



Composite & Garments

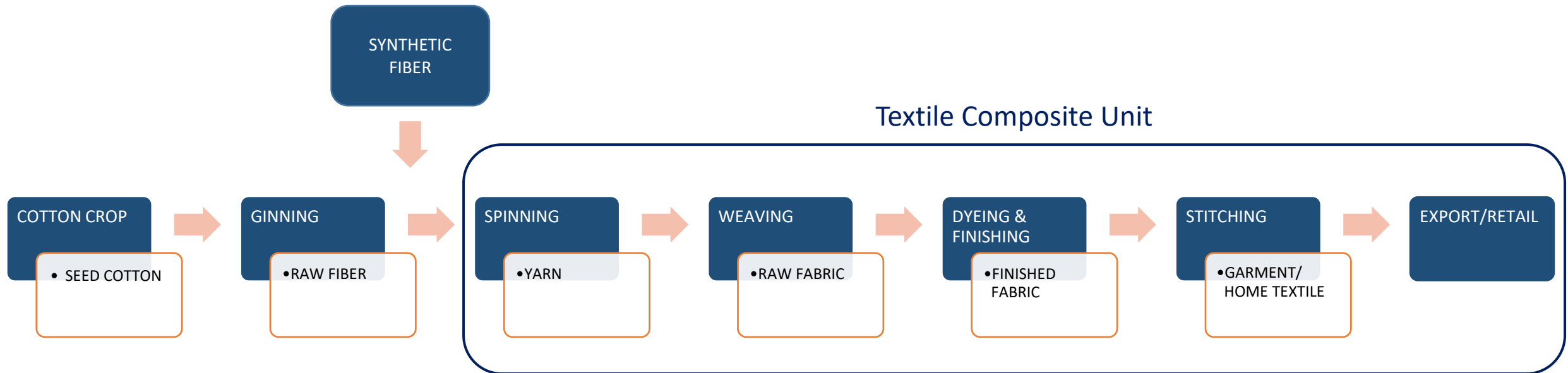
Sector Study



Contents	Page No.	Contents	Page No.
Introduction	1	Financial Risk Working Capital Management	15
Global Industry Overview	2	Financial Risk Borrowing Mix	16
Local Industry Overview	3	Regulatory Environment	17
Cotton Dynamics	4	Duty Structure	18
Yarn & Fabric Production	6	Rating Curve	19
Textile Imports	7	SWOT Analysis	20
Textile Exports	8	Outlook & Future Prospects	21
Export Destinations	9	Bibliography	22
Denim Sector	11		
Business Risk	12		
Regional Cost Comparison	13		
Margins & Cost Structure	14		

Composite & Garments | Introduction

- The 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 every process of the textile cluster's value chain
- A composite textile unit comprises of two or more processes from spinning of yarn till finished goods are produced.





Overview

- **Size:** The market size of the global textile and apparel industry is estimated to be USD~1,480bln in CY21 as compared to USD~1,372bln in CY20. This represents a growth rate of ~7.9%. The growth occurred due to recovery from the impact of the COVID-19 pandemic in the previous year which had led to lockdowns and other restrictions ultimately resulting in a decline in demand.
- **Demand Drivers:** The growth of textile industry in pre-pandemic years is attributable to increasing demand for apparels in developing countries. Moreover, the rapid pace of urbanization and rising disposable incomes are also contributing factors to growth.
- **Region Wise Textile Market:** The largest regional textile market is Asia-Pacific. It includes countries such as India, China and Pakistan which are amongst the top producers of cotton. Moreover, due to the availability of cheap labor, these countries along with Bangladesh have become textile producing hubs. They cater to both growing local demand and export demand from other regions.
- China is the largest exporter of textiles followed by India, Bangladesh and Vietnam. Meanwhile, the European Union and United States are two of the largest importers of textile finished goods such as garments and apparel.



Composite & Garments | Local Industry

Overview

- The overall textile industry contributes ~8.5% to the GDP of the country, which amounted to a market size of PKR~3,816bln in FY21 as compared to PKR~3,345bln in FY20.
- In FY21, the export contribution from textile segment was of PKR~2,461bln (~61% of total country exports) and grew by ~25% from PKR~1,972bln in FY20. This increase was attributable to diversion of export orders to Pakistan as regional competitors went through longer periods of lockdown as a result of the COVID-19 pandemic.
- Textile composite entities encompass the majority of processes within the textile value chain. These units have applied forwards or backwards integration in order to increase efficiencies. There are around 50 organized textile composite entities operating in the country, 30 of which are listed on the Pakistan Stock Exchange. The market capitalization of listed composite firms stood at PKR~310bln as on 22nd Oct, 2021.
- There is a high level of product differentiation achieved as a variety of finished goods are produced including knitwear, towels, home textiles and a range of readymade garments. Some units also sell yarn and unprocessed fabric.

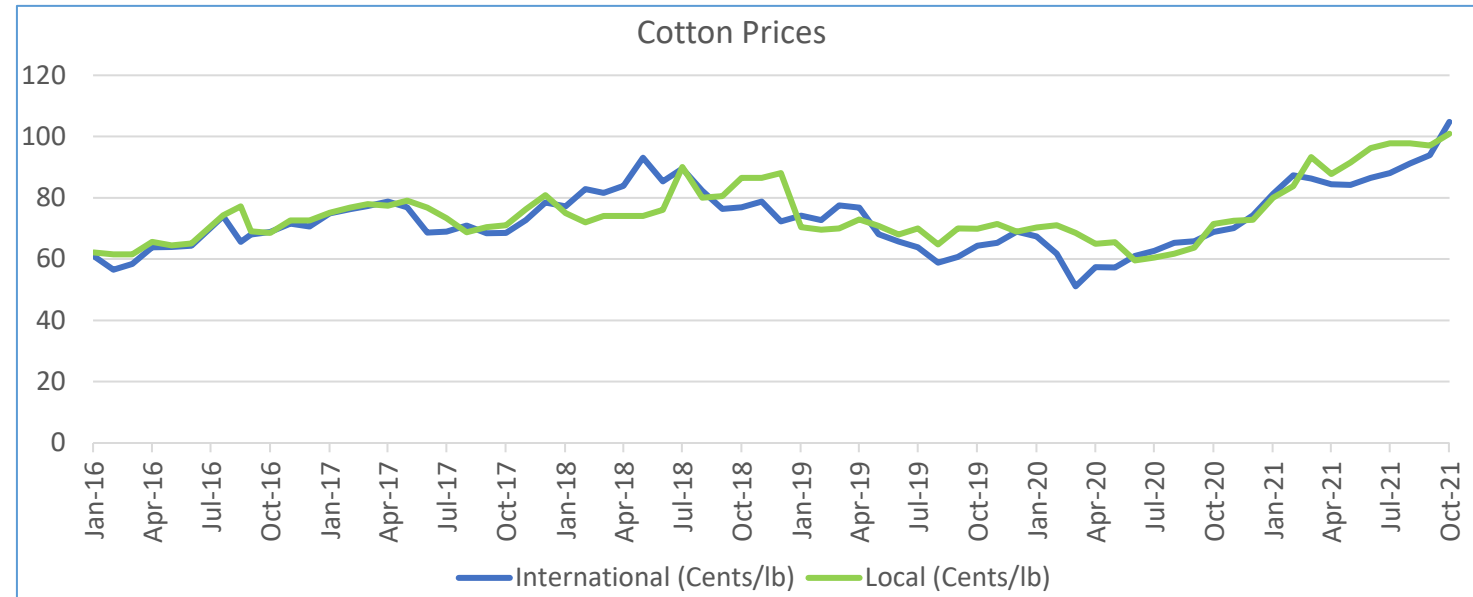
Sector Overview	FY19	FY20	FY21
Textile Industry Size (PKR bln) [Estimate]	3,051	3,345	3,816
Contribution to GDP	8.5% of GDP		
No of Players*	~50 Players		
Textile Exports Value (PKR bln)	1,813	1,972	2,461
Share of Total Country Exports	58%	59%	61%
Textile Imports Value (PKR bln)	442	399	616
Industry Association	All Pakistan Textile Mills Association (APTMA)		

* No of Players only includes composite units and garment manufacturers in the organized segment.

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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 ~72%.
- Prices have recently reached a new peak of ~108 cents/lb in Oct-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 ~167% in PKR terms since 2016 with currency depreciation being a major factor since 2018.
- Prices recently touched a new peak of PKR~14,700 per maund during Oct-21. The price increase is driven by the increase in international prices as well as greater demand in the local market.



Average Cotton Prices	FY17	FY18	FY19	FY20	FY21	3MFY22	Cotton Unit Conversion	
	Unit	Conversion						
International (Cents/lb)	73	78	76	62	76	95	1 Maund	37.3kg
Local (Cents/lb)	75	74	78	68	78	98	1 Bale	170kg
Local (PKR/maund)	6,458	6,888	8,604	8,742	10,290	13,476	1 Bale	4.6 Maund

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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.
- 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 ~8-9mln bales. As per PCGA figures, arrivals for current season up till mid-October stand at ~5.2mln bales as compared to ~2.7mln bales at the same time last year. The increase has come on the back of favourable weather conditions and earlier sowing/harvest period.
- 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.

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
Net Import (USD mln)	673	766	1,020	748	863	1,479
% Change (volume)	-	31%	17%	-29%	30%	64%
Total Cotton Supply (000 MT)	2,034	2,300	2,535	2,221	1,985	1,816

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Yarn and Fabric Production

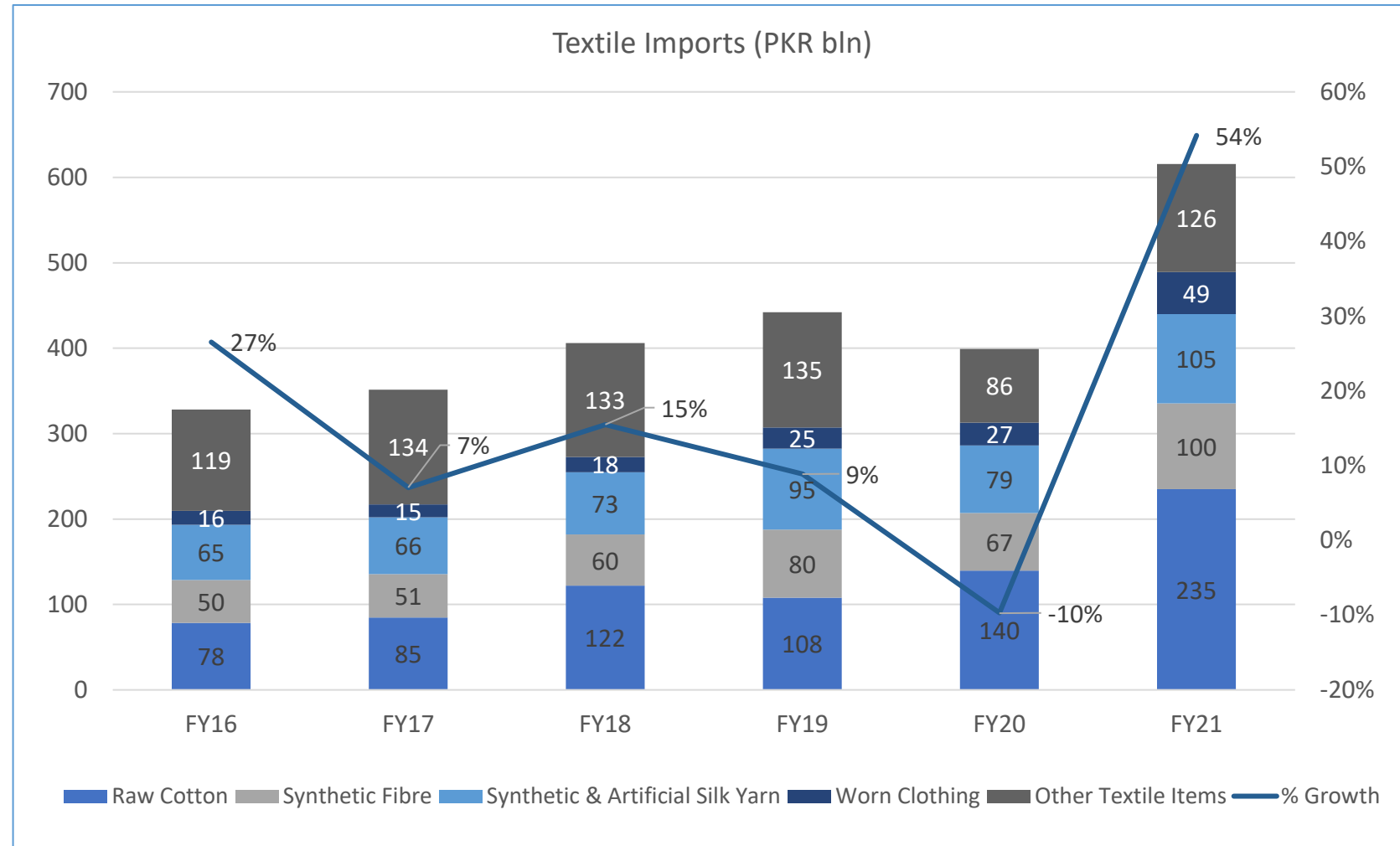
- Pakistan’s annual production of yarn and fabric has remained relatively stable in the past few years. During FY21, the production of both yarn and fabric grew by ~12% as there was recovery from the COVID-19 pandemic which had slowed down production in the previous year.
- Synthetic or blended yarn has the largest share of total yarn production. Moreover, there is greater production of coarse and medium type yarn as compared to fine cotton yarn. This has a negative impact on quality of fabric and finished goods as fine yarn is considered to be of a higher quality.
- Production of grey cloth has the greatest share in overall cloth production followed by dyed and printed cloth.

Production of Yarn (MT)	FY16	FY17	FY18	FY19	FY20	FY21
Coarse	783,279	835,510	787,376	790,223	704,702	792,594
Medium	817,334	702,144	826,399	823,784	734,631	826,256
Fine	391,639	424,822	393,126	395,655	352,835	396,841
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	1,339,937
Total	3,405,559	3,422,326	3,430,050	3,431,390	3,059,942	3,441,585
Production of Fabric (000 Sq. M)	FY16	FY17	FY18	FY19	FY20	FY21
Grey	571,393	584,532	582,812	583,364	521,212	584,670
Bleached	87,852	75,805	111,110	114,146	101,985	114,402
Dyed & Printed	302,781	299,519	269,082	267,397	238,908	267,996
Blended	77,157	83,488	80,736	81,073	72,435	81,255
Total Organized Mill Production	1,039,183	1,043,344	1,043,740	1,045,980	934,540	1,048,447
Unorganized Mill Production	8,120,017	8,126,356	8,127,160	8,101,820	7,239,019	8,120,652
Total Fabric Production	9,159,200	9,169,700	9,170,900	9,147,800	8,173,559	9,169,099
Growth		0.11%	0.01%	-0.25%	-10.65%	12.18%

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Textile Imports

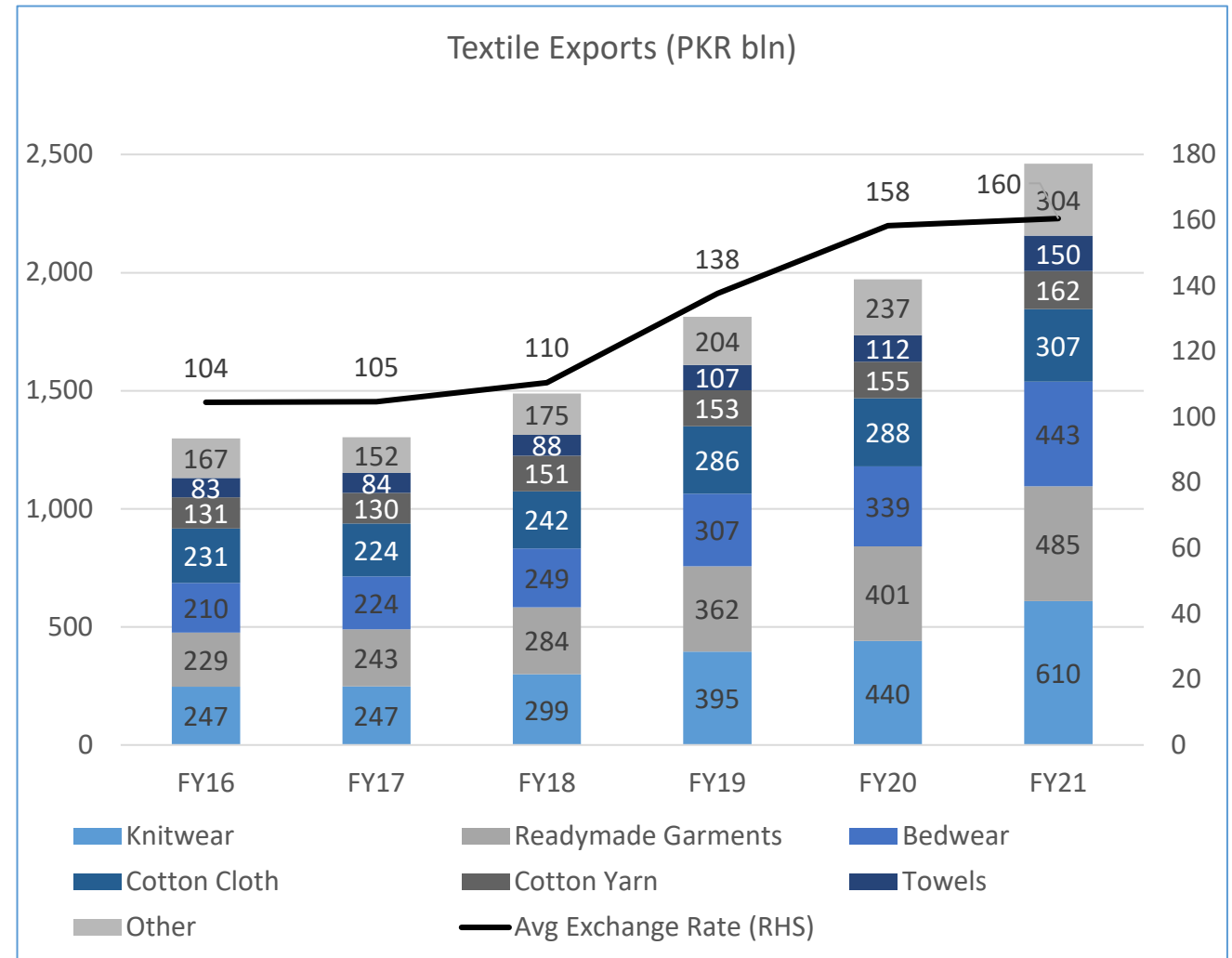
- In addition to the increased imports of raw cotton due decline in local production, the imports of synthetic fibres, silk yarn, worn clothing and other textile items have all increased during FY21. Textile imports exhibited an overall ~54% increase during FY21.
- The total textile imports stood at PKR~616bn in FY21 as compared to PKR~399bn in FY20. The largest component was import of raw cotton which stood at PKR~235bn in FY21.
- During 3MFY22, textile imports stood at PKR~195bn as compared to PKR~113bn during 3MFY21.



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Textile Exports

- Pakistan’s textile exports stood at PKR~2,461bIn in FY21 as compared to PKR~1,971bIn in FY20, exhibiting phenomenal growth of ~25% during the period.
- The growth came on the back of volumetric increase in exports, particularly in the value added segments such as towels, knitwear and bedwear. For all other segments, growth was spurred by higher average export prices which increased in the aftermath of the COVID-19 pandemic due to higher raw material prices and supply constraints.
- The volumetric increase in value added exports was driven by a larger number of export orders diverted from regional competitors such as Bangladesh and Vietnam, where the pandemic resulted in relatively longer lockdowns and other restrictions which hindered production activities.
- The largest contribution to textile exports emanates from knitwear, ~25%, and readymade garments, ~20%. The four value added segments combine to contribute ~68% to total textile exports. Meanwhile, textile exports had a share of ~61% in the country’s total exports during FY21.
- During 3MFY22, the country’s total textile exports stood at PKR~725bIn, growing ~25% from PKR~579bIn in 3MFY21.



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Exports Destinations

- The adjacent tables show major export destinations of cotton yarn, cotton fabric and ready-made garments.
- There is a high level of concentration in yarn exports with ~71% of yarn being exported to China in FY21.
- The level of concentration in fabric exports is moderate with exports to Bangladesh comprising ~23% of total fabric exports in FY21.
- China and Bangladesh are both major textile producing countries and therefore have significant demand for raw materials such as yarn and fabric.
- Exports of garments are concentrated towards the USA which contributes ~23% to total garment exports. Other export destinations are European countries such as Spain, UK, Germany and Netherlands.

Cotton Yarn	FY19		FY20		FY21	
Countries	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%
China	708	63%	663	67%	723	71%
Bangladesh	84	7%	58	6%	70	7%
Turkey	44	4%	52	5%	35	3%
Portugal	43	4%	39	4%	31	3%
S. Korea	27	2%	22	2%	25	3%
Other	220	20%	151	15%	132	13%
Total	1,125	80%	985	85%	1,017	87%
Cotton Cloth	FY19		FY20		FY21	
Countries	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%
Bangladesh	482	23%	431	24%	437	23%
USA	112	5%	136	7%	139	7%
Italy	145	7%	124	7%	129	7%
Turkey	126	6%	101	6%	105	5%
Portugal	79	4%	81	4%	85	4%
Other	1,158	55%	957	52%	1,026	53%
Total	2,102	100%	1,830	100%	1,921	100%
Ready Made Garments	FY19		FY20		FY21	
Countries	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%
USA	622	23%	604	24%	693	23%
Spain	345	13%	291	11%	383	13%
UK	296	11%	288	11%	355	12%
Germany	287	11%	279	11%	347	11%
Netherlands	201	8%	240	9%	227	7%
Other	903	34%	850	33%	1,027	34%
Total	2,654	100%	2,553	100%	3,033	100%

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Exports Destinations

- The adjacent tables show the major export destinations of knitwear and bedwear.
- The United States is the largest market for exports of both knitwear and bedwear with a share in total exports of ~36% and ~22%, respectively.
- The remaining demand is largely concentrated towards Europe with countries such as UK, Germany, Netherlands, Spain and Belgium making significant contributions to export of knitwear and bedwear.

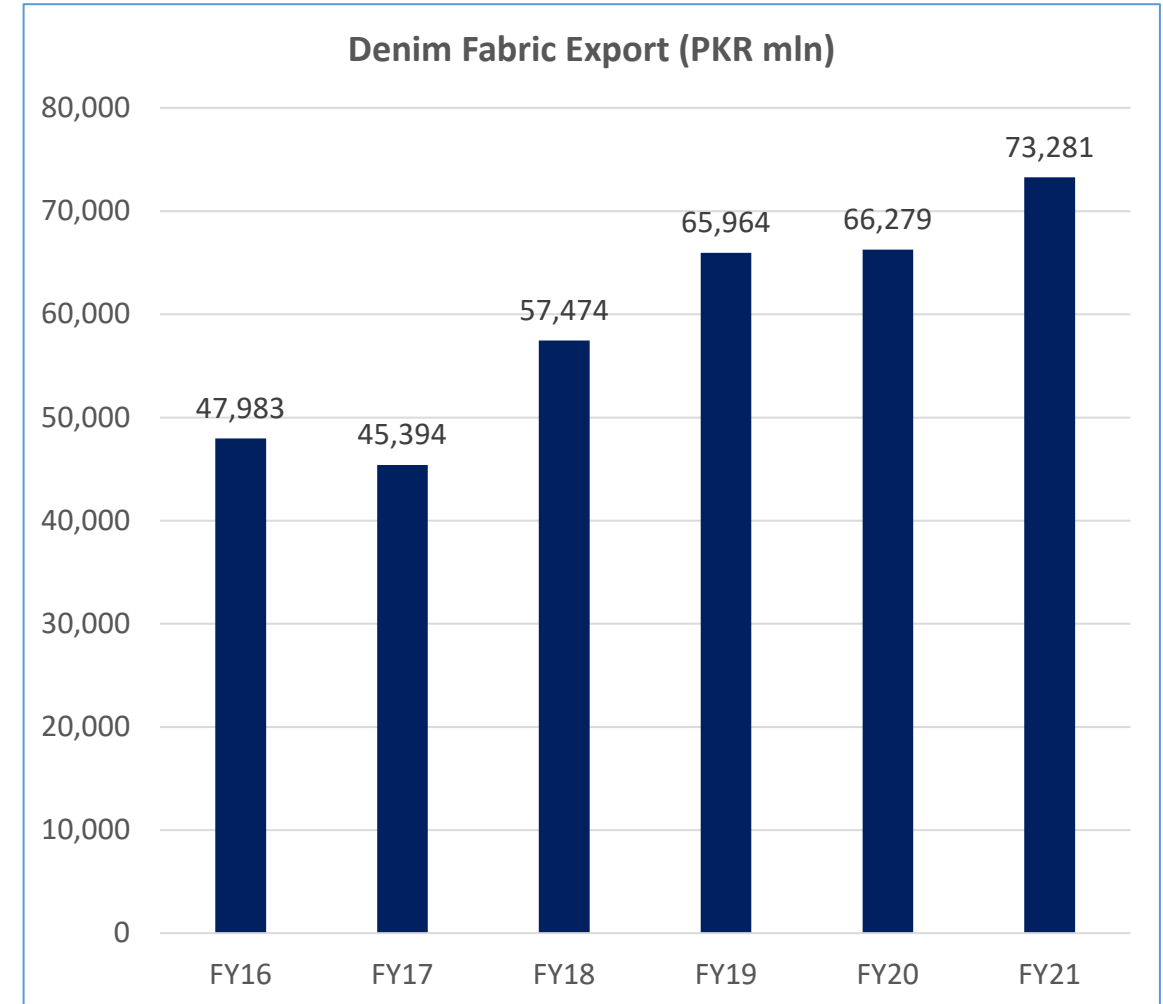
Knitwear	FY19		FY20		FY21	
	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%
USA	1,083	37%	1,000	36%	1,387	36%
UK	419	14%	397	14%	560	15%
Germany	224	8%	253	9%	318	8%
Netherlands	235	8%	242	9%	305	8%
Spain	221	8%	192	7%	280	7%
Other	718	25%	710	25%	967	25%
Total	2,900	100%	2,795	100%	3,816	100%

Bedwear	FY19		FY20		FY21	
	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%
USA	484	21%	501	23%	611	22%
UK	410	18%	336	16%	476	17%
Germany	241	11%	241	11%	300	11%
Netherlands	188	8%	178	8%	229	8%
Belgium	126	6%	131	6%	167	6%
Other	813	36%	764	36%	987	36%
Total	2,262	100%	2,151	100%	2,772	100%

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Denim

- Denim is a sturdy cotton twill fabric woven with an indigo, grey, or white yarn. Denim is among the most well-known and commonly worn fabrics there is, and is traditionally used for the classic blue jeans but also has a variety of other applications such as jackets, dresses, overalls, and more.
- Pakistan is amongst the largest suppliers of denim fabric in the world. According to the Pakistan Business Council (PBC), in 2017, Pakistan ranked second in denim fabric exports with a share of ~17% of global exports.
- Meanwhile, Pakistan also has significant production and export of finished denim apparel such as jeans. During the first half of 2021, the export of jeans from Pakistan to United States reached USD~151mIn, an increase of ~50% from same period last year. Pakistan contributed ~26% to the United States' total jeans imports during the period. During CY20, Pakistan exported USD~251mIn worth of denim to the United States.
- In addition, Pakistan's denim exports to the EU are also significant and during CY20, ranked third with a share of ~17% of the EUs total denim product imports.



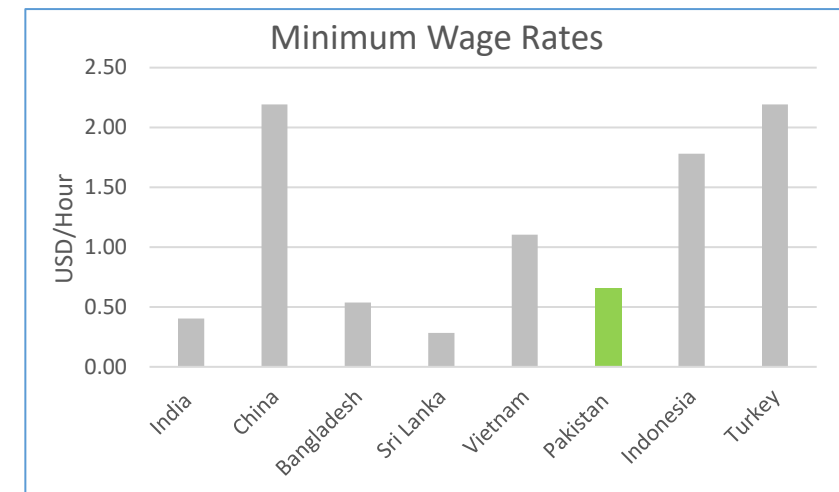
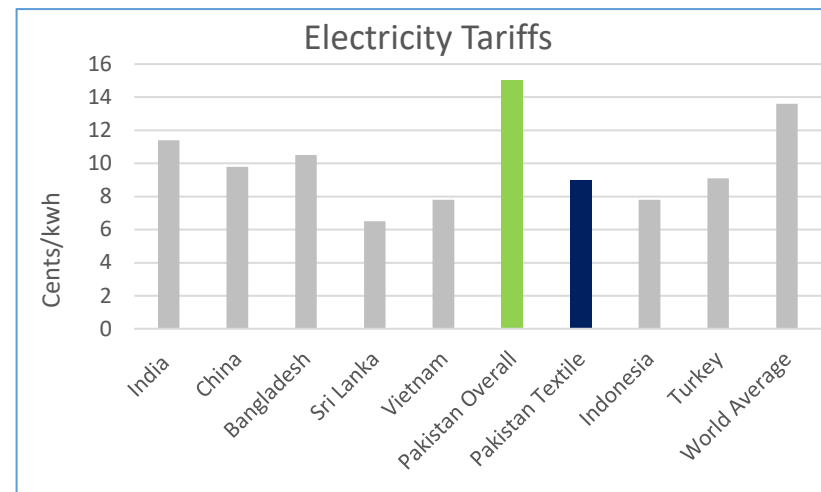
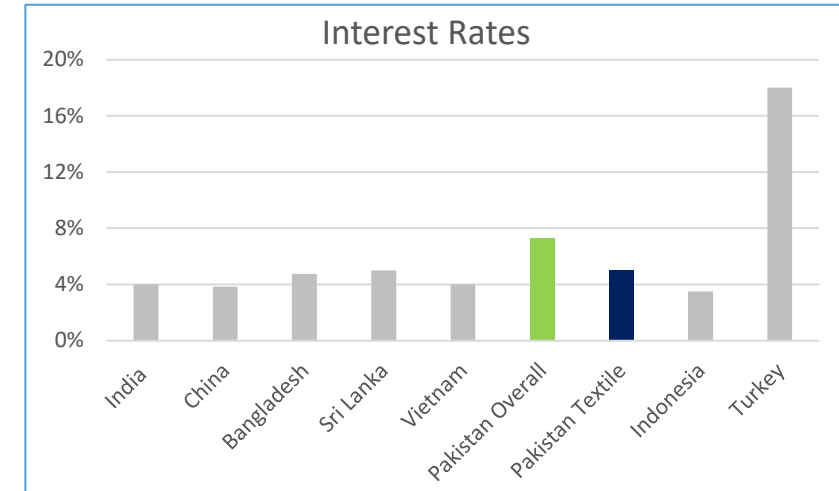
Business Risk

- **Decline in 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. The reduced local production has increased the country's reliance on imported cotton and thus the exposure to exchange rate fluctuations and international price volatility. However, latest cotton arrival figures depict a healthier picture, with significant increase in production as compared to the previous season.
- **Rising raw material prices:** The shortage in supply of cotton in local and international markets has resulted in significant price increase for cotton as well as other raw materials such as yarn and fabrics. Raw material constitutes ~64% of the sector's direct costs and thus profitability depends on the players' ability to continue to pass on the increased price impact.
- **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 textile exports.
- **High level of regional competition:** Pakistan's textile exporters have traditionally faced a high level of competition from regional players such as Bangladesh and Vietnam which has driven down the average export prices and margins in previous years. Although, many regional players were severely impacted by the COVID-19 pandemic which benefited Pakistan, the regional competition will continue once COVID-19 crisis subsides.
- **Review of GSP+ Status:** Pakistan relies heavily on its GSP+ Status with regards to its exports to the European market. The GSP+ Status was extended recently, however, it will be under review in two years time. The review will evaluate Pakistan's implementation of 27 international conventions related to human rights, labour rights and environmental factors.

Composite & Garments | Local Industry

Regional Cost Comparison

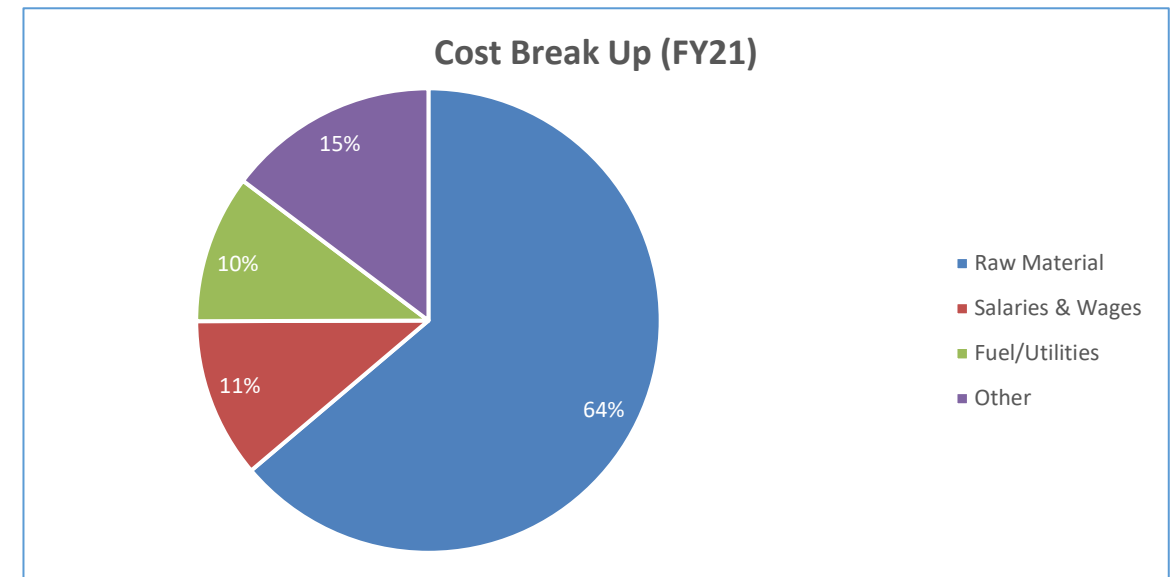
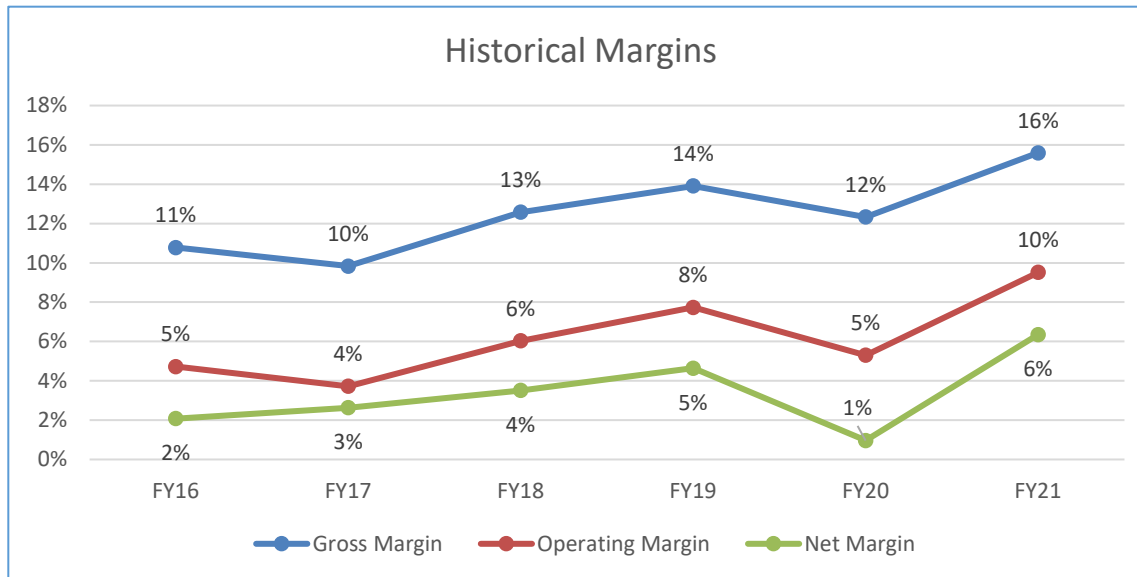
- Pakistan has the second highest interest rate in the region behind Turkey. The high cost of borrowing acts as a barrier to investment in the country. Textiles, on the contrary fall within the ambit of the export sector and have access to subsidized financing facilities from SBP in the form of short term Export Finance Scheme (EFS) and Long Term Financing Facility (LTFF). On regional level, China and Indonesia have the lowest borrowing rates.
- 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/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 0.82 USD per hour in Sindh and 0.66 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.



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Margins & Cost Structure

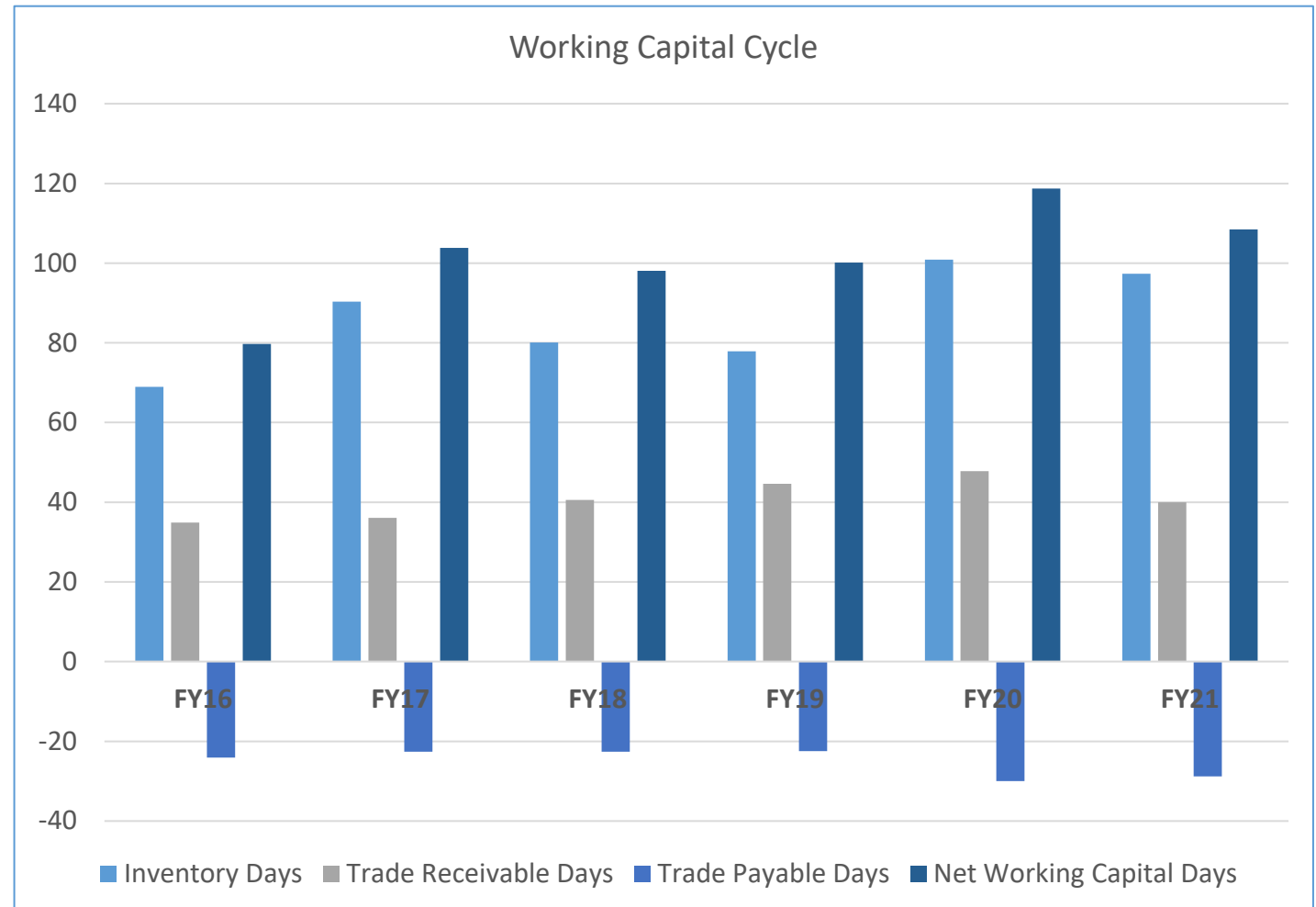
- Over the last five years (FY16-FY20), the average gross margins for textile composite units have stood at ~12% while average net margins stood at ~3%. Apart from FY20, the sector's margins have exhibited a growing trend each year, with net margin improving from ~2% in FY16 to ~6% in FY21.
- During FY21, margins improved significantly, with gross margins standing at ~16% as compared to ~12% in FY20. The increase came on the back of higher demand as compared to the previous period as well as higher prices of finished goods particularly in the export market. Meanwhile, the decline in policy rate reduced finance costs which resulted in improved net margins from ~1% in FY20 to ~6% in FY21.
- The largest component within direct costs is raw material which comprises ~64% of the total manufacturing cost. Declining local cotton production has propelled higher quantities of import of cotton and yarn. As a result, players are exposed to greater risk due to exchange rate volatility and international price fluctuations.



Composite & Garments | Local Industry

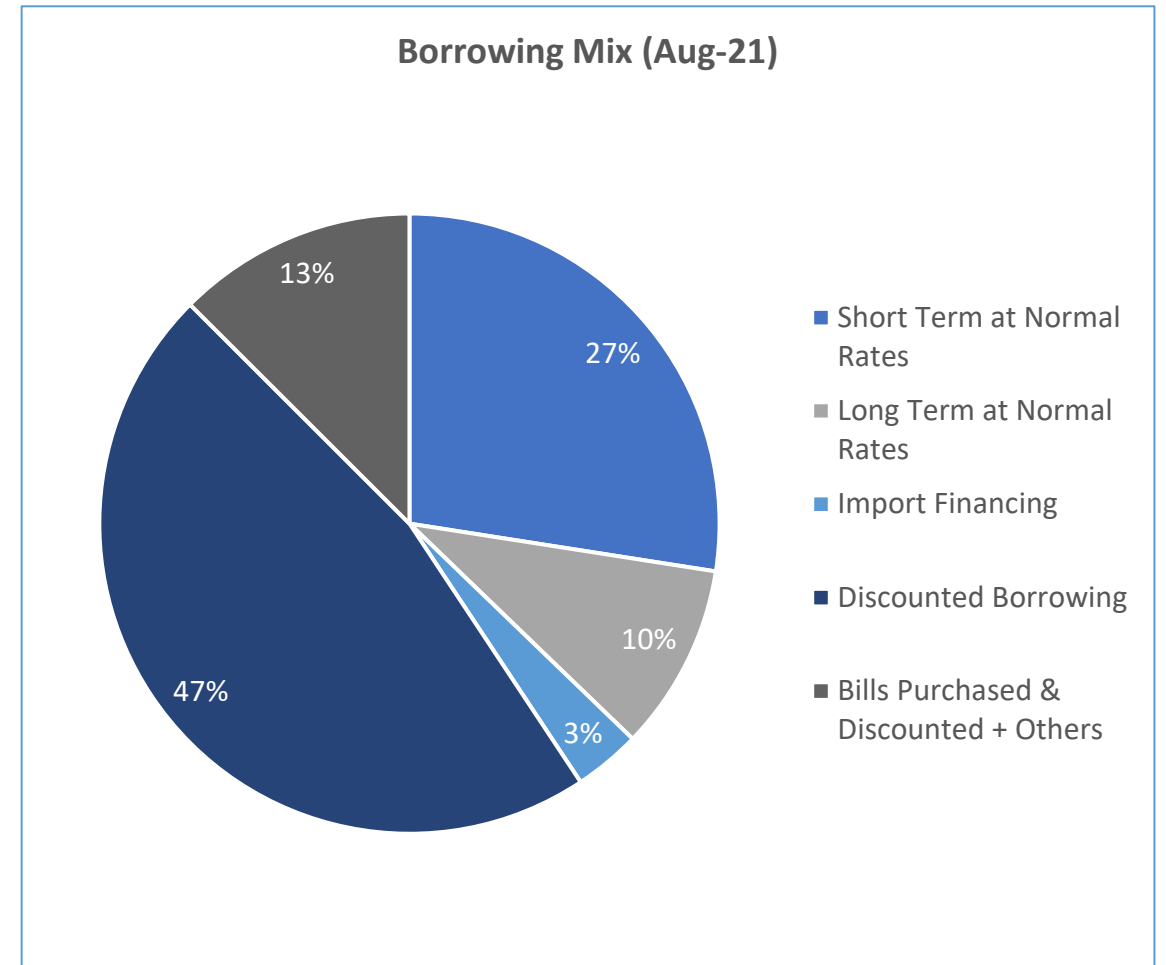
Financial Risk | Working Capital Management

- The composite sector’s working capital is largely a function of inventory and trade receivables. Inventory is the most significant component and majorly includes raw material and finished goods, with work-in-process making the smallest contribution.
- The average working capital cycle for the industry is ~100 days - a relatively larger period than other textile sectors due to the fact that composite units encompass multiple processes within the textile value chain.
- While the previous year had witnessed an increase in the working capital cycle (~119 days) due to the COVID-19 pandemic and resulting lockdown, FY21 exhibited a recovery with the working capital cycle reducing to ~108 days.



Financial Risk | Borrowing Mix

- The total borrowing for textile sector in Aug'21 stood at PKR~1,445bln as compared to PKR~1,277bln in Aug'20.
- The largest component within the borrowing of textile sector is discounted borrowing, amounting to ~47% of the total borrowing. This 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%.
- Total discounted borrowing amounted to PKR~676bln as at End-Aug'21 (EFS: PKR~388bln, LTFF/TERF: PKR~288bln).
- The sector's short term borrowing at normal rates accounts for ~27% of total borrowing and stood at PKR~397bln as at End-Aug'21.
- The average leveraging for the textile composite sector is moderate and stands at ~48%.
- As of June'21, the total Non-Performing Loans (NPLs) of the textile industry stood at PKR~160,173mln while infection ratio was recorded around ~11.4%, exhibiting a minute improvement from infection ratio of ~12% as of March'21. Despite the improvement, it remains well above the total infection ratio of 8.9% (Jun-21) indicating higher level of financial risk.



Regulatory Environment

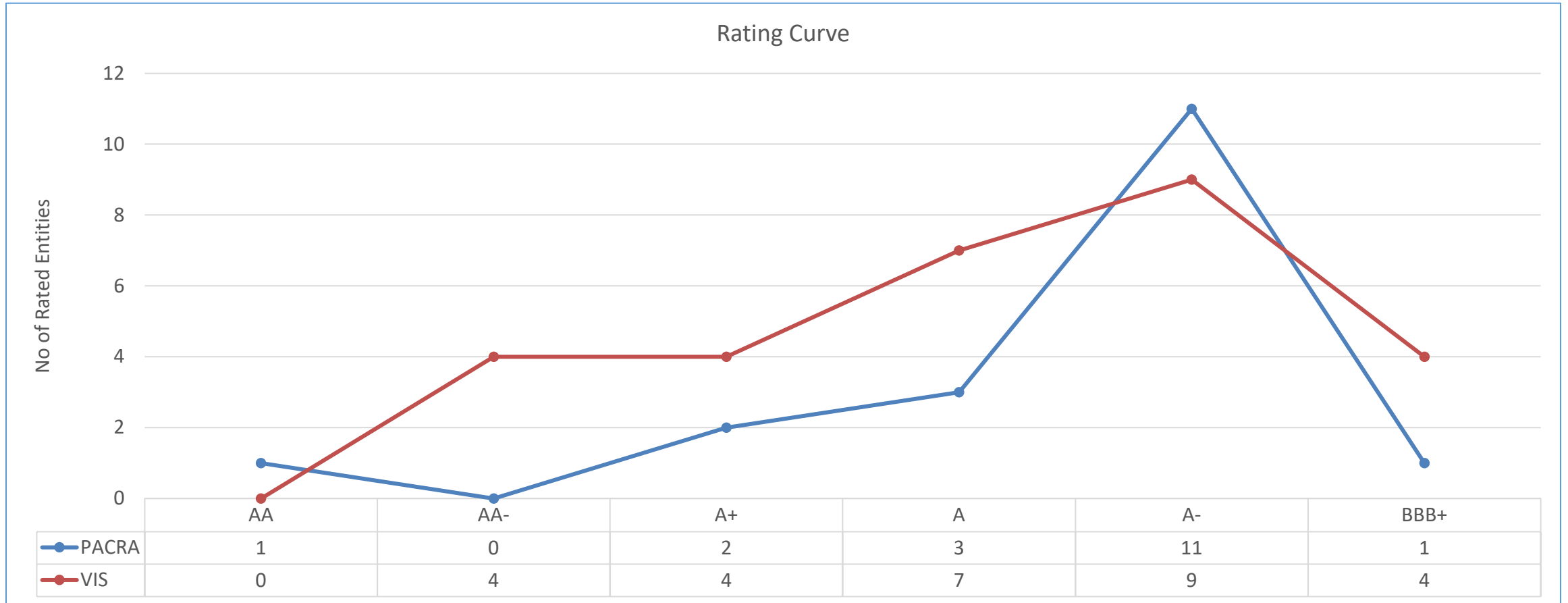
- With respect to Income Tax, the textile composite sector is under the Normal Tax Regime (NTR). Further, the sector is also subject to Minimum Tax @ 1.5% of turnover, if tax liability under NTR is lower than minimum tax. However, the additional tax paid under minimum tax is adjustable against future tax liabilities for the next 5 years.
- In addition, sales tax of 17% is applicable on all products within the textile value chain such as cotton, yarn and fabric. Moreover, 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 government provides Drawback of Local Taxes and Levies (DLTL) at the rate of 2% on eligible product line of processed fabric (2% additional drawback is also allowable for exports to non-traditional markets).
- The government also provides subsidized electricity to the textile industry at USD 9 cents/kwh and gas at USD 6.5/mmbtu in order to increase export competitiveness in international markets.
- In addition, the sector receives subsidized financing from SBP under the Export Finance Scheme (EFS) and the Long Term Financing Facility (LTFF).
- The duty structure of the sector provides protection to those local players who are producing finished goods such as garments and knitwear.
- All Pakistan Textile Mill Association (APTMA) acts as the national trade association of textile cluster in the country. It represent 396 textile mills which fall under spinning, weaving and composite categories

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%
52.04	Cotton sewing thread, whether or not put up for retail sale	16%	16%	4%	4%	0%	0%	20%	20%
52.05	Cotton yarn (other than sewing thread), containing 85% or more by weight of cotton, not put up for retail sale	11%	11%	2%	2%	0%	5%	13%	18%
52.06	Cotton yarn (other than sewing thread), containing less than 85% by weight of cotton, not put up for retail sale	11%	11%	2%	2%	0%	5%	13%	18%
52.07	Cotton Yarn (other than sewing thread) put up for retail sale	11%	11%	2%	2%	0%	5%	13%	18%
52.08	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing not more than 200g/m2	11%	20%	2%	7%	0%	10%	13%	37%
52.09	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing more than 200g/m2	11%	20%	2%	7%	0%	10%	13%	37%
52.10	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with mand-made fibres, weighting not more than 200g/m2	11%	16%	2%	4%	0%	10%	13%	30%
52.11	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with mand-made fibres, weighting more than 200g/m2	11%	16%	2%	4%	0%	10%	13%	30%
52.12	Other woven fabrics of cotton	16%	20%	4%	7%	0%	10%	20%	37%
61.01-61.17	Knitted or crocheted clothing articles and accessories	20%	20%	6%	7%	10%	10%	36%	37%
62.01-62.17	Clothing articles and accessories (other than knitted and crocheted)	20%	20%	6%	7%	10%	10%	36%	37%
63.01-63.07	Other made up articles (including blankets, bedsheets, towels etc.)	20%	20%	6%	7%	10%	10%	36%	37%

Rating Curve

- PACRA rates 18 textile composite & garments players with a long term rating bandwidth ranging from BBB+ to AA.





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SWOT Analysis



Composite & Garments | 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 brought various businesses to a halt. Despite steady increase in the number of vaccinations, the pandemic continues to be a source of uncertainty.
- The economic recovery is exhibited by the GDP growth of ~3.9% during FY21. Among the contributors of GDP growth is industrial activity which has picked up in various sectors with the Large Scale Manufacturing (LSM) 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%.
- The latest cotton production figures for ongoing season depict an increase in local cotton production, which will in turn reduce reliance on imported raw materials and exposure to exchange rate risks.
- Meanwhile, the textile export segments are expected to benefit from the recent currency depreciation with exchange rate rising significantly since the start of current fiscal year.
- The decision taken by the State Bank of Pakistan (SBP) to lower the policy rate by 625bps to 7% during the last quarter of FY20 lowered the sector's finance costs. The policy rate has, however, sharply reversed recently in the wake of rising inflation and increased to 8.75% from 7.25%, a jump of 150 bps. While the Sector has significant reliance on discounted borrowings, the finance cost is expected to rise steeply to the extent of normal rate borrowings.
- The overall textile industry's infection ratio stands at ~11.4% as of Jun-21, exhibiting gradual improvement from infection ratio of ~12% as of Mar-21. Despite the improvement, it remains well above the total infection ratio of 8.9% indicating higher level of financial risk.
- In addition, the industry is expected to continue to receive significant support from the government in the form of subsidized borrowings and energy prices due to its considerable contribution to the country's GDP and exports.

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