mixed according to particular length to form a specific size of lap.

Carding: The lap is shifted to carding machine where cleaning and intermixing of fibers occurs to produce a continuous web.

Combing: Fibres are straightened and arranged in parallel manner and short fibers are separated from long fibers.

Drawing: Strengthening of fibers by passing them through rollers.

Roving/Ring Frame: Roving frames carry out process of converting fibers into low twist lea. Further twisting is done to form yarn of required count and strength.

Cone Winding: Final stage where yarn is wound into cones so that it can be shipped to the customer.

Source: Textile InfoMedia

Spinning | Introduction

Yarn Count

- Yarn count is a measurement which determines its fineness or coarseness.
- There are two methods of calculation of Yarn Count, Direct and Indirect, with Indirect method more widely practiced.
- The Direct Method uses weight per unit length to determine count with thicker/coarse yarn having higher count. There are various numbering systems as shown in the adjacent table.
- The Indirect Method uses length per unit weight to determine count with finer yarn having higher count. There are various numbering systems as shown in the table.
- The English numbering system is practiced in Pakistan. The unit length of 840 yards is also known as a hank. The number of hanks per lb. of yarn equals the yarn count.
- In Pakistan, yarn is divided between coarse, medium, fine and super fine categories based on count with major production concentrated in coarse and medium count yarns.
- Different dying and chemical processes add value to the product.
- The higher count yarn attracts higher price.

Direct Method		
Numbering System	**Unit of Length**	**Unit of Weight**
Tex System, Tt	1000 m	No. of grams
Denier, D or Td	9000 m	No. of grams
DeciTex, dtex	10,000 m	No. of grams
Millitex, mtex	1000 m	No. of milligrams
Kilotex, ktex	1000 m	No. of kg
Jute Count	14,400 yards	No. of lb.

Indirect Method		
Numbering System	**Unit of Length**	**Unit of Weight**
English cotton count, Ne/S	840 yards	1 lb.
Metric count, Nm	1000m / 1km	1 kg
Woollen Count (YSW)	256 yds.	1 lb.
Woollen Count (Dewsbury)	1 yd.	1 ounce (oz.)
Worsted Count Nek	560 yds.	1 lb.
Linen Count, NeL	300 yds.	1 lb

Yarn Type	Count
Coarse	1s - 20s
Medium	21s - 34s
Fine	36s - 47s
S.Fine	48s - 80s

Source: Yarn Counts & Calculations, Thomas Woodhouse (Oxford Technical Manuals), TCO

Spinning | Introduction

Technology & Machines

- Major manufacturers of spinning machines (i.e. spindles & rotor machines) and other textile machinery are based in Germany, Italy, Belgium, Switzerland, China, and Japan.
- Major manufacturing brands include Saurer Schlafhorst GmbH & Co., Toyota, Murata Machinery Limited, Savio Machine Tessilli, Rieter, RIFA Textile Machinery Co. Ltd. Lakshmi Machine Works Limited, among others.
- The efficiency of spinning machines is determined by the number of spindles installed on the machine and its RPM (Rotations Per Minute). More advanced machines have higher RPM, resulting in higher efficiency. The RPM of latest spinning machines from major manufacturers can reach up to ~125,000 - 150,000RPM.
- Overall, the cost of spinning machines depends on number of spindles, RPM and level of automation of back processes. However, import and installation costs are also significant and raise the overall cost for spinning players.
- Almost all machinery used in the sector is imported from Europe and East Asian Countries (mainly China). Further, there is a need for continuous technological BMR to improve efficiency to remain competitive in the international landscape.

Source: Manufacturers' Websites

Spinning | Global Overview

- The global market size of spinning industry fell ~3%, from USD~77.2bln in CY19 to USD~74.9bln in CY20. The decline came on the back of the COVID-19 pandemic due to which consumption and demand declined during the year.
- China remains the global leader in terms of cotton yarn production and consumption. In CY19, China produced 6.4mln MT of cotton yarn. Other large cotton yarn producers include India, 5.3mln MT and Pakistan,3.4mln MT. These three countries accounted for ~72% of global cotton yarn production.
- Meanwhile, China accounted for ~38% of global cotton yarn consumption at 8.1mln MT while India accounted for ~15% with 4.3mln MT.
- As a result, Asia-Pacific is the leading region in the global yarn market, which is followed by the North American region. Changing consumption pattern, increasing population, disposable income, the rise in demand for clothing along with home furnishing products in Asia-Pacific region are major growth factors of the market.
- As the world recovers from the COVID-19 pandemic, the spinning industry is expected to experience growth, going forward. Rapid growth in urbanization and increasing requirement of the industries are the major factors that anticipate driving the market growth.
- Moreover, blended varieties of yarn are becoming more common in the market owing to significant features of both artificial and natural yarn thus opening up new growth opportunities in the coming years.

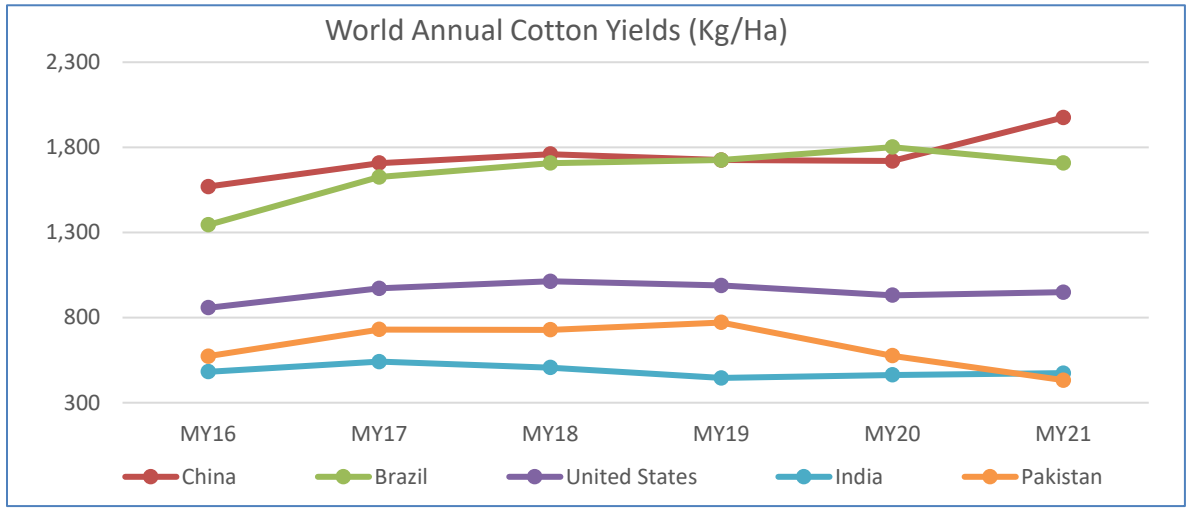
Source: globaltrademag.com, marketwatch.com

Spinning | Global Cotton Dynamics

Production & Yield

- During MY21, the global production of cotton stood at ~24.5mln MT as compared to ~26.4mln MT in MY20. This decline of ~7% came on the back of reduced area under cultivation which fell from 34.85mln Ha. in MY20 to 31.41mln Ha. in MY21.
- The decline in area under cultivation was a result of the COVID-19 pandemic which hampered crop cultivation in various parts of the world.
- India and China are the largest cotton producers in the world, accounting for ~51% of total production during MY21. China was the only one amongst 5 largest producers to exhibit an increase in cotton production during the year.
- Meanwhile, the global cotton yield increased slightly by ~3% with India, USA and China contributing to the increase. Pakistan's cotton yield exhibited the steepest decline falling ~25% from 577 Kg per Ha in MY20 to 433 Kg per Ha in MY21. The decline was due to pest attacks and adverse climatic conditions during the year. In addition, low quality of cotton seed and greater profitability of alternate crops has caused yields and overall production to decline in recent years.

World Cotton Production (000 MT)					
Country	MY17	MY18	MY19	MY20	MY21
China	4,953	5,987	6,042	5,933	6,423
India	5,879	6,314	5,617	6,271	6,162
United States	3,738	4,555	3,999	4,336	3,181
Brazil	1,528	2,007	2,830	3,000	2,341
Pakistan	1,819	1,969	1,832	1,457	960
Rest of World	5,309	6,156	5,498	5,435	5,405
Total	**23,226**	**26,988**	**25,818**	**26,432**	**24,472**



Note: MY stands for marketing year which is August to July

Source: USDA

Spinning | Global Cotton Dynamics

Import & Export

- During FY21, the trade of cotton recovered with an overall increase in imports of ~20% after suffering a decline in FY20 due to the COVID-19 pandemic.
- China is the largest importer of cotton, with a share of ~26% of total imports during FY21. Other major importers include Bangladesh (~18%), Vietnam (~15%), Turkey (~11%) and Pakistan (~8%). These countries are among the major producers of finished goods, such as garments and apparel, within the textile value chain.
- United States and Brazil are the largest exporters of cotton, with ~34% and ~23% share in total exports, respectively. Both countries export a significant share of their total cotton production. Meanwhile, India also has significant share of ~13% in total export, however, this is a relatively small share of production as the majority is consumed locally.

World Cotton Imports (000 MT)					
Country	MY17	MY18	MY19	MY20	MY21
China	1,096	1,243	2,099	1,554	2,801
Bangladesh	1,481	1,655	1,524	1,633	1,905
Vietnam	1,197	1,524	1,511	1,411	1,585
Turkey	838	956	785	1,017	1,160
Pakistan	506	599	415	536	857
Rest of World	3,128	3,070	2,905	2,718	2,340
Total	**8,246**	**9,047**	**9,239**	**8,869**	**10,648**

World Cotton Exports (000 MT)					
Country	MY17	MY18	MY19	MY20	MY21
United States	3,248	3,545	3,230	3,377	3,564
Brazil	607	909	1,310	1,946	2,398
India	991	1,128	767	697	1,350
Australia	812	852	791	296	349
Greece	221	234	295	319	348
Rest of World	2,367	2,379	2,846	2,234	2,639
Total	**8,246**	**9,047**	**9,239**	**8,869**	**10,648**

Source: USDA

Spinning | Global Cotton Dynamics

Consumption & Ending Stocks

- The growth in global cotton consumption during FY21 of ~16% was primarily due to the low base effect of previous year. During FY20, the COVID-19 pandemic greatly reduced cotton consumption, particularly in the second half of the fiscal year as many countries went through extended lockdowns.
- While the COVID-19 pandemic continues to cause uncertainty, the increase in vaccination rates and adoption of social distancing measures have enabled textile and allied industries to resume operations, thus increasing demand and consumption of cotton.
- China and India are the largest consumers of cotton, accounting for ~53% of global consumption. Meanwhile, Pakistan has had a relatively stable share of ~9% in global cotton consumption from FY16 to FY21.
- The reduced consumption in FY20 had resulted in increase in ending stocks of the period. However, revived consumption alongside lower production levels have brought FY21 ending stock levels down by ~7%. Despite this ending stocks are above pre-COVID levels.
- China maintains the largest ending stock levels, amounting to ~43% of global cotton ending stocks.

World Cotton Consumtion (000 MT)					
Country	MY17	MY18	MY19	MY20	MY21
China	8,382	8,927	8,600	7,185	8,709
India	5,302	5,258	5,291	4,355	5,225
Pakistan	2,243	2,373	2,330	2,003	2,308
Bangladesh	1,481	1,633	1,568	1,502	1,851
Turkey	1,448	1,644	1,502	1,437	1,676
Rest of World	6,459	6,919	6,940	5,905	6,279
Total	**25,315**	**26,754**	**26,231**	**22,387**	**26,048**

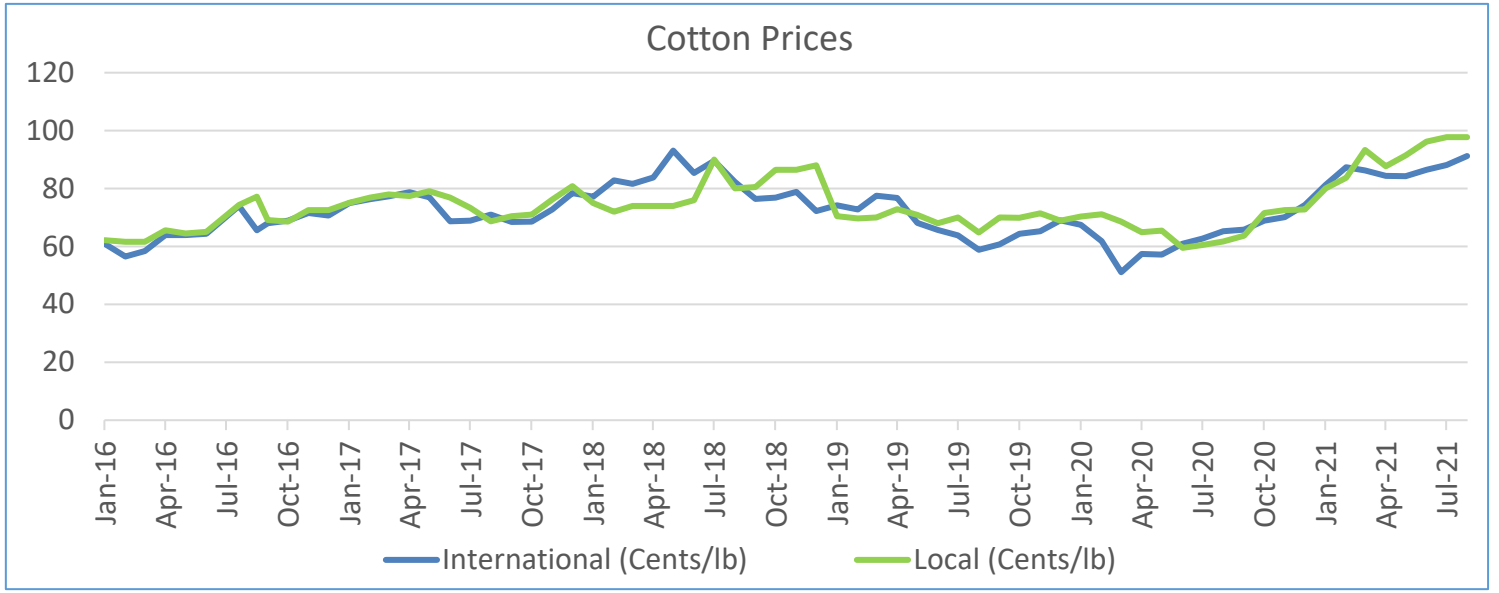
World Cotton Ending Stocks (000 MT)					
Country	MY17	MY18	MY19	MY20	MY21
China	9,998	8,272	7,766	8,034	8,547
India	1,716	2,009	1,960	3,676	3,447
Brazil	1,509	1,885	2,668	3,136	2,406
United States	599	914	1,056	1,579	686
Pakistan	504	616	543	738	597
Rest of World	3,151	3,961	3,434	4,209	4,214
Total	**17,477**	**17,657**	**17,427**	**21,372**	**19,897**

Source: USDA

Spinning | Local Industry

Cotton Dynamics | Prices

- **International:** Prices in the international market fluctuate based on supply and demand factors. Cotton, like other commodities, is heavily traded and thus speculative factors influence its price.
- Since 2016, international cotton prices have experienced an overall increase of ~50%.
- Prices have recently reached a new peak of ~94 cents/lb in Aug-21 and have been on an increasing trend since the start of COVID-19 pandemic.
- Prior to COVID-19, the prices were on a declining trend due to the US-China trade war as US prices decreased due to higher tariffs imposed by China resulting in lower exports.
- **Local:** Cotton prices have also been on an increasing trend in the local market, growing ~148% in PKR terms since 2016 with currency depreciation being a major factor since 2018.
- Prices recently touched a new peak of PKR~14,200 per maund towards the end of Aug-21. The price increase is driven by the increase in international prices as well as greater demand in the local market.



Average Cotton Prices	CY16	CY17	CY18	CY19	CY20	8MCY21
International (Cents/lb)	66	73	82	68	64	86
Local (Cents/lb)	68	75	80	70	67	91
Local (PKR/maund)	5,846	6,521	7,971	8,721	8,923	11,906

Cotton Unit Conversion	
Unit	**Conversion**
1 Maund	37.3kg
1 Bale	170kg
1 Bale	4.6 Maunds

Source: PCCC

Spinning | Local Industry

Cotton Dynamics | Supply

- Pakistan's production of cotton declined significantly during FY21, from ~8.6mln bales to ~5.6mln bales, due to pest attacks and adverse climate events.
- Cotton is a pesticide hungry crop that requires considerable amount of pesticide in order to resist or prevent pest attacks. This, however, increases the input costs for farmers.
- In addition, the cotton seed used in Pakistan is of a relatively lower quality and more vulnerable to pest attacks, resulting in lower yield.
- Other prevailing factors that have continued to hamper cotton production is lack of support from government and adverse climatic conditions. These factors ultimately result in lower area sown as farmers switch to more profitable Kharif season crops such as sugarcane and maize.

Pakistan's Cotton Supply						
	FY16	FY17	FY18	FY19	FY20	FY21
Production (Mln Bales)	9.8	10.7	11.6	10.7	8.6	5.6
Production (000 MT)	1,666	1,819	1,972	1,819	1,462	959
% Change	-	9%	8%	-8%	-20%	-34%
Net Imports (000 MT)	368	481	563	402	523	857
% Change	-	31%	17%	-29%	30%	64%
Total Cotton Supply (000 MT)	**2,034**	**2,300**	**2,535**	**2,221**	**1,985**	**1,816**

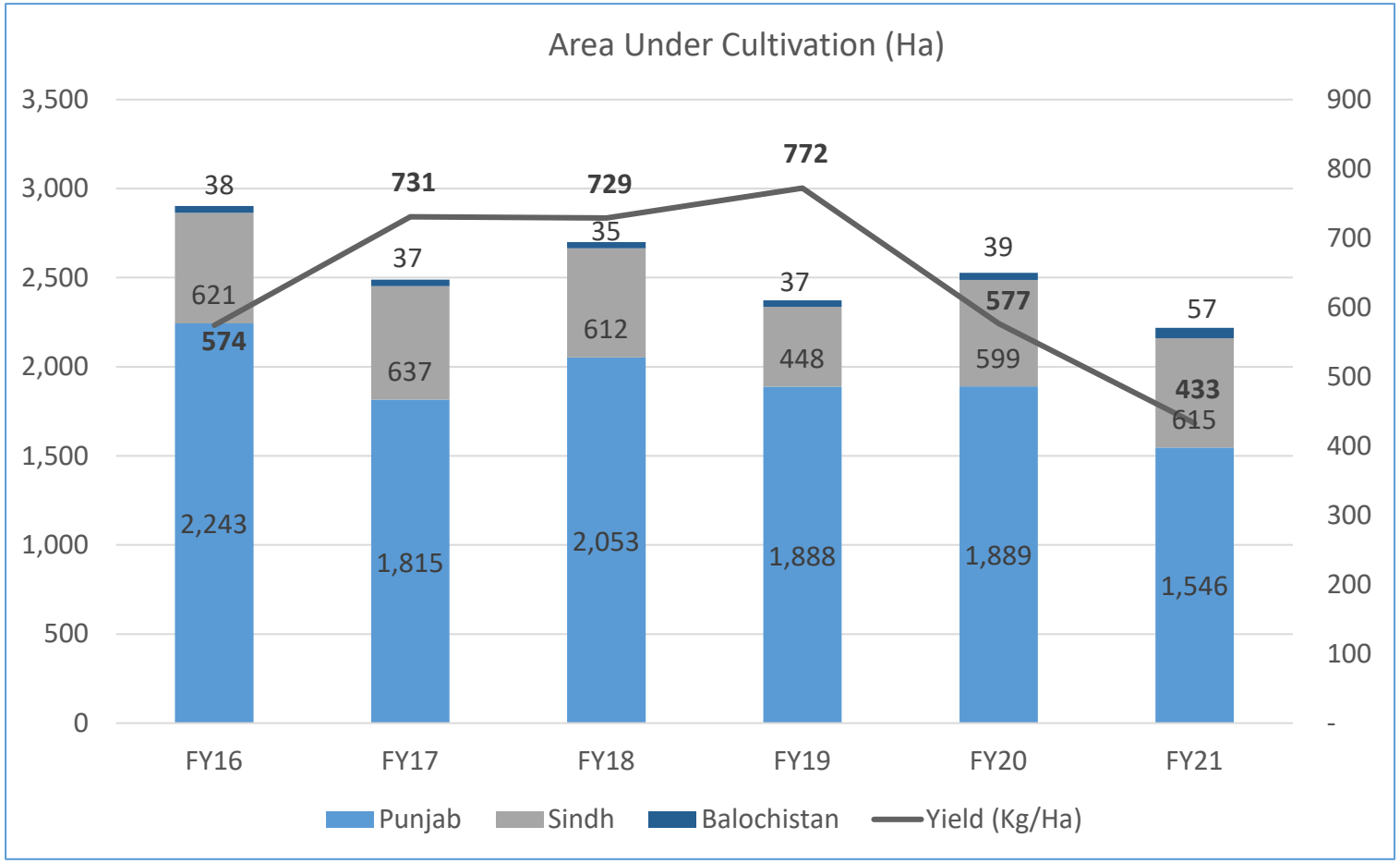
- The government has set a cotton production target of ~10.5mln bales for FY22 season. However, market sources estimate size of cotton crop to stand at ~8mln bales. As per PCGA figures, arrivals for current season up till mid-September stand at ~2.68mln bales as compared to ~1.04mln bales at the same time last year.
- The decline in local production has increased reliance on imports growing by ~64% during FY21, from 523,000 MT in FY20 to 857,000 MT in FY21.

Source: PBS, PCGA

Spinning | Local Industry

Cotton Dynamics | Area Under Cultivation

- Pakistan's cotton area under cultivation declined significantly from 2.5 mln Ha in FY20 to 2.2mln Ha in FY21.
- Moreover, the cotton crop yield in FY21 fell ~25% to ~433 Kg/Ha from ~577 Kg/Ha.
- For the current season, i.e. FY22, the government has set a target of 2.32mln Ha for area under cultivation. So far, 1.94mln Ha which is ~83.4% of the target, has been sown.
- Moreover, the government recently announced intervention price for seed cotton of PKR~5,000 per 40kg in order to support farmers and prevent switching.



Source: PCCC, PCGA

Spinning | Local Industry

Overview

- The spinning sector comprises ~477 spinning mills in the country and the sector is largely organized.
- The sector is at a mature stage and has a long operating history in the country. The market structure is competitive, with a large number of players making a relatively homogenous product.
- During FY21, Pakistan's yarn production grew ~12% to 3.4mln MT as the country recovered from the impact of the COVID-19 pandemic. Yarn production has stood at ~3.1mln MT in FY20.
- Yarn exports stood at 391,000 MT, equivalent to PKR~127bln in FY21, and accounted for ~11% of total production. There is significant export concentration with the majority of exports made to China.
- The remaining ~89% of locally produced cotton yarn is used within the local textile value chain by the weaving sector. Demand from the local market grew during the year as the entire textile value chain benefitted from the increase in export orders for finished goods segments.
- The estimated market size for cotton yarn, excluding blended and synthetic yarn, stood at PKR~847bln, a growth of ~24% as compared to PKR~678bln in FY20. The growth came on the back of increase in prices of cotton yarn which experienced average increase of ~20% during FY21.

Sector Overview	FY19	FY20	FY21
Sector Players	~477 Spinning Mills		
Production (000 MT)	3,431	3,060	3,442
Export Volume (000 MT)	434	413	391
Export Value (PKR bln)	124	123	127
Industry Association	All Pakistan Textile Mills Association		

Source: SBP, PBS, TCO

Spinning | Local Industry

Installed Capacity & Utilization

- There are ~477 spinning units operating in the country with a total number of spindles standing at ~13.4mln. Out of these ~11.3mln spindles are in operation.
- The average capacity utilization of spinning units declined in FY20 due to the COVID-19 pandemic and resulting lockdowns which forced spinning mills to suspend operations during the last quarter of FY20.
- Capacity utilization in FY21 is expected to be improved due to increase in demand and fewer restrictions during the period.

Capacity utilization	FY16	FY17	FY18	FY19	FY20
Spindles Installed	13,142,000	13,265,614	14,613,327	19,122,377	19,049,310
Average Capacity Utilization	91%	85%	91%	88%	83%

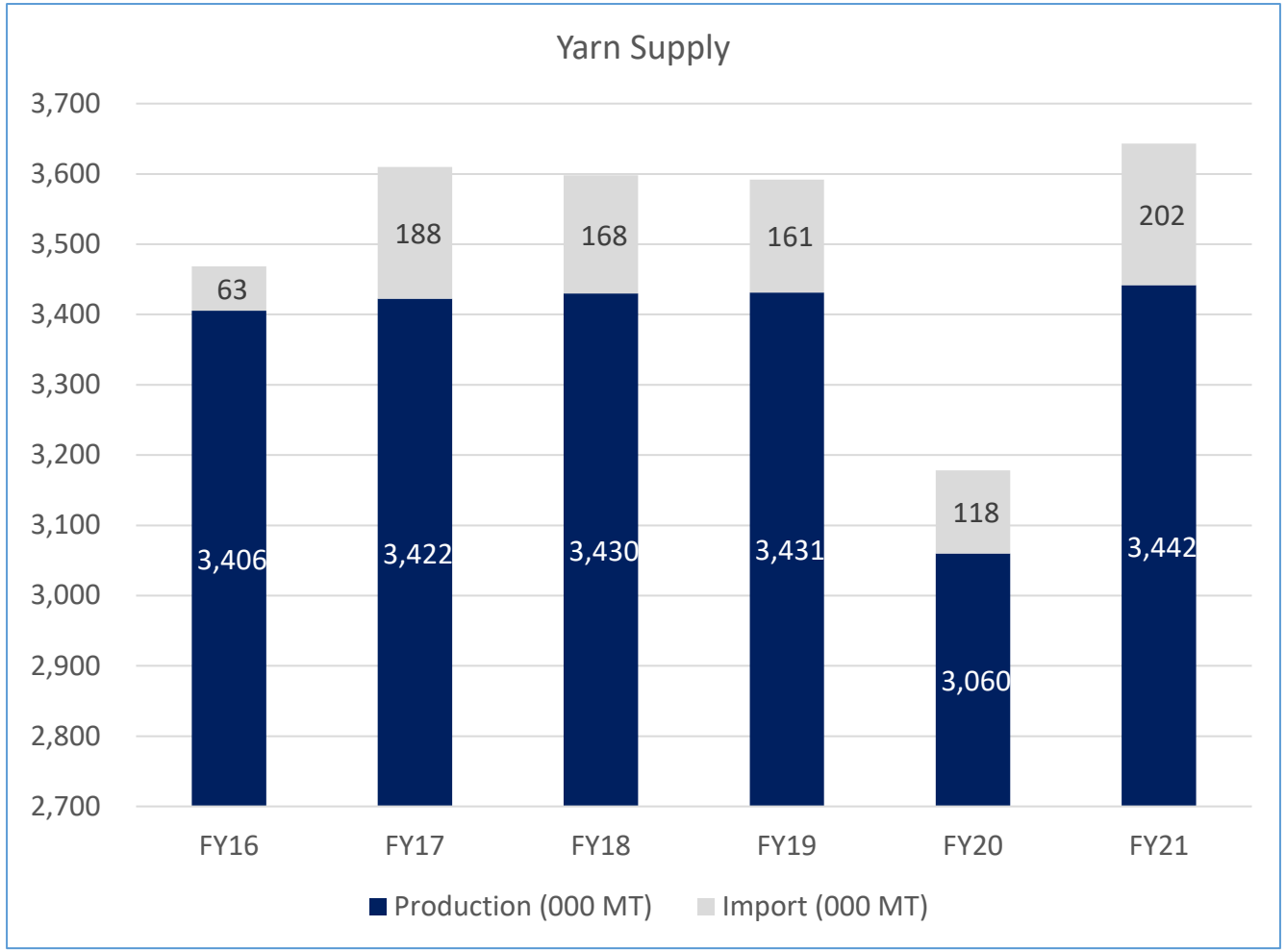
Note: Average Capacity Utilization figure is reflective of ~39 listed/rated Spinning players

Source: TCO, Economic Survey

Spinning | Local Industry

Yarn Supply

- The production of yarn increased approximately ~12% during FY21 and stood at ~3.4mln MT as demand recovered from previous year's decline due to the COVID-19 pandemic. The pandemic had resulted in lockdowns and other restrictions which hampered production particularly during the last quarter of FY20.
- Meanwhile, import of yarn reached approximately ~202,000 MT, bolstered particularly by the removal of regulatory duty in December.
- As a result, overall supply of yarn reached its highest level in last six years and stood at ~3.6mln MT, as compared to 3.2mln MT in FY20.



Note: Import quantity is estimated based on average prices and value figures

Source: PBS, SBP

Spinning | Local Industry

Yarn Production

- During FY21, ~3.4mln MT of yarn of various types was produced in the country, as compared to ~3.1mln MT produced during FY20. The growth of ~12% came on the back of low base effect of previous year, when production was significantly hampered due to the COVID-19 pandemic.

- A majority of the yarn produced is of coarse or medium count, with ~23% and ~24% share in total production respectively. Meanwhile, ~39% of the yarn produced is blended or synthetic yarn made by blending cotton with materials such as polyester and nylon.

Production of Yarn (MT)	FY16	FY17	FY18	FY19	FY20	FY21
Coarse	783,279	835,510	787,376	790,223	704,702	792,598
Medium	817,334	702,144	826,399	823,784	734,631	826,261
Fine	391,639	424,822	393,126	395,655	352,835	396,844
Super Fine	85,138	114,876	88,406	85,799	76,425	85,957
Synthetic/Blended	1,328,169	1,344,974	1,334,743	1,335,929	1,191,349	1,339,945
Total	**3,405,559**	**3,422,326**	**3,430,050**	**3,431,390**	**3,059,942**	**3,441,605**

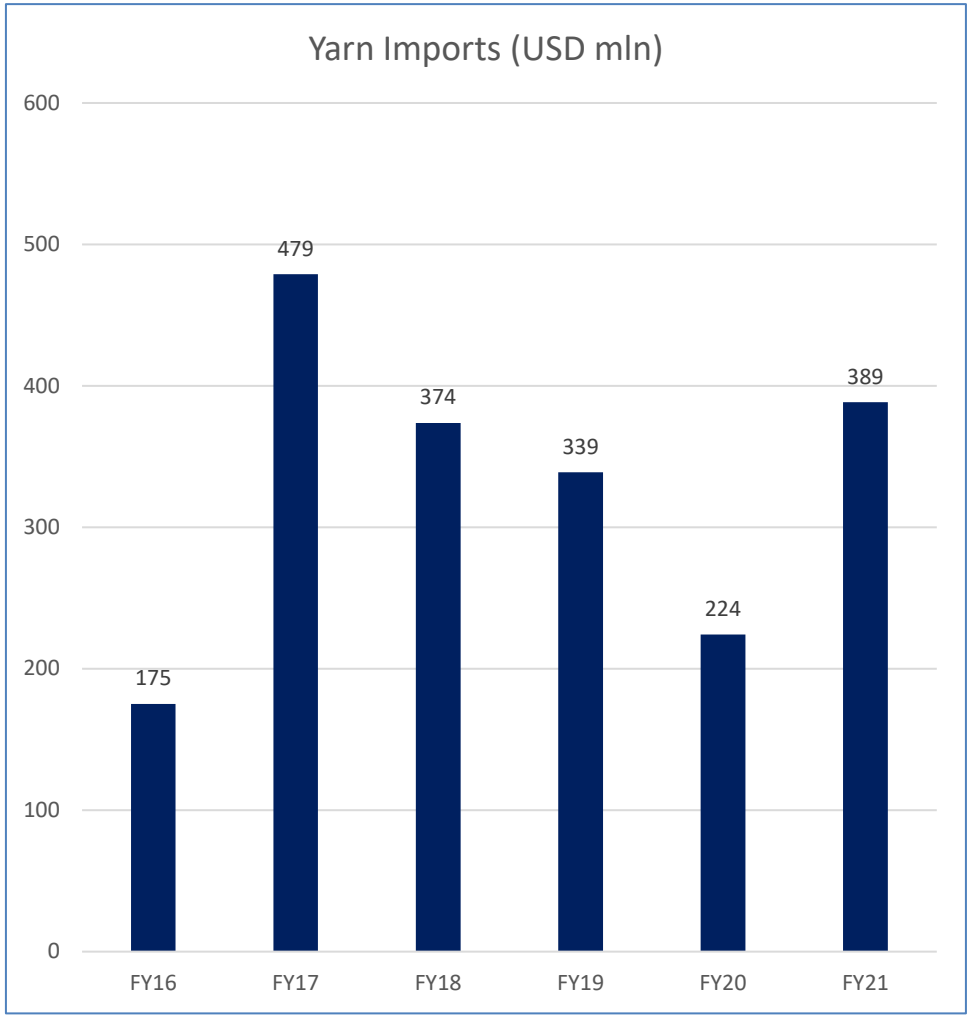
Source: TCO, PBS

Spinning | Local Industry

Yarn Imports

- Pakistan's import of cotton yarn exhibited significant increase of ~73% in FY21, after consecutive years of decline. The increase came on the back of significant decline in local cotton production which resulted in shortage of locally produced cotton.
- During FY21, ~47% of yarn imported was from China. Other major import countries include Turkey (~16%), Oman (~14%) and Uzbekistan (~7%). In previous years, India was the largest source of yarn imports, however trade from India has ceased since FY19 due to political reasons.

Import Destinations	FY18		FY19		FY20		FY21	
Countries	Value (000 USD)	%	Value (000 USD)	%	Value (000 USD)	%	Value (000 USD)	%
China	70,247	19%	90,800	27%	132,995	59%	181,214	47%
Turkey	18,283	5%	35,072	10%	21,892	10%	62,340	16%
Oman	0	0%	833	0%	12,296	5%	55,812	14%
Uzbekistan	1,616	0%	4,144	1%	5,604	3%	28,968	7%
Egypt	7,936	2%	4,607	1%	5,238	2%	13,614	4%
India	261,212	70%	189,593	56%	20,160	9%	0	0%
Other	14,481	4%	13,953	4%	25,909	12%	46,560	12%
Total	**373,775**	**100%**	**339,002**	**100%**	**224,094**	**100%**	**388,508**	**100%**



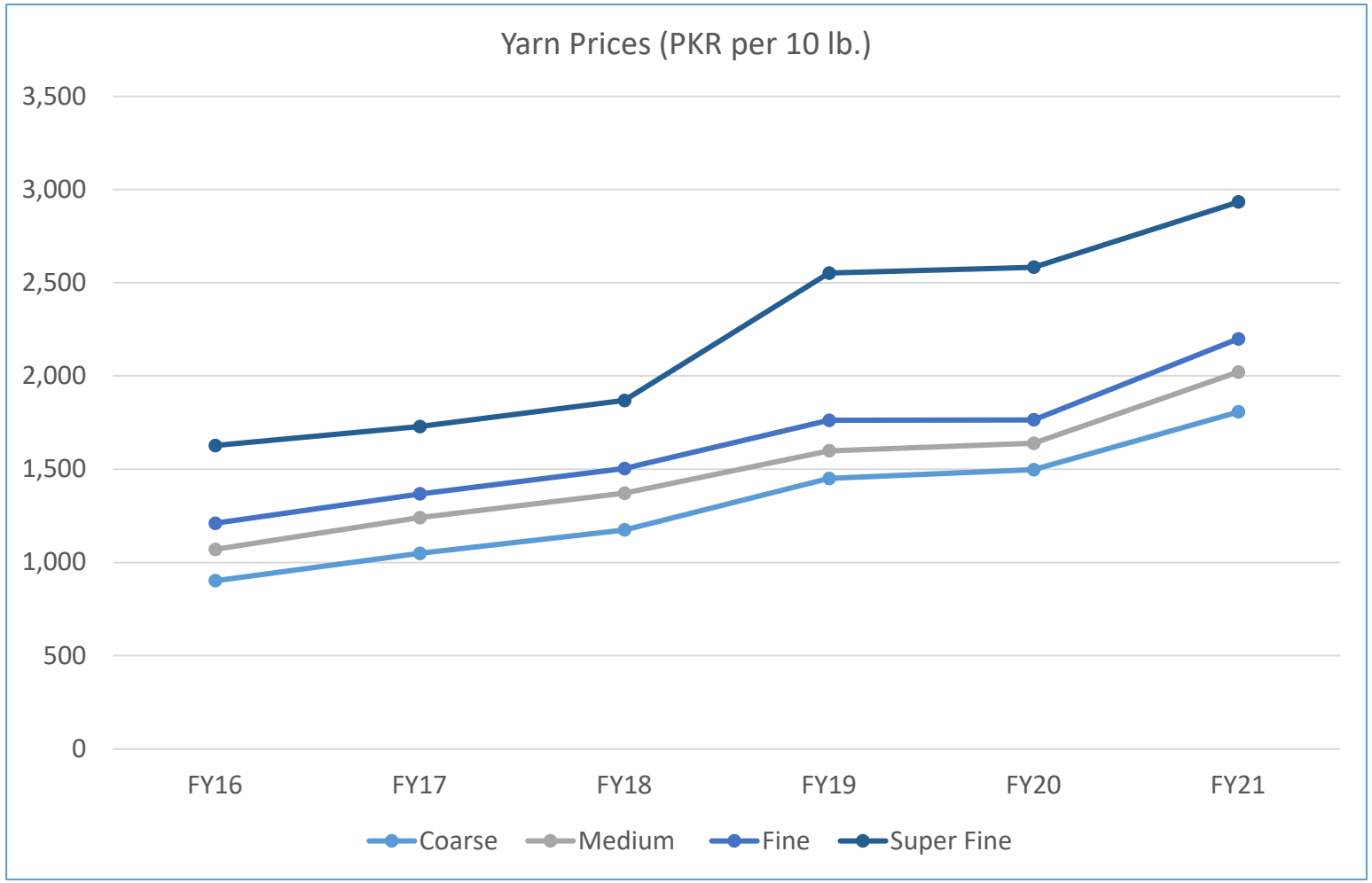
Note: FY21 figures are prorated based on 9MFY21 data

Source: SBP

Spinning | Local Industry

Yarn Prices

- Prices of cotton yarn have been on a rising trend in recent years. During FY21, yarn prices increased on the back of higher raw material prices, i.e. cotton, both in local and international markets.
- Cotton price increase in the local market was particularly impacted by the decline in local cotton production during FY21. This price increase was also passed on to cotton yarn.
- The average cotton yarn prices increased approximately ~21% during FY21.

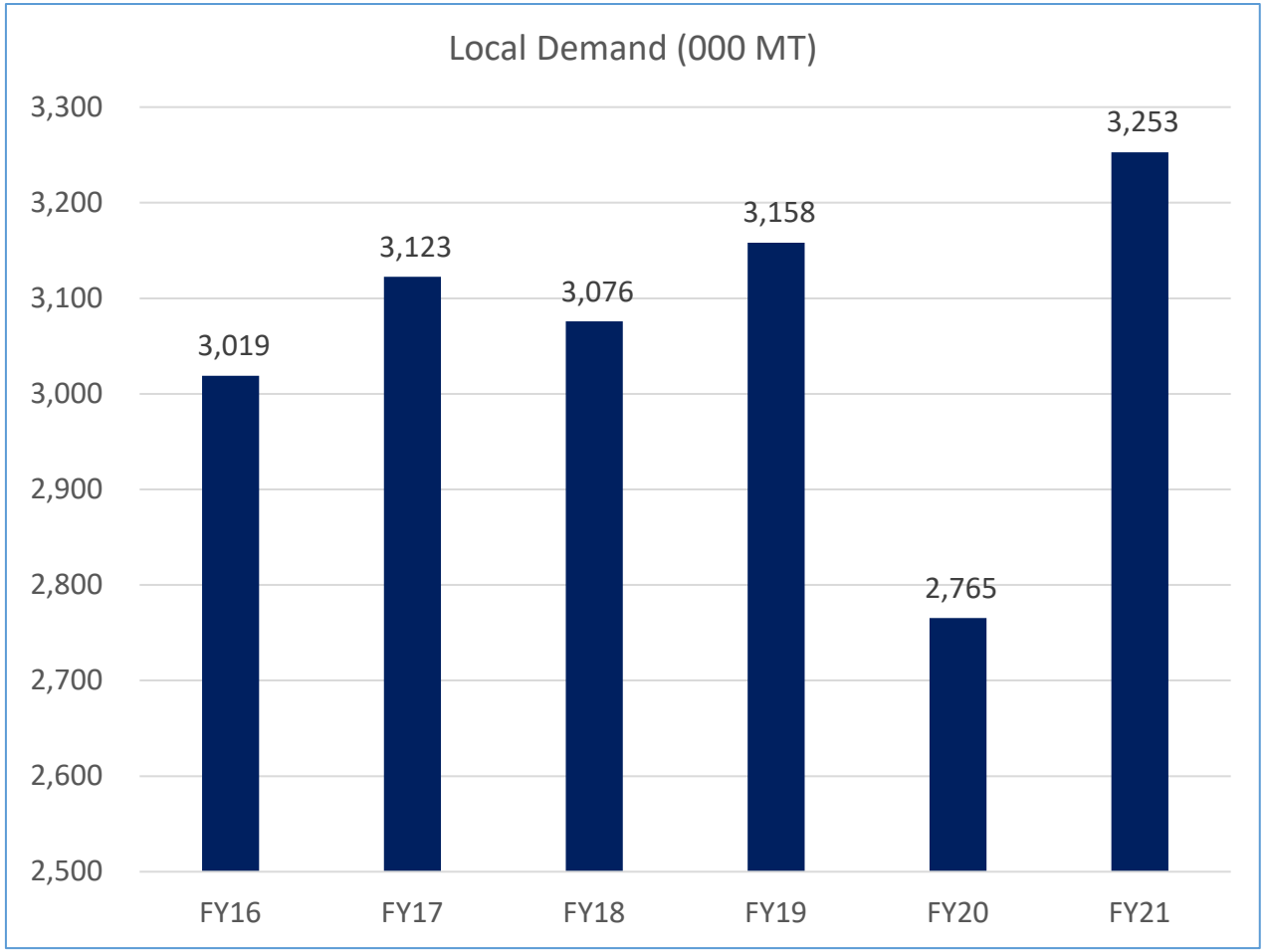


Source: PCCC

Spinning | Local Industry

Yarn Demand

- Approximately ~89% of locally produced yarn is used within the local weaving sector of the textile industry.
- During FY21, demand for cotton yarn was at its highest level in recent years. It exhibited growth of ~18% as compared to the previous year which was negatively impacted by the COVID-19 pandemic and subsequent restrictions.
- The increase in demand during FY21 came on the back of higher export orders received by the value added textile segments which in turn boosted demand for cotton yarn.

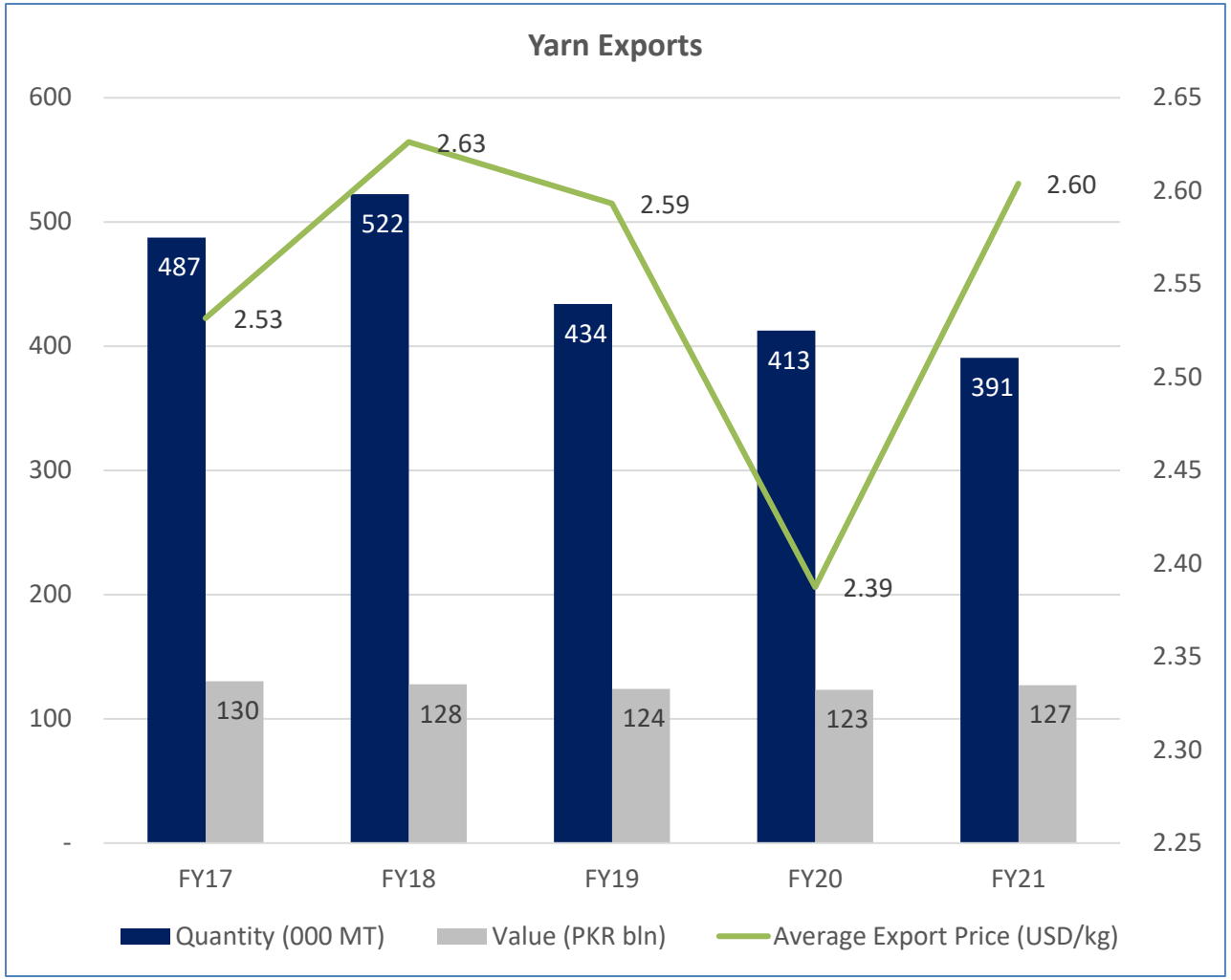


Source: PBS, SBP

Spinning | Local Industry

Yarn Exports

- During FY21, the export of yarn remained relatively stable in value terms and stood at PKR~127bln as compared to PKR~123bln in FY20.
- However, exports declined slightly in volumetric terms from 413,000 MT in FY20 to 391,000 MT in FY21. The decline of ~5% occurred as a greater share of locally produced yarn was diverted to local weaving clients.
- Meanwhile, average export price of yarn recovered to USD~2.6 per kg in FY21 after a decline of ~8% in FY20. Increase in yarn export price during FY21 was driven by higher cotton prices globally as well as disruptions in supply chains. The exchange rate impact was minimal with the average rate increasing slightly from 158.4 in FY20 to 160.5 in FY21.
- During FY21, the export of yarn contributed ~5% to the country's total textile exports which amounted to ~3% of the country's total exports.



Source: PBS

Export Destinations

- Pakistan's exports of yarn are largely concentrated towards China which accounted for ~69% of total yarn exports during FY21.
- Other export destinations include Bangladesh and Turkey, which accounted for ~7% and ~4% of Pakistan's total yarn exports, respectively. Both countries have significant positions in the global textile industry.

Export Destinations	FY18		FY19		FY20		FY21	
Countries	Value (000 USD)	%	Value (000 USD)	%	Value (000 USD)	%	Value (000 USD)	%
China	869,780	63%	707,923	63%	662,586	67%	705,791	69%
Bangladesh	83,602	6%	83,508	7%	58,494	6%	74,538	7%
Turkey	72,540	5%	44,442	4%	51,974	5%	44,473	4%
Portugal	56,472	4%	42,808	4%	38,828	4%	31,000	3%
S. Korea	34,004	2%	26,602	2%	22,004	2%	25,805	3%
Japan	33,191	2%	30,854	3%	23,330	2%	23,547	2%
Total	**1,371,919**	**100%**	**1,125,419**	**100%**	**984,903**	**100%**	**1,016,908**	**100%**

Note: FY21 figures are prorated based on 9MFY21 data

Source: TDAP, SBP

Spinning | Local Industry

Business Risk

- **Decline in local cotton production:** In the previous season, cotton production was significantly reduced, from ~8mln bales down to ~5mln bales, due to severe impact of pest attacks and climate change. While the current season's crop estimates stands at ~8mln bales, the actual production may fall as pest attacks and adverse climate events are unpredictable and remain unaddressed. The reduced local production has increased the country's reliance on imported cotton and thus the exposure to exchange rate fluctuations.

- **Rising raw material prices:** The shortage in supply of cotton in local and international markets has resulted in significant price increase. Raw material constitutes ~74% of the sector's direct costs and thus 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 past year has increased the overall profitability of the sector, it remains a low value addition sector with historically narrow margins.

- **High Energy Costs:** Although the government provides the textile industry with subsidized RLNG at USD~6.5 per mmbtu and electricity at USD~9 cents per kwh, which was increased from USD~7.5 cents per hour in September 2020, these rates are above the regional average for countries such as India, Bangladesh and Vietnam which reduces the competitiveness of Pakistan's yarn exports.

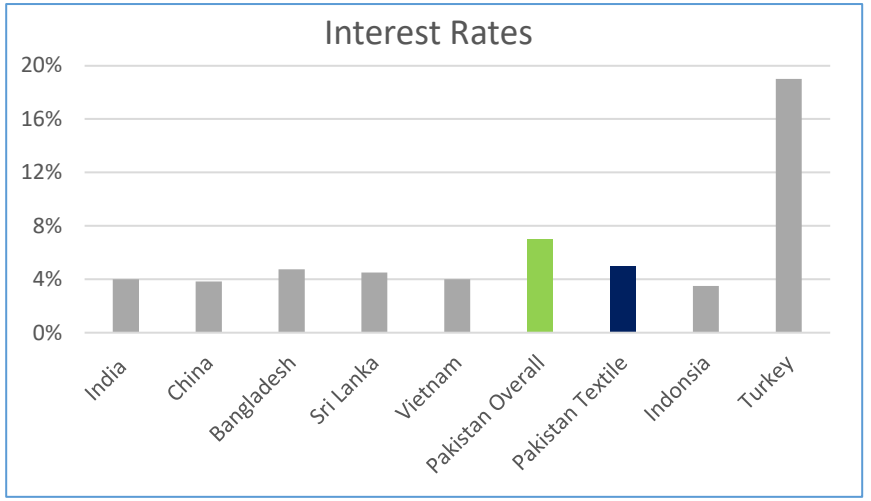
- **COVID-19 pandemic:** The pandemic continues to create challenges for the local market due to ongoing restrictions, such as closure of malls/markets on weekends and reduced timings, as well as occasional complete lockdowns which are imposed when infection rates reach high levels. In addition, the country's vaccination rate remains low and therefore, the restrictions are expected to remain in place for some time.

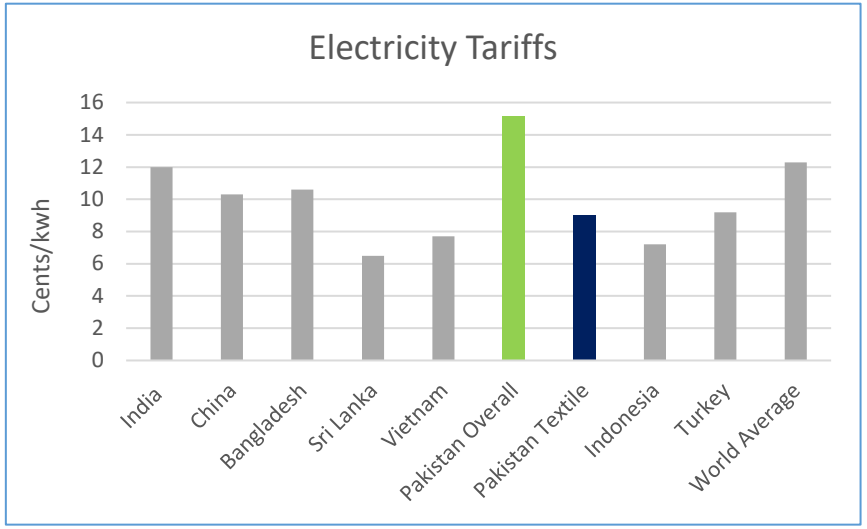
- **Reduction in Import Duties on Yarn:** The recent reduction of custom duty on imported yarn has increased competition for the sector and may create pressure on margins going forward.

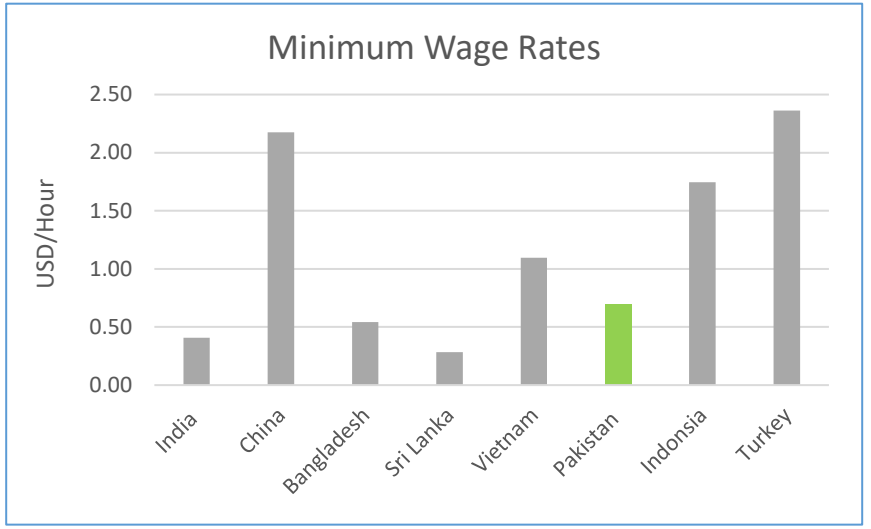
Spinning | Local Industry

Regional Cost Comparison

- Pakistan has the second highest interest rate in the region behind Turkey. The high cost of borrowing acts as a barrier to investments in various sectors. Garments, on the contrary, falls in the ambit of export sector which has access to subsidized financing facilities from the SBP in the form of short term Export Refinance Facility (ERF) and Long Term Financing Facility (LTFF). On regional level, China and Indonesia have the lowest borrowing rate.
- The Pakistani businesses face competitive disadvantage due to the high electricity tariffs it incurs which exceed all regional players. However, the government provides subsidized electricity and gas at internationally competitive prices to the textile cluster. Electricity tariff for textile sector amounts to 9 cents/kwh while gas rates are at USD~6.5 per mmbtu. In contrast, Sri Lanka and Indonesia have access to the lowest electricity tariffs in the region.
- Despite recent increase in minimum wage, which now translates to 0.86 USD per hour for Sindh and 0.69 USD per hour for the rest of Pakistan, the country maintains competitive advantage of low labor cost over regional players China, Vietnam, Indonesia and Turkey. However, countries such as Sri Lanka, Bangladesh and India continue to have comparatively lower minimum wage rates.





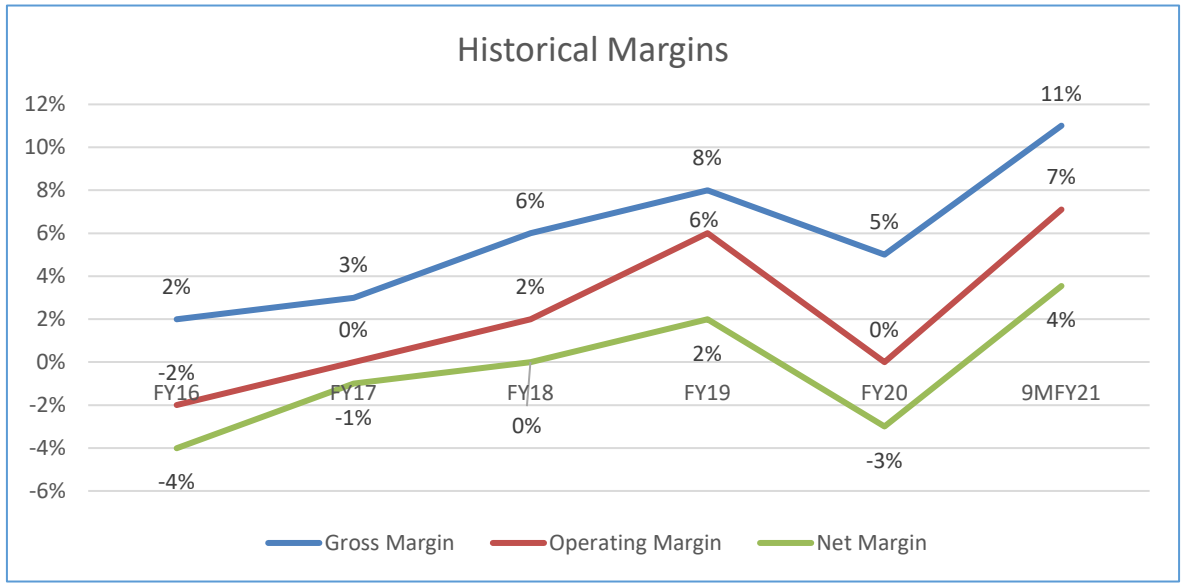


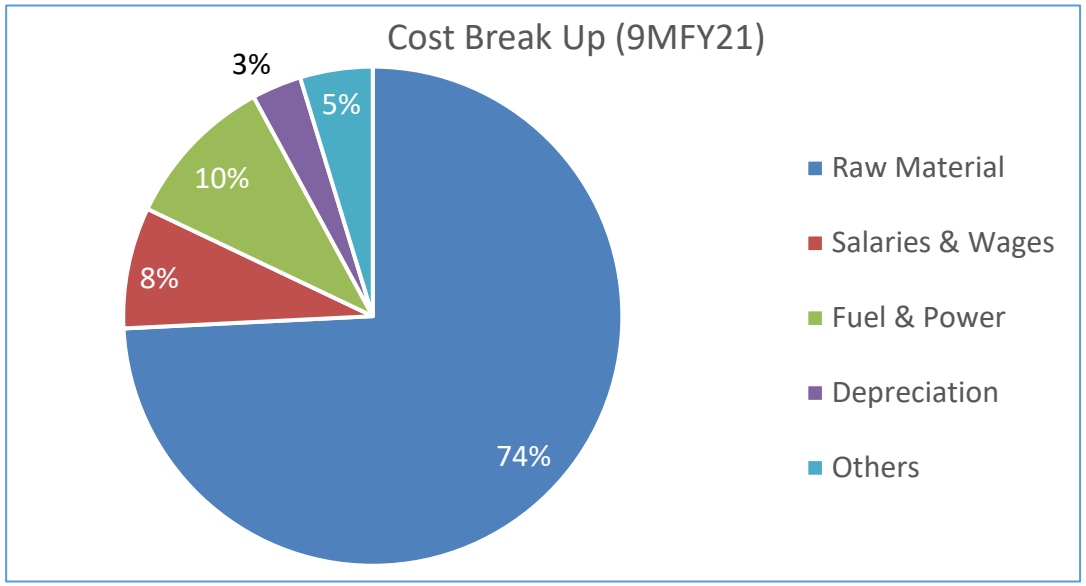
Source: Trading Economics, globalpetrolprices.com

Spinning | Local Industry

Margins & Cost Structure

- Over the last five years, the spinning sector's average gross margin have stood at ~5% while average net margins were -1% over the same period. The historically low margins are reflective of the low level of value addition by the sector. Moreover, the decline in profitability in FY20 due to the COVID-19 pandemic further brought down the five years' average.
- During 9MFY21, margins improved significantly, with gross margins standing at ~11% as compared to ~5% in FY20 while net margins stood at ~4% as compared to -3% in FY20. The improvement in margins came on the back of higher demand and significant increase in yarn prices. Meanwhile, the decline in policy rate reduced finance costs and provided relief to net margins.
- The largest component within direct costs is raw material, i.e. cotton, which constitutes ~ 74% of total manufacturing costs. The decline in local cotton production has caused cotton prices to rise and also increased the spinning sector's reliance on imports. During FY21, local cotton prices increased ~22% while cotton yarn prices increase ~21%, indicating that increase in raw material price was almost entirely passed on.





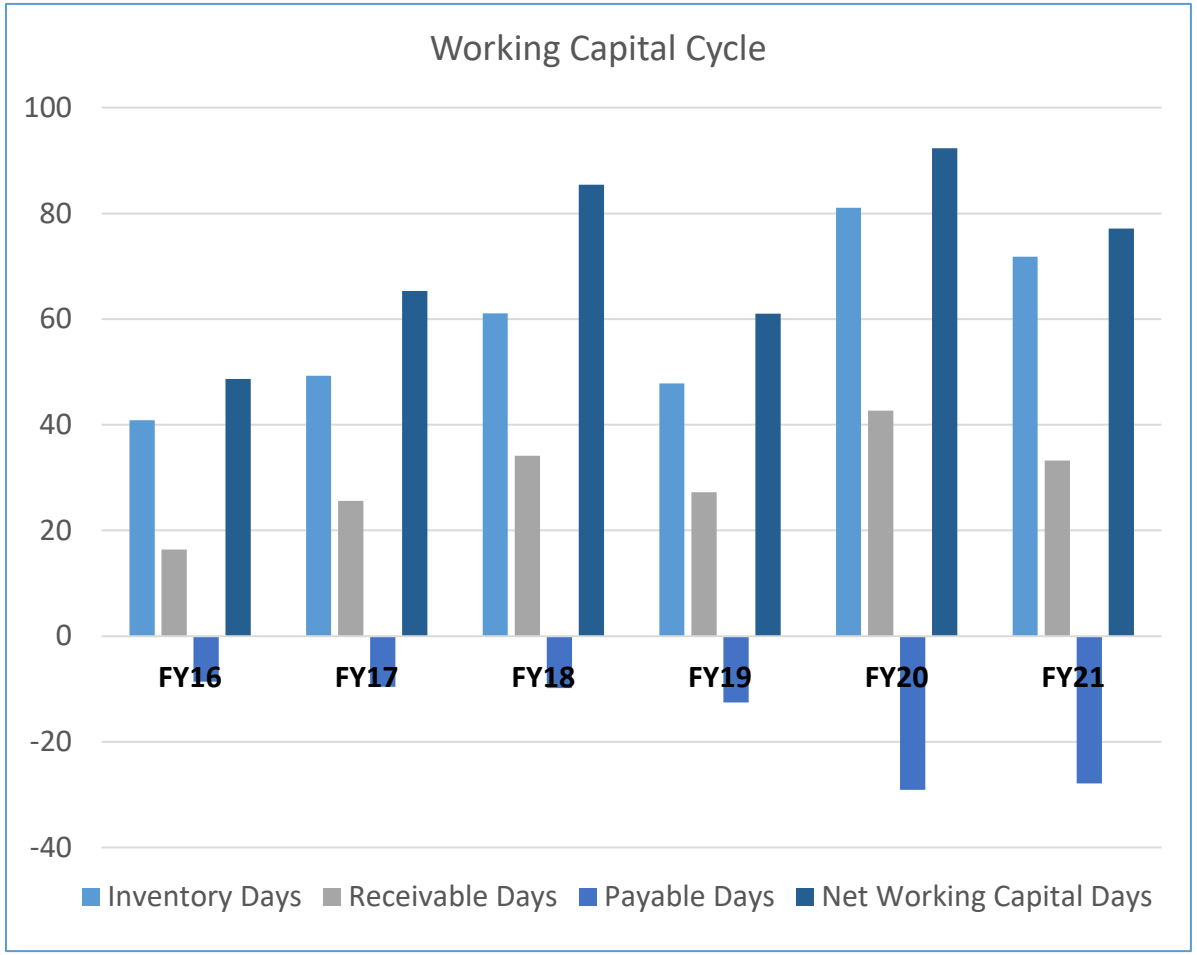
Note: Margins and cost break up are reflective of ~39 listed/rated spinning players

Source: PACRA Database

Spinning | Local Industry

Financial Risk – Working Capital

- The sector's working capital is largely a function of inventory and trade receivables. Inventory consists mostly of raw material and finished goods, with work-in-process making a small contribution.
- The industry's average working capital cycle ranges from 70-75 days.
- The working capital had experienced an increase during FY20 due to the pandemic which had resulted in suspension of operations and decline in demand which in turn caused inventory to pile-up while also increasing payable and receivable days.
- During FY21, the working capital days decreased to 77 days, as demand has recovered significantly and there have been fewer COVID-19 restrictions.
- Many players within the organized mill segment are integrated with group companies, resulting in more efficient working capital management.



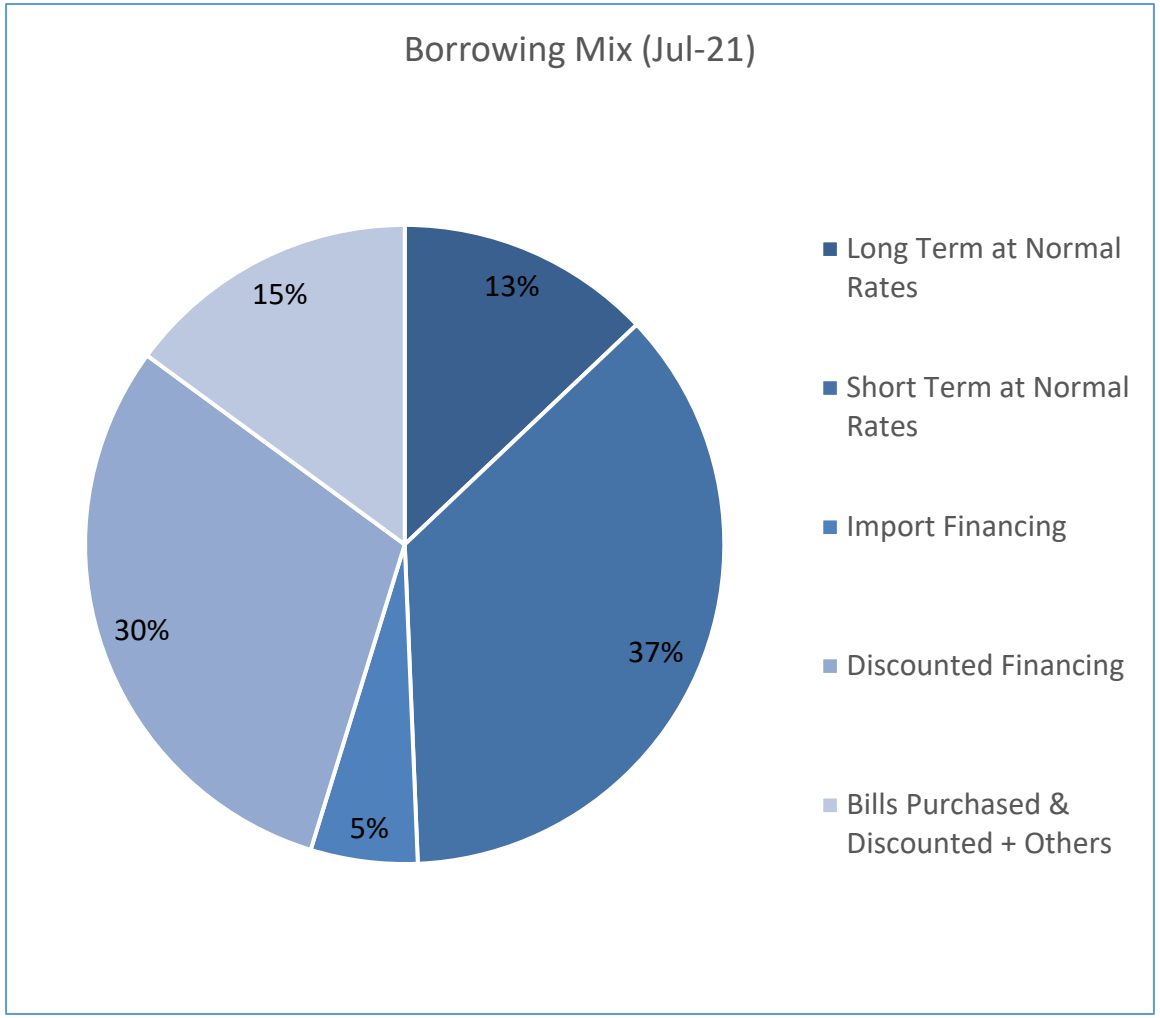
Note: Working capital cycle is reflective of ~39 listed/rated spinning players

Source: PSX, PACRA Database

Spinning | Local Industry

Financial Risk – Borrowing Mix

- The total borrowing of spinning sector stood at PKR~413bln as at End-Jul-21 as compared to PKR~436bln as at End-Jul-20.
- The largest share is occupied by short term borrowing at normal rates which stands at PKR~150bln and accounts for ~37% of total borrowing.
- The sector avails discounted financing, which includes Export Finance Scheme (EFS) at rate of ~3%, as well as Long Term Finance Facility (LTFF) and Temporary Economic Refinance Facility (TERF) at rate of ~5%.
- Discounted financing accounts for ~30% of the sector's borrowings and stood at PKR~125bln as at End-Jul-21 (EFS: PKR~50bln, LTFF/TERF: PKR~75bln).
- The average leveraging for the spinning sector stands at ~49% (moderately leveraged).
- The overall textile industry's infection ratio stood at ~11.4% in Jun-21, exhibiting improvement from Mar-21 when it was ~12%. However, the infection ratio still remains elevated in comparison to overall banking credit NPL which stood at ~8.9% in Jun-21.



Note: Leverage figure is reflective of ~39 listed/rated spinning players

Source: SBP, PACRA Database

Spinning | Local Industry

Regulatory Framework

- With respect to Income Tax, the spinning 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 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 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).
- In addition, SBP also reduced the monetary policy rate by 625bps to 7% which significantly reduced the sector's finance costs. The policy rate has recently been increased by 25 basis points to 7.25%.
- Recent changes in the custom duty structure applicable on the spinning sector have removed protection for the local manufactures, as duties on imported cotton yarn have been reduced.
- All Pakistan Textile Mill Association (APTMA) acts as the national trade association of textile cluster in the country.

Source: SBP

Spinning | Local Industry

Custom Duty Structure

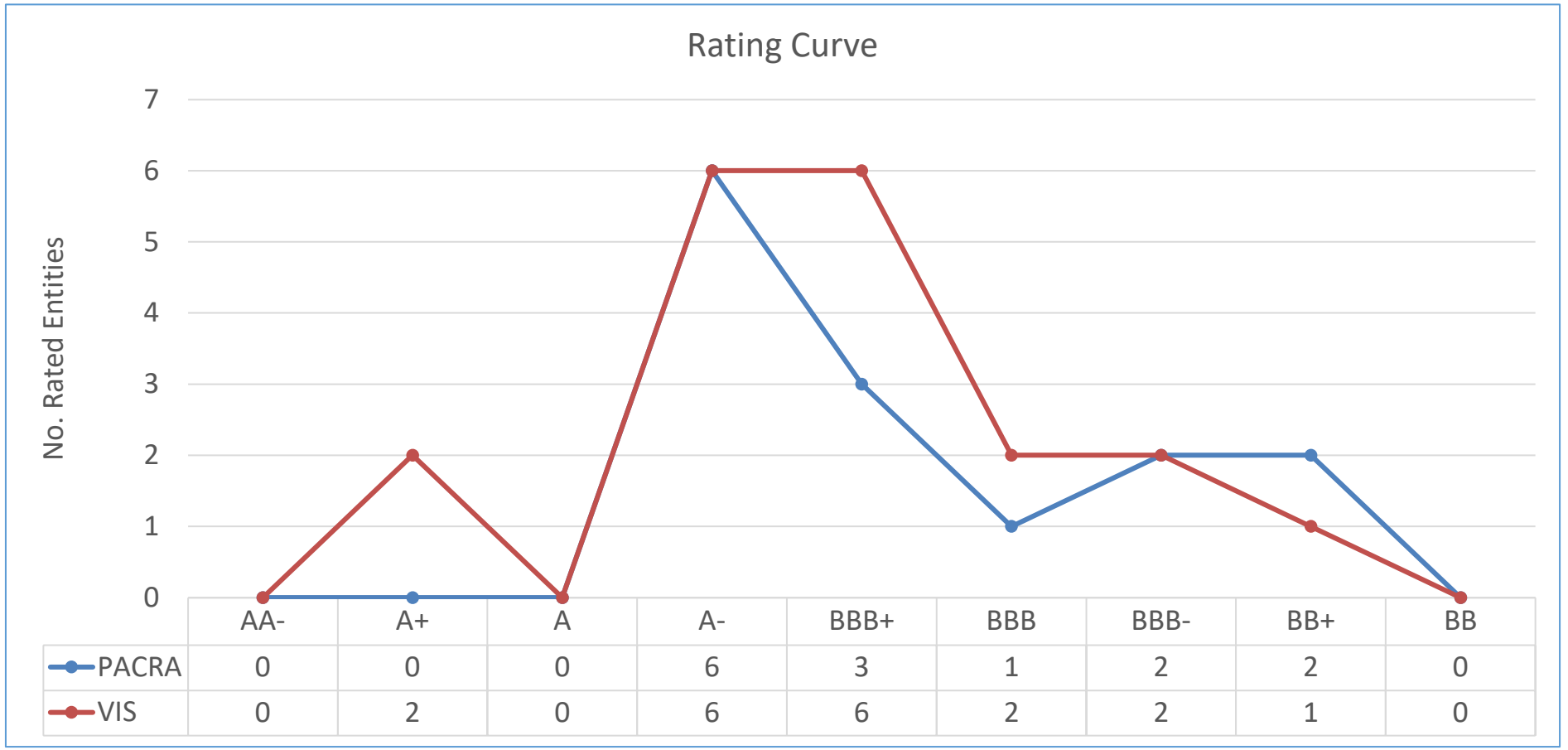
PCT Code	Description	Custom Duty		Additional Custom Duty		Regulatory Duty		Total	
		FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21
52.01	Cotton, not carded or combed	0%	0%	0%	0%	0%	0%	0%	0%
52.03	Cotton, carded or combed	0%	0%	0%	0%	0%	0%	0%	0%
52.05	Cotton yarn (other than sewing thread), containing 85% or more by weight of cotton, not put up for retail sale	0%	11%	0%	2%	0%	5%	0%	18%
52.06	Cotton yarn (other than sewing thread), containing less than 85% by weight of cotton, not put up for retail sale	0%	11%	0%	2%	0%	5%	0%	18%
52.07	Cotton Yarn (other than sewing thread) put up for retail sale	0%	11%	0%	2%	0%	5%	0%	18%
54.02	Synthetic Filament Yarn (other than sewing thread), not put up for retail sale (includes polyester and nylon)	0-11%	11%	0-2%	2%	0-2%	2%	0-15%	15%
54.03	Artificial Filament Yarn (other than sewing thread), not put up for retail sale (includes viscose rayon)	0-11%	11%	0-2%	2%	0%	0%	0-13%	13%

Source: FBR

Spinning | Local Industry

Rating Curve

- PACRA rates 14 spinning players with a long term rating bandwidth ranging from BB+ to A-.



	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB
PACRA	0	0	0	6	3	1	2	2	0
VIS	0	2	0	6	6	2	2	1	0

Spinning | Local Industry

SWOT Analysis

- Large installed capacity
- Integrated into textile value chain as key raw material
- Government protection from tariff & duty structure
- Strong sector association resulting in high lobbying power
- Mature and long-standing textile sector

- Low BMR resulting in technological obsolescence
- Low value addition/commodity product
- Periodic imposition of import duties on import of cotton
- Lower focus on synthetic fibers
- Restrictions on sales to unorganized segment creating hurdles

- Uncertainty due to the continuing COVID-19 pandemic.
- Geographical export concentration
- Intense competition from regional players in international market
- Strong bargaining power of buyers
- Possible withdrawal of subsidies on electricity and gas

- Forward and horizontal integration to produce value added and differentiated products
- Opportunity to increase efficiency through technological upgrade
- Special Economic Zones provide incentives to sector

Spinning | Outlook & Future Prospects

Outlook: STABLE

- The domestic economy has started to gradually recover from the impact of the COVID-19 pandemic which slowed down industrial activities and bought various businesses to a halt. Despite steady increase in the rate of vaccinations, the country is experiencing a fourth wave of the pandemic which could hinder economic activity.
- The economic recovery is exhibited by the GDP growth of ~3.9% during FY21 (based on provisional figures). Among the contributors of GDP growth is industrial activity which has picked up in various sectors with the Large Scale Manufacturing Industries output increasing ~15% YoY during FY21. The textile sector which holds a weight of ~21% in the LSM Index, exhibited a YoY growth in output of ~4%.
- During FY21, the spinning sector's yarn exports grew slightly to PKR~127bln from PKR~123bln in FY20. This growth resulted from higher average export price and despite the reduction in export volumes. Meanwhile, demand from local market grew as it was bolstered by greater demand for finished goods products in the form of increased exports.
- The current seasons cotton crop estimates are ~8mln bales, however, pest attacks or adverse climate may negatively impact cotton production going forward. Moreover, the rising trend in local and international markets is expected to continue due to lower crop prospects in Brazil and USA while on the other hand demand is steadily increasing.
- The overall textile industry's infection ratio stands at ~11%, and although there is slight improvement from previous periods this is well above the total infection ratio of ~8.9% indicating higher level of financial risk.
- The decision taken by the State Bank of Pakistan (SBP) to lower the policy rate by 625bps to 7% in the last quarter of FY20 lowered the finance costs for the sector. The policy rate has recently been increased to 7.25%, however, impact on textile sector will be marginal as it avails significant share of discounted borrowing.
- Meanwhile, the removal of custom and regulatory duty on yarn will increase level of competition and create pressure on margins for the sector. It may also bring down prices of yarn which had increased in FY21 due to supply shortages.
- The textile industry is expected to continue to receive significant support from the government in the form of subsidized borrowing and energy prices due to its considerable contribution to the country's GDP and exports.

Source: PBS, SBP

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