The Pakistan Credit Rating Agency Limited

PRESS RELEASE

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SECTORWATCH | CORONAVIRUS | TOWEL

Since the start of 2020, the novel coronavirus (COVID-19) outbreak has quickly spread across the world and caused disruptions in economies worldwide. Starting in China – itself a global manufacturing hub – and now capturing almost the entire planet, all major economies and markets have been adversely impacted. Pakistan has also been severely impacted by the pandemic. Economic activity, after coming to a halt for almost two months, is beginning a start, albeit, slow and disruptive. Pakistan experienced contraction in demand and output as well as disruption in international trade. It is clear that credit conditions are under stress with consequent pressure on credit quality of many entities and sectors. In this context, PACRA aims to provide analysis on how the COVID-19 is impacting various sectors in Pakistan.

SECTOR	**SUB-SECTOR**
TEXTILE & ALLIED	**TOWEL**
SIZE	- Textile is the single largest export-oriented industry of Pakistan with USD ~11.5bln exports in 11MFY20 (FY19: USD ~13.3bln) comprising ~58% of total exports. - Towel segment contributed USD ~711mln in FY20 (FY19: USD ~786mln), representing ~5.7% of country's total textile exports.
NUMBER OF PLAYERS	- 188 members of Towel Manufacturers Association of Pakistan - Export Oriented Sector: Around 6-8 members represent around half of Pakistan's towel exports
PACRA PENETRATION	- PACRA rates 3 entities in towel sector. - PACRA rated universe comprises ~15% of towel segment exports.
IMPACT	- Demand: Pakistan's towel manufacturing sector is export oriented with around 80-85% exports concentrated to USA and Europe. The export demand has been severely impacted since March-20 as most of the demand regions were under lockdown. This was reflected in export numbers of April (April 20: USD ~18.3mln, April 19: USD ~70.7mln) & May (May 20: USD ~41.6mln, May 19: USD ~72.5mln). - However, exports are expected to gain momentum as most of the countries have gradually opened up. Demand for towels is rebounding slowly as buyers/stores replenish their inventories. Further, greater hygiene consciousness and higher demand from medical industry amid COVID-19 may boost demand, going forward. - Operations: The operations of local players were severely impacted after imposition of countrywide lockdown in late March-20 due to disruptions in both local & international supply chains and labour issues despite exemption from restrictions to export oriented sectors. However, supply chain and labour issues have been resolved since late April - early May and the operations have resumed since government's initiative for smart lockdown. The capacity utilization of local players remain optimal since June-20 ~ 80-90%. Maintaining high utilization is important due to specified nature of machinery. - Supply Chain: Towel sector's supply chain is locally dominated as Pakistan's coarse cotton is more suitable for towel manufacturing due to its better moisture absorption capacity. However, a portion of raw material, mainly dyes and chemicals, are imported from China and other East & South East Asian countries. - Both local and international supply chain was disrupted during the 4QFY20 due to lockdowns across the globe. Considering government's recent stance on smart lockdown and decrease in daily new cases in the country, the supply chain is expected to normalize. The threat of locust attack on upcoming cotton crop could impact cotton availability but this remains to be seen. - Financial obligations: Overall, towel segment is moderately leveraged. Borrowings mainly comprise short-term loans to finance the working capital requirements (industry's average gross working capital cycle is ~130-180 days). Majority of these borrowings are on subsidized SBP refinance schemes. Hence, recent interest rate cuts will be moderately beneficial for the sector. SBP refinance

of salaries and principal repayment deferral is expected to provide room in short-term liquidity crunch. The liquidity position is improving with fresh orders and payments for stuck up orders now being realized.

- Profitability and margins: Towel manufacturer enjoy relatively high gross margins ranging between 18%-25%. The lower finance cost (being export oriented sector) and rupee devaluation also buffers margins and profitability. Margins were depressed as capacity utilizations dropped in 4QFY20. The sector is looking at a gradual recovery in sales and is expected to reach its optimal capacity utilizations in next 6-9 months. This should bring margins and bottom-line to normal range.

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