



Towels

Sector Study

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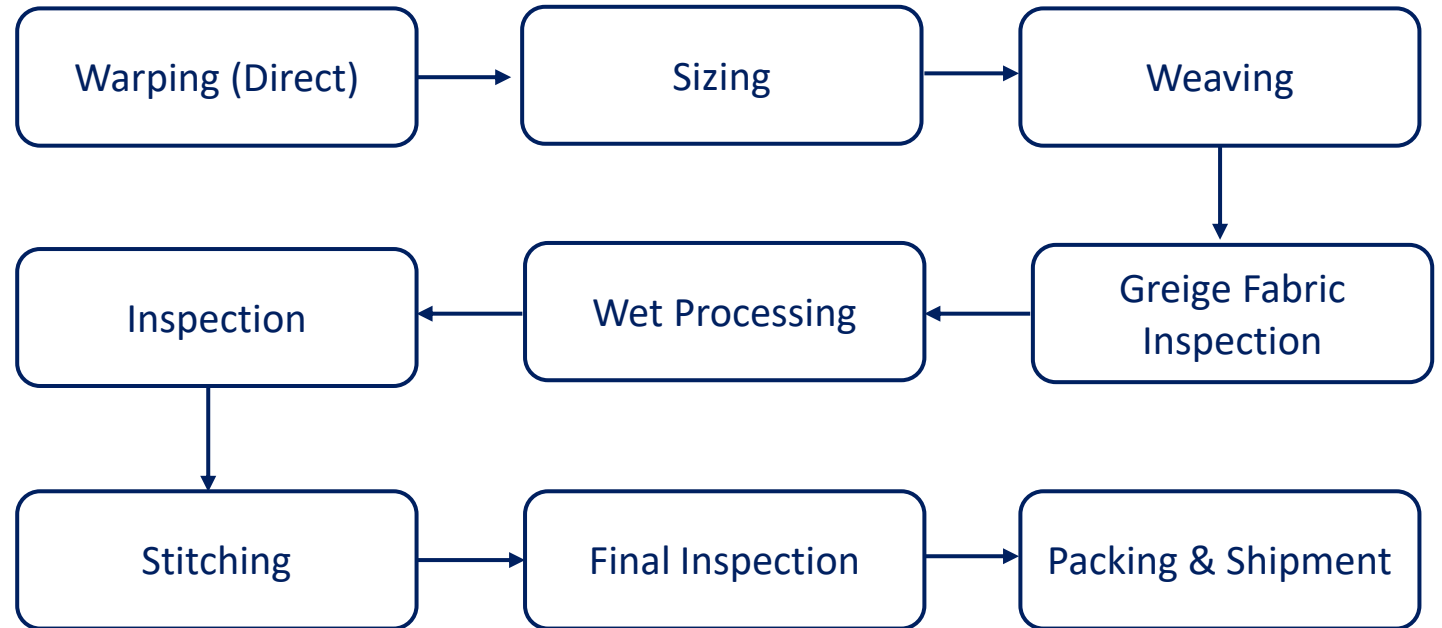
Introduction

- Terry towels, commonly known as towels, are thick, absorbent cloths used for cleaning, wiping surfaces, bathing, and drying.
- They are made of pile loops on one or both sides of the fabric, covering the entire surface. The loops are often formed into strips, checks, or other decorative patterns. The loop length determines fluid absorption ability; therefore, longer loops absorb more water.
- Cotton is the most common fiber used for the production of towels due to its natural qualities, which include:
 - Absorbency
 - Wet Strength
 - Hypoallergenic
- Other fibers sometimes used in towel production include polyester, linen, nylon, flax, and bamboo.
- The most commonly used towels are beach, bath, hand, face, and kitchen towels, each available in multiple colors with borders, cross hems, and side hems.



Manufacturing Process

- The adjacent flow chart shows various processes involved in producing towels.
- Towel is a type of woven fabric where two 2 beams are used to weave this fabric. One beam is for ground fabrication, and the other is for loop formation.
- Wet processing involves multiple stages, including scouring, bleaching, dyeing, and finishing.
- Finishing can be done through a chemical process, such as antimicrobial treatment, or a mechanical procedure, such as tumble drying, which increases softness.
- Terry loom formation ranges from "2 pick terry towel" to "7 pick terry towel". "3 pick terry" is the most popular and commercially used.



Global | Overview

- The global towels market is primarily segmented into kitchen and bath towels. The combined size of both markets is estimated to stand at USD~13.8bln in CY22 compared to USD~8.2bln in CY21, a YoY growth of ~68.3%. However, this growth is expected to slow down for at least 1HCY23, as global economies suffer from recession, resulting in weak global demand.
- The global kitchen towel market is estimated to have a value of USD~2.6bln in CY23, growing ~4.8% from a market size of USD~2.4bln in CY22.
- Meanwhile, the market value of the bath towel segment reached USD~11.2bln in CY22, and will continue to grow between CY23-27. The hospitality sector is a crucial driver of growth in the bath towel sector.
- Growing demand from commercial end users like hotels, fitness clubs, and hospitals has driven this growth, especially from rising construction in countries like China, India, and Brazil. The hospitality sector had to cater to increasing awareness about the health and hygiene of consumers' account. Customer trends also indicate a shift towards branded and luxurious textile products.
- The bathroom accessories market is estimated to be at USD~23.1bln in CY23. Over the last decades, the surge in demand for bathroom accessories can be largely attributed to the rise of urbanization and the increasing awareness among consumers about new and innovative bathroom products. Demand for bathroom accessories will continue to grow owing to urban households having at least one bathroom.
- Some prominent players in towel manufacturing include Welspun, Trident Group, 1888 Mills, Loftex, Noman Group, Alok Industries, and American Textile Systems.
- On the consumption side, major retail outlets such as Kohl's, Walmart, TESCO, IKEA, Asda, and Home Depot play a significant role as they cater to household and individual demand.



Global | Towels Trade

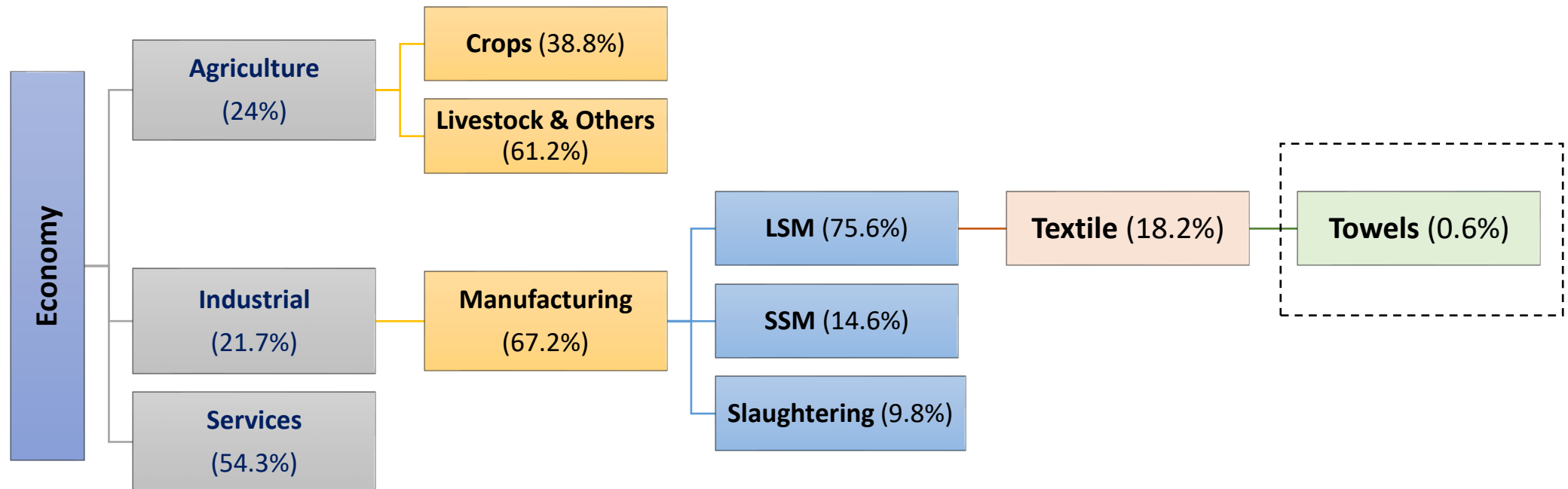
Top Exporters Towels					
USD mln	CY18	CY19	CY20	CY21	CY22
China	2,873	2,383	2,032	2,456	2,313
Pakistan	786	785	777	1,017	1,053
India	1,055	1,082	1,009	1,014	996
Turkiye	599	568	531	689	664
Portugal	258	209	186	248	236
Other	1139	1132	994	1212	650
Total	6,710	6,159	5,529	6,636	5,912

Top Importers Towels					
USD mln	CY18	CY19	CY20	CY21	CY22
USA	2,111	2,064	1,867	2,612	2,429
Japan	543	550	459	500	587
Germany	312	289	283	329	359
UK	242	248	197	215	221
France	231	205	173	227	254
Other	3,271	2,803	2,550	2,753	2,062
Total	6,710	6,159	5,529	6,636	5,912

- The Russia-Ukraine war disrupted the chances of global economic recovery from the COVID-19 pandemic. The geopolitical conflict has resulted in economic sanctions on multiple countries, surge in commodity prices, and supply chain disruptions, causing inflation across goods and services affecting many markets across the globe.
- From CY18-22, USA remained the largest importer of towels with imports of over USD~2bln during CY18-19 and CY21-22. During CY22, USA's imports stood at USD~2.4bln. Meanwhile, in regional terms, Europe is also a major importer with countries such as Germany, UK and France having significant towel imports.
- Similar to other textile segments, the supply or export of towels is concentrated in the Asian continent. This is due to the easy access to raw material and cheap labor. Top exporters of Towels (during CY18-22) included China, India, Pakistan, Turkey and Portugal. During 6MCY23, Pakistan exported cotton towels of mill made and hand loom worth PKR~508mln, while India recorded exports amounting to USD~443mln. Similarly, USA and Germany recorded imports worth USD~924mln and USD~134mln, respectively, over 5MCY23 period.

Local | Overview

- In FY23, Pakistan's GDP (nominal) stood at PKR~79.3trn (FY22: PKR~63.3trn) and posted a growth in real terms of ~0.29% (FY22: ~6.1%). Industrial activities in FY23 represented ~18.5% share of the (constant) GDP.
- Large Scale Manufacturing (LSM) in Pakistan is essential for economic growth, considering its linkages with other sectors, as it represents ~75.6% value of all manufacturing activities in FY23. The QIM dipped by ~10.3% during FY23 when compared with the same period of last year.
- The textile sector is classified as a Large Scale Manufacturing (LSM) industrial component within the industrial sector. In FY23, the textile industry's weight in the QIM was recorded at ~18.2%. Towels and bath robes have ~0.6% share in the textile category of the QIM.



Local | Overview

- In Pakistan, there are ~10,000 towel looms, including shuttle and shuttle-less looms operating in both organized and unorganized segments of the towel manufacturing sector.
- The towel sector is predominantly export-oriented. During FY23 (Jul-May), exports clocked in at PKR~223bln (USD~912mln) as compared to PKR~198bln (USD~1,111mln) in FY22. The ~24.6% increase in FY23's export revenue (in PKR terms) was attributable mainly to a rise in export price and exchange rate influence seeing as there was a volumetric decline of ~12.9%.
- During May'23, towel exports stood at PKR~25bln (USD~87mln) compared to PKR~18bln (USD~92mln) in May'22. This reflects a YoY increase of ~38.5% in PKR terms from May'22 to May'23. Meanwhile, there was a ~3.3% decline in quantitative terms. This decline was mainly due to global recessionary conditions putting downward pressure on export orders.
- During FY23, the towel sector's contribution to textile exports was more than ~6%. Meanwhile, the contribution to total country exports was over ~3.5%. This trend can also be seen in the monthly figures for May'23. Similarly, in Jun'23, towel exports amounted to PKR~25bln, and ~5.9% to textile exports, making up ~3.7% of country's total exports.
- The sector is represented by both the All Pakistan Textile Mills Association (APTMA) and the Towel Manufacturers Association of Pakistan (TMA). Currently, ~197 towel manufacturing players are registered as members of TMA. These players are largely concentrated in the South region. Only four players are listed on the Pakistan Stock Exchange and have a combined free market capitalization of PKR~32,673mln as of Jul'23.

Particulars	FY21	FY22	FY23
Towel Exports (PKR bln)	150	198	228
Share in Total Textile Exports	6.1%	5.8%	6.1%
Share in Total Country Exports	3.7%	3.5%	3.6%
Towel Exports (000 MT)	212	221	196
No. of Players	~197 Players		
Industry Association	Towel Manufacturers Association (TMA); All Pakistan Textile Mills Association (APTMA)		

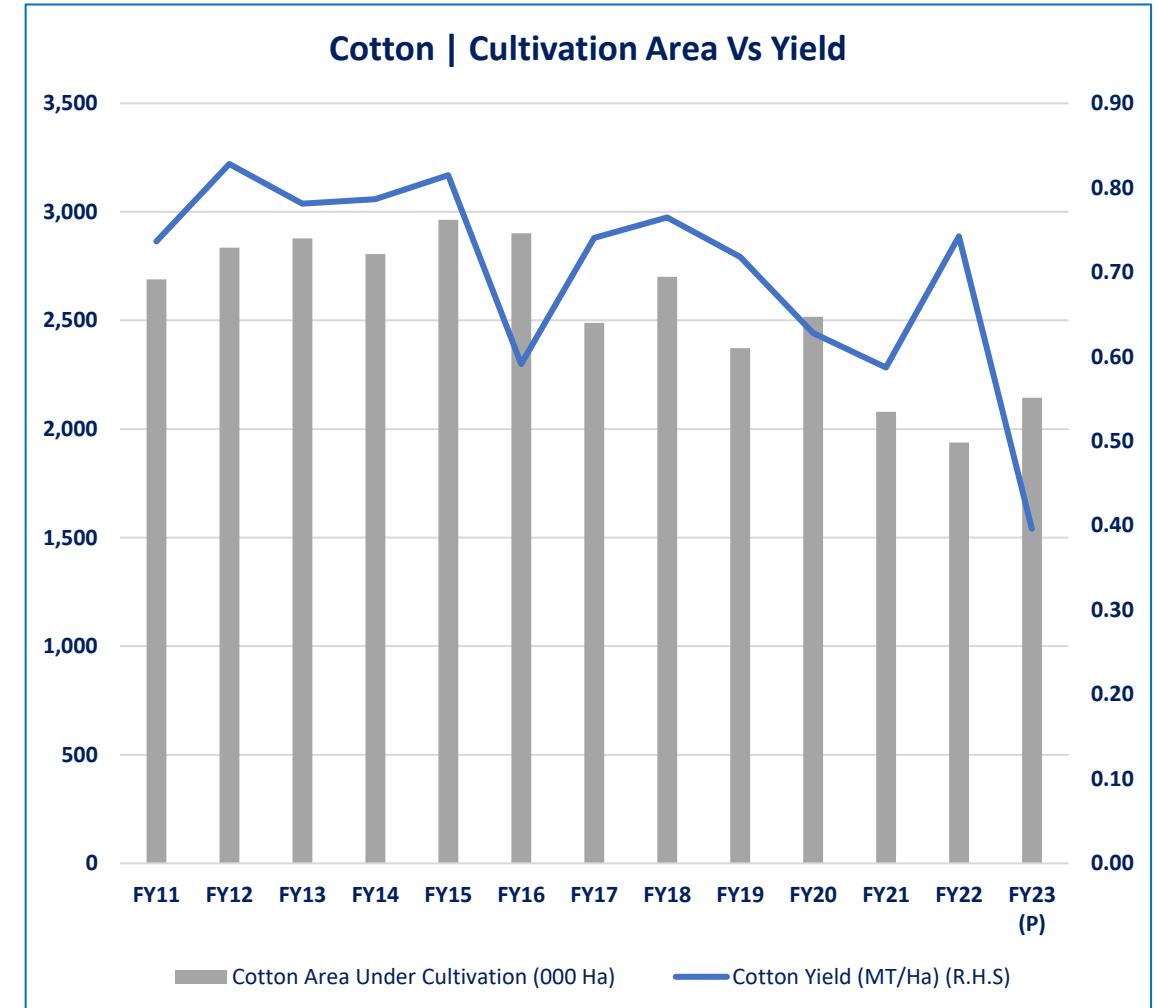
Local | Cotton Dynamics

Pakistan's Cotton Supply (000 Bales)						
	FY18	FY19	FY20	FY21	FY22	FY23
Opening Stock	464	987	1,136	202	209	174
Production	11,946	9,861	9,148	7,064	8,329	4,910
Imports	3,519	2,438	3,149	5,035	4,636	4,023
Total Supply	15,929	13,286	13,433	12,301	13,174	9,107
Local Consumption	14,736	12,074	13,155	12,086	12,984	7,254
Exports	206	76	76	6	16	68
Closing Stock	987	1,136	202	209	174	1,785

- The majority of Pakistan's cotton crop is grown in Punjab and Sindh, with KPK and Balochistan sharing a relatively small fraction of total outputs. The two major cotton producing provinces are Punjab (~66%) and Sindh (~33%) based on USDA's recent 3-year average estimate.
- Pakistan's cotton production decreased by ~41% in FY23 (FY22: ~18% growth) as the Aug'22 floods damaged cotton crop in major cotton producing districts like Rajanpur, DG Khan and Taunsa which were worst hit by flood and registered significant crop damages. The post-flood estimates of cotton production are ~4.9mln bales (or ~0.8mln MT) during FY23 as compared to ~8.3mln bales (or ~1.4mln MT) last year.
- FY23 was the second consecutive year when Pakistan's net imports of raw cotton declined after FY15 and FY19. Prior to FY22, cotton imports rose by ~78.1% over the FY17-21 period. However, for the outgoing FY23, estimates suggest a ~15% decline in cotton imports. The decline in imports can likely be explained by the tightening economic conditions faced by the country during 2HFY23, and the resultant lower quantum of imports. Moreover, there was also a slowdown in the global trade for cotton on the back of lower demand.
- The proposed target for cotton crop for FY24 season is ~2.2mln MT (or ~12.7mln bales), of which ~65.3% has been budgeted for Punjab and ~31.3% for Sindh and the remainder for KPK and Balochistan.

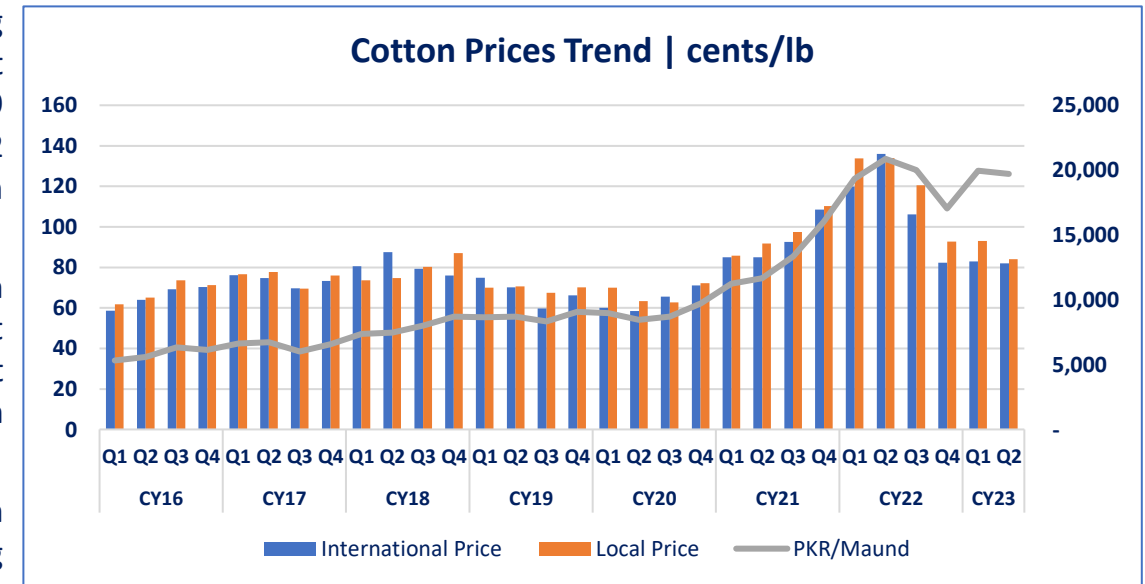
Local | Cultivation Area and Yield

- The decline in cotton yield came despite area under cultivation having increased by ~10.7% in FY23 (FY22: ~-6.8%). The area under cultivation in FY23 Kharif season has been recorded at ~2.1mln hectares, compared to FY22 when the area under cultivation was ~1.9mln hectares.
- Despite ~10.1% increase in area under cultivation, the floods caused a significant damage to cotton crop, with its production declining by ~41% to ~4.9mln bales (SPLY: ~8.3mln bales).
- On the other hand, area under cultivation for Maize grew only by ~4.1%, while that for rice declined by ~15.9% during FY23. Maize and Rice compete directly with cotton for area. However, besides the floods, other factors such as high temperatures and shortage of irrigation water resulted in lower cotton germination, seedlings growth and leaf wilting problems impacting cotton production during Mar-May'23.
- For FY24, production target is set at ~12.7mln bales, with targeted yield set at ~785Kg/Ha. However, area under cultivation is expected to remain stagnant due to Maize and Rice capturing higher local prices, paving way for farmers to make good profits with regards to these crops.



Cotton Dynamics | Prices

- International cotton prices, historically (CY16-20), exhibited a range-bound trend, hovering in the range ~60-80cents/lb. Prices are largely determined by supply-demand factors but can also fluctuate based on unforeseen events. For instance, during the COVID-19 pandemic, international prices had dipped to ~60cents/lb. However, the 1QCY21-2QCY22 period registered the highest levels of ~136cents/lb largely on the back of an uptick in economic activity across the globe.
- A significant variable influencing global cotton prices is the sluggish import demand from China, the world's largest cotton importer and producer, which has built significant stockpiles within the country in the recent past. The price stability of cotton in recent times can also be likely attributed to U.S. ban on textile exports made from cotton harvested in Xinjiang region of China.
- Local cotton prices, on average, exhibited little volatility during CY16-20, growing from PKR~5,846/maund to PKR~8,969/maund during 3QCY20, and hitting lowest levels during 3QCY17 of PKR~6,025/maund. However, prices started registering a steep growth post-CY20 and climbed up a high of PKR~20,862/maund during 2QCY22. Higher local prices moved in tandem with international prices during this time.
- A slight deviation has been observed for local and international prices (cents/lb) during CY23. At the start of CY23, delay in determining cotton price support by the government allowed prices to fall as ginneries tried to sell cotton at lower rates while spinners were reluctant to buy them. In Mar'23, the ECC fixed cotton intervention price at PKR~8,500/40Kg. This has failed to improve market conditions since growers were demanding a higher rate.
- Going forward, cotton prices are expected to continue similar trajectory in the face of lower demand from China and sluggish growth in top cotton-consuming countries.



Average Cotton Prices	FY19	FY20	FY21	FY22	FY23	Jun'23
International (Cents/lb)	76	62	76	114	87	82
Local (Cents/lb)	78	68	78	123	94	83
Local (PKR/maund)	8,604	8,742	10,290	13,476	19,108	19,568

Local | Yarn Supply

Production of Yarn (MT)	FY18	FY19	FY20	FY21	FY22
Coarse	787,376	790,223	707,732	792,771	793,742
Medium	826,399	823,784	735,970	826,441	827,453
Fine	393,126	395,655	350,824	350,824	351,254
Super Fine	88,406	85,699	75,891	85,975	86,080
Synthetic/Blended	1,334,743	1,335,929	1,179,211	1,385,574	1,387,271
Total	3,430,050	3,431,290	3,049,628	3,441,585	3,445,800

- Pakistan’s annual production of yarn has remained relatively stable in the past few years with production of yarn being consistent from FY21-FY22, growing by only ~0.1%. During 9MFY23, a total of ~2.1mln MT of yarn was produced.
- Synthetic or blended yarn, which includes Polyester-Viscose and Polyester-Cotton, has the largest share of total yarn production. Moreover, there is greater production of coarse and medium type yarn as compared to fine and super fine cotton yarn.

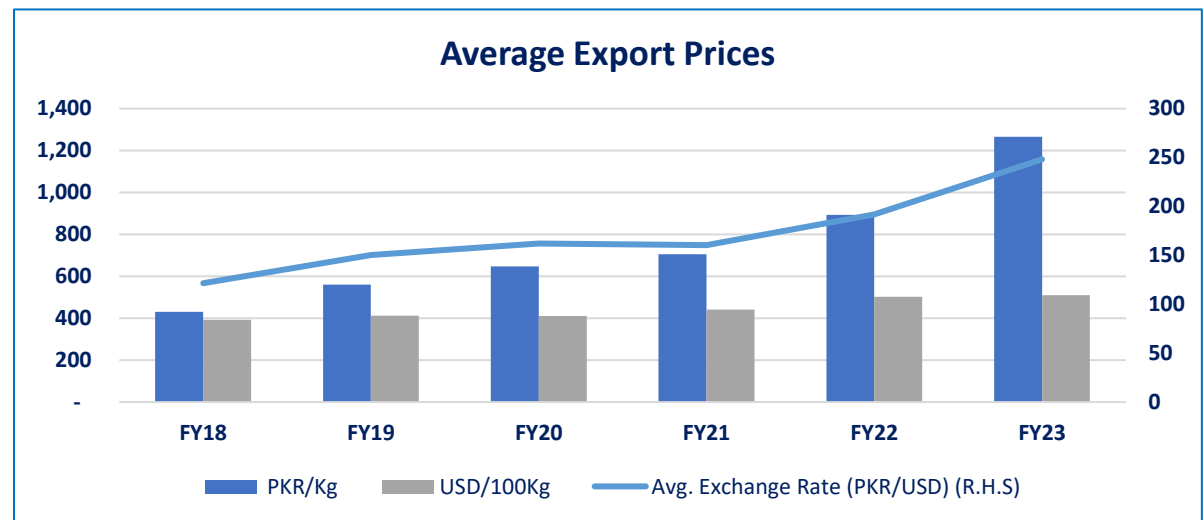
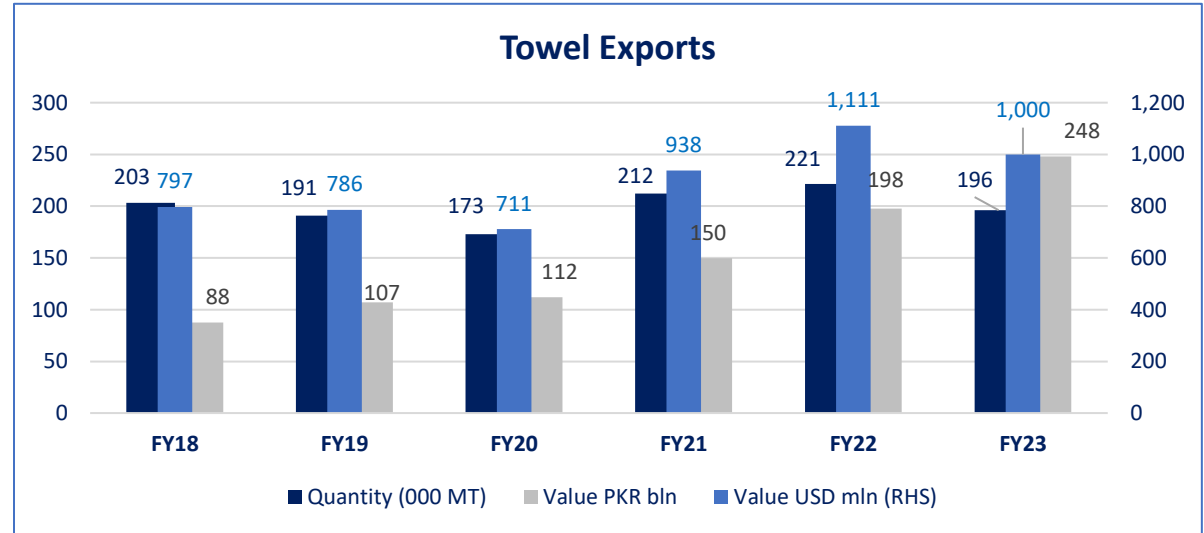
**Production figures for individual yarn categories is estimated using actual total production figures from FY21 (ratio of product wise yarn production to total production) for FY22 and 9MFY23*

Local | Textile Exports

Pakistan Textile Exports (PKR bln)	FY19		FY20		FY21		FY22		FY23		May'22		May'23	
	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value
Knitwear (Th. Doz)	117,673	395	106,027	440	179,365	610	167,630	912	179,126	1,089	13,128	84	16,858	94
Readymade Garments (Th. Doz)	55,665	362	48,588	401	37,418	485	55,657	696	80,578	861	6,115	63	7,014	76
Bedwear (MT)	414,845	307	405,184	339	460,143	443	516,042	585	407,733	664	40,650	55	32,064	57
Cotton Cloth (Th. Sqm)	2,827,064	286	2,365,874	288	992,145	307	444,537	434	339,260	499	36,978	45	34,181	50
Cotton Yarn (MT)	433,978	153	412,559	155	390,090	162	335,647	214	281,225	212	27,776	21	35,435	29
Towels (MT)	190,855	107	172,903	112	212,163	150	221,489	198	196,313	248	17,559	18	16,987	25
Raw Cotton (MT)	12,992	2.7	12,776	2.6	594	0.13	2,752	1.1	11,635	3	0	0	49	0.02
Other		201		234		304		400		496		35		45.98
Total Textile Exports		1,814		1,972		2,461		3,439		4,072		321		377
Total Country Exports		3,128		3,370		4,042		5,663		6,862		513		628
Towel % of Textile Exports		5.9%		5.7%		6.1%		5.8%		6.1%		5.6%		6.6%
Towel % of Total Country Exports		3.4%		3.3%		3.7%		3.5%		3.6%		3.5%		3.9%

Local | Towel Exports

- Pakistan’s towel exports increased from PKR~88bIn in FY18 to PKR~198bIn in FY22, exhibiting a CAGR of ~17.6% during the period.
- In FY23, towel exports grew to PKR~248bIn as compared to PKR~198bIn in the SPLY. In dollar terms, the exports stood at USD~1bIn in FY23 as compared to USD~1.1bIn in FY22.
- The 11MFY23 growth in export revenues from the SPLY (~19.7%) occurred largely on the back of currency depreciation and increase in export price since quantitatively, exports declined by a ~15% to stand at ~177,966 MT.
- During May’23, towel exports stood at PKR~25bIn, an increase of ~39% from PKR~18bIn during May’22. The growth came on the back of greater increase in export price, which increased during the period, in addition to currency depreciation. There was a marked decline in the quantity of towels exported during this period of ~3.3%; exports fell from ~17,559 MT in May’22 to ~16,987 MT in May’23. This decline is likely due to recessionary pressures dominating global economies.
- Exports for Jun’23 remained consistent at PKR~25bIn compared with May’23. In volumetric terms, however, towel exports exhibited an upward trend reaching ~18,398 MT, an increase of ~8.3% MoM.
- The average export price of towels has increased significantly in the last five years. In the previous years, price increase occurred largely due to currency depreciation. However, supply constraints and increase in prices of raw materials have also contributed to significant price increase since FY20, both in PKR and USD terms.



Local | Export Destinations

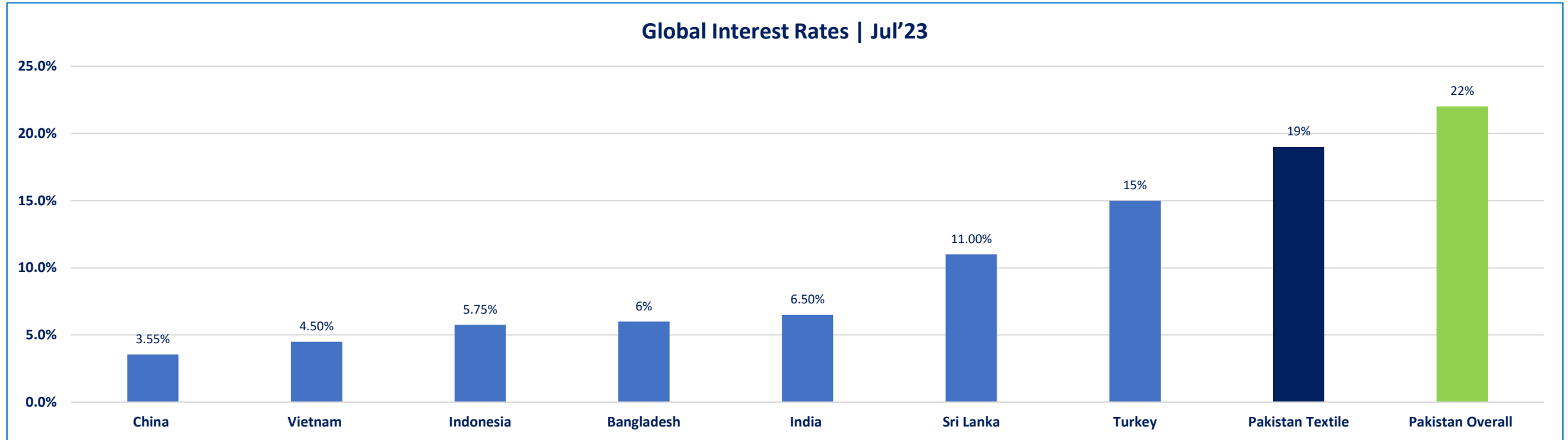
Export Destinations	FY19		FY20		FY21		FY22	
	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%	Value (USD mln)	%
USA	345	44%	299	42%	430	46%	395	41%
UK	78	10%	66	9%	94	10%	88	9%
Netherlands	49	6%	56	8%	69	7%	84	9%
Germany	39	5%	37	5%	47	5%	42	4%
Italy	38	5%	29	4%	36	4%	46	5%
Spain	32	4%	29	4%	29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

- Pakistan’s towel exports are largely concentrated towards the United States with the country accounting for ~41% of total towel exports in FY22. The remaining top exporting export destinations consist of European countries such as UK, Netherlands, Germany, Italy and Spain. The top six export destinations combined accounted for approximately ~73% of Pakistan’s total towel exports.
- While the towel industry is a growing market given the demand by hospitality sector, in the backdrop of current economic conditions and IMF pressure for subsidy take back will hinder production across supply chains.

Local | Business Risk

- **Decline in Local Cotton Production:** Cotton harvest declined by a hefty ~34% YoY in Apr'23 falling to ~4.9mIn bales from ~7.4mIn bales during SPLY. This is the most significant risk to impact the textile sector as damage to local crop will mean more cotton will need to be imported and with the presently high PKR/USD exchange rate, sourcing raw material from overseas will hurt the bottom lines of industry players. Due to high cost of production, Pakistani textile exports are losing their competitiveness to other regional rivals.
- **Dependency on Cotton Imports:** The Aug'22 floods are estimated to have destroyed ~40% of cotton crop. This increased the dependency on imports; raw material constitutes ~71% of the sector's direct costs and thus the sector remains vulnerable to fluctuations in the price of the raw material which is at a low level. Profitability depends on sector players' ability to continue to pass on the increased price impact.
- **Low Level of Value Addition:** Although, the increased demand has increased the overall profitability of the sector, it remains a low value addition sector with historically narrow margins. Pakistan's textile exports are low-priced, and closely follow cotton price trends. Recent drops in USD/lb cotton prices will lead to farmers getting a lower price for cotton acting as a disincentive for growing cotton and instead shifting to other cash crops.
- **High Energy Costs:** The government no longer provides the textile industry with RLNG at a subsidized rate. Price of energy for Pakistani industry stands above the regional average for countries such as India, Bangladesh and Vietnam which reduced the competitiveness of Pakistan's exports. Furthermore, the withdrawal of the RCET has forced smaller mill owners to close down businesses. As of Oct'22, APTMA reports ~1,600 mills have been forced to shut down as a result due to the rising power tariff.
- **Disruption in Electricity and Gas Supply:** The towels sector depends on an uninterrupted supply of electricity and gas. During FY23, interruptions in energy supply and curtailment of gas supply meant that the industry output was affected.
- **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, the regional competition continues post-pandemic. In CY22, India exported towels at an average price of USD~6.57/kg. On the other hand, Bangladesh apparel exports to the U.S. increased by ~51% in 9MFY23 compared to SPLY.

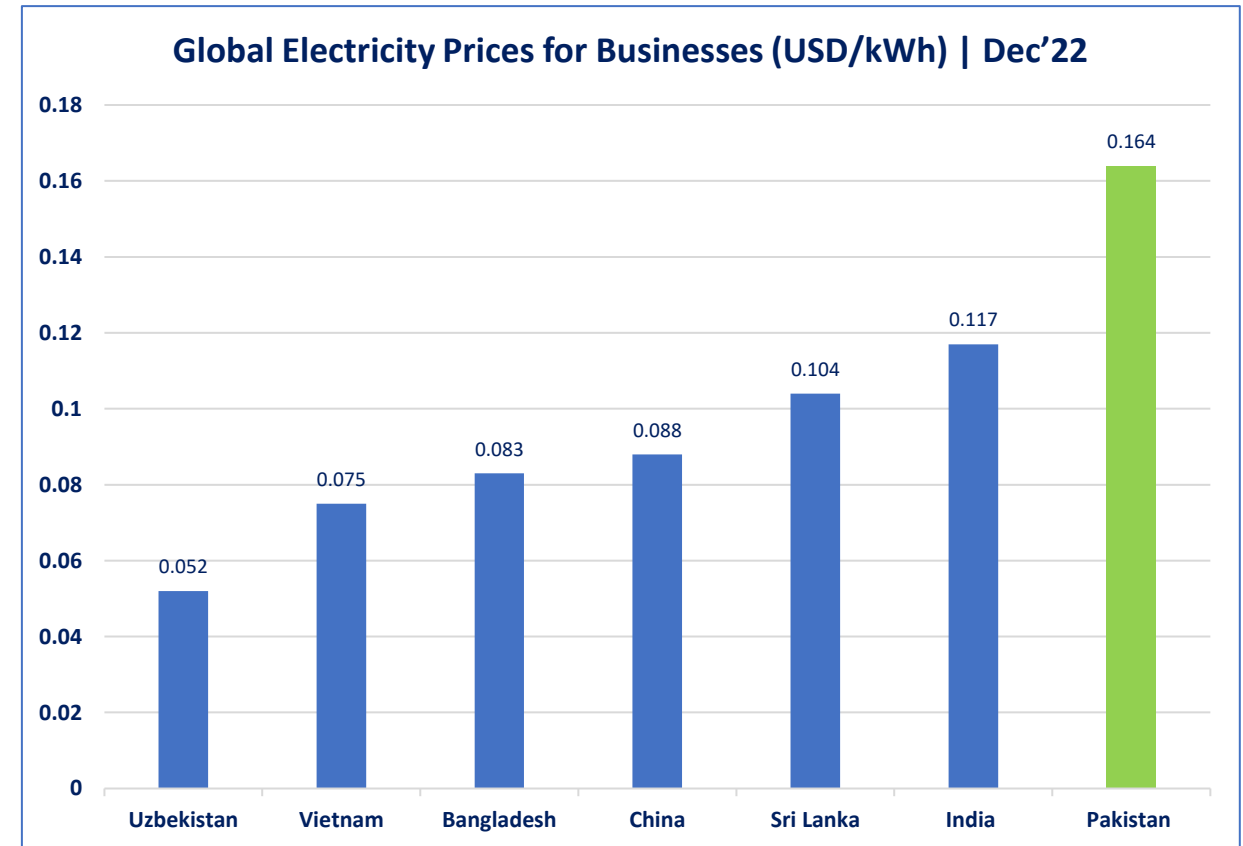
Interest Rates | Regional Comparison



- With the recent hike in policy rate to ~22% in May'23, Pakistan has the highest interest rate in the region. In comparison, many regional countries either cut their policy rates or held them consistent. The high cost of borrowing acts as a barrier to investments in various sectors. The textile sector is a beneficiary of subsidized financing facilities from the SBP in the form of short-term Export Refinance Facility (ERF) and Long-Term Financing Facility (LTFF). In Jul'22, the SBP announced that any subsequent revisions in the LTFF and EFR rates will be linked to policy rate revisions such that the difference between the former two rates and the latter is maintained at ~5%; this difference was reduced to 3% in Dec'22.
- With respect to the incremental cost of borrowing per MT of Towels produced, the finance cost has gone up by PKR~82,000/MT in FY23 as compared to FY22. Of this, ~32% resulted from increase in borrowings in absolute terms, while the rest was wholly assigned to an increase in finance cost.

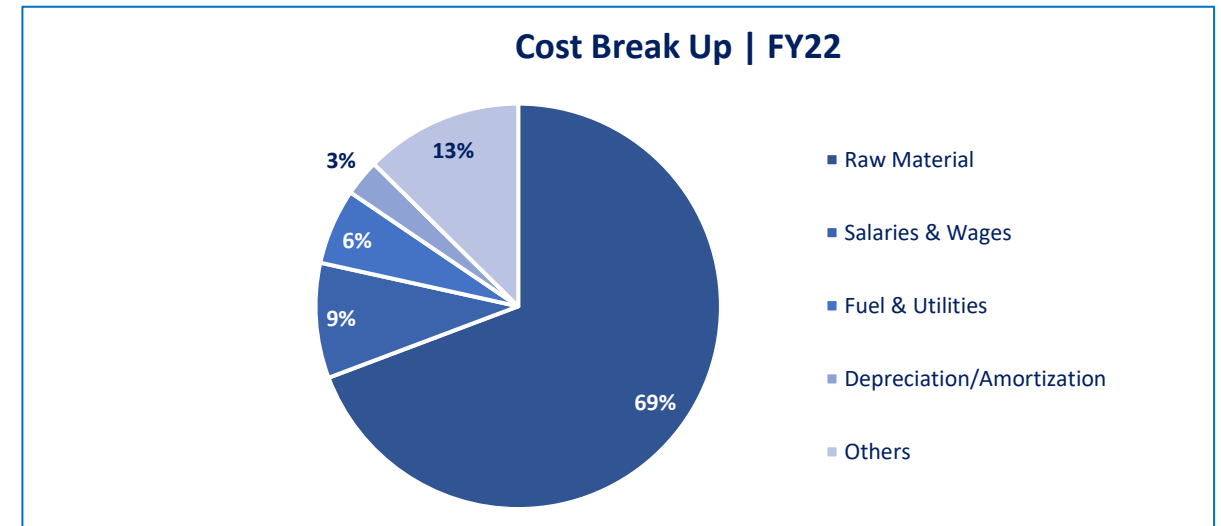
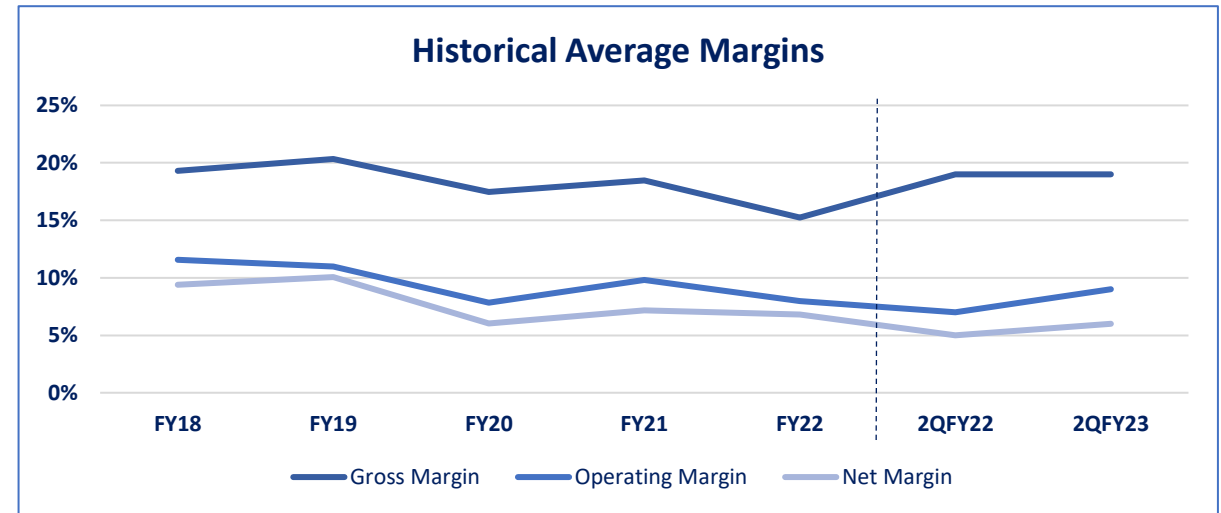
Electricity Prices | Regional Comparison

- Pakistan's businesses face a competitive disadvantage when it comes to comparing national and regional electricity tariffs. Energy costs have a significant share in the final conversion costs of textile mills and these costs cannot be ignored for achieving a competitive edge.
- The government used to provide gas at internationally competitive prices or at regionally competitive energy tariffs (RCET) to the five export-oriented sectors of the economy including the textile cluster. However, this has now been discontinued as of Mar'23, despite government's pledge to provide electricity at PKR~19.99/kWh for Export-Oriented Units until Jun'23. Disruptions in the supply of electricity from the national grid (loadshedding and fluctuations) due to obsolete infrastructure and disconnection of gas supply make it challenging to rely on these energy supply sources. Furthermore, in the winter season, gas provided to the sector is further curtailed.
- There is also a severe lack of gas and RLNG due to declining reserves and high prices caused by Russia-Ukraine situation. According to NEPRA calculations, the cost of electricity is ~8.1cents/kWh and excluding cross-subsidies plus transmission and distribution cost makes a total of ~9.3cents/kWh, for FY22.
- Withdrawal of RCET of PKR~19.99/kWh and a gas tariff of USD~9/MMBTU for gas/RLNG in Punjab has resulted in closure of Punjab-based textiles due to reliance on grid electricity at over PKR~40/kWh, making them uncompetitive in the global market. The revocation of RCET is expected to render more than ~50% of Pakistan's installed capacity in the Punjab-based industry non-operational and may amount to a loss of USD~10bln yearly exports.

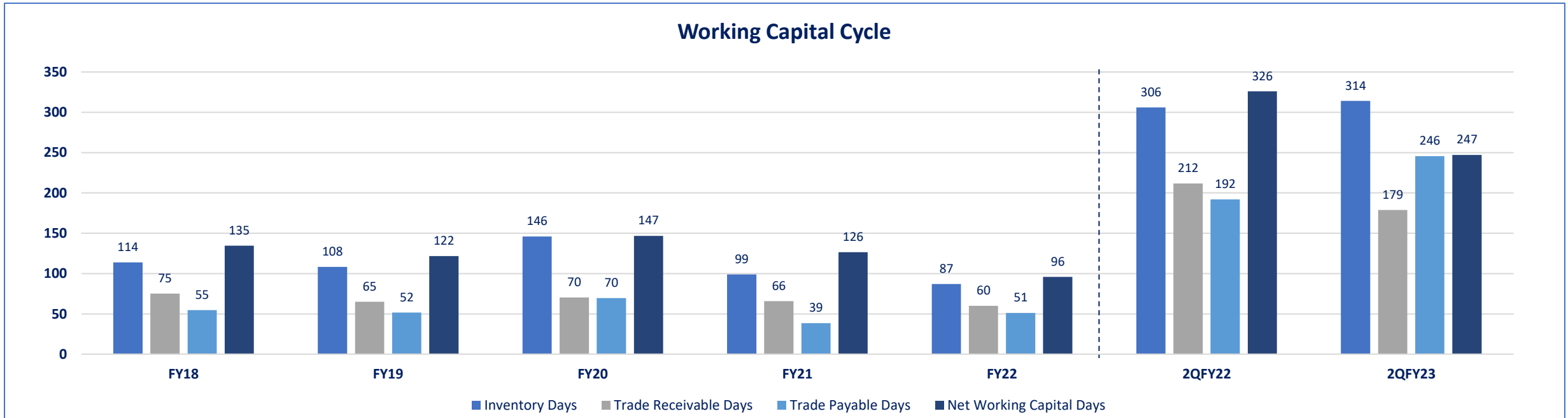


Business Risk | Margins & Cost Structure

- During FY18-22, the average gross margins for the towel manufacturing sector stood at ~18.2%, while average net margins during the period registered at ~7.9%. The towels sector exhibits relatively higher margins due to significant value-addition. Moreover, margins have remained relatively stable in recent years.
- During FY22, the average gross margin fell from ~18.5% in FY21 to ~15.0% in FY22 while net margin remained stable at ~7.0%. Rising cost of raw material owing to depreciation of the PKR relative to the USD as well as higher international freight rates increased cost of sales by ~39% compared to the SPLY.
- During the 2QFY23 period, average gross margins remained steady at ~18.5%, while average operating margins increased by ~2% and average net profit margins increased by ~1%, compared to the SPLY. The marginal increase in sales revenue was set off by a slight increase in cost of sales.
- Raw materials constitute the largest component within direct costs at ~65%. Prices of cotton have been on a continuous increasing trend since the COVID-19 pandemic in part due to lower global production along with supply constraints. More recently cotton prices declined post-pandemic, and in CY23 stabilized.



Financial Risk | Working Capital Management

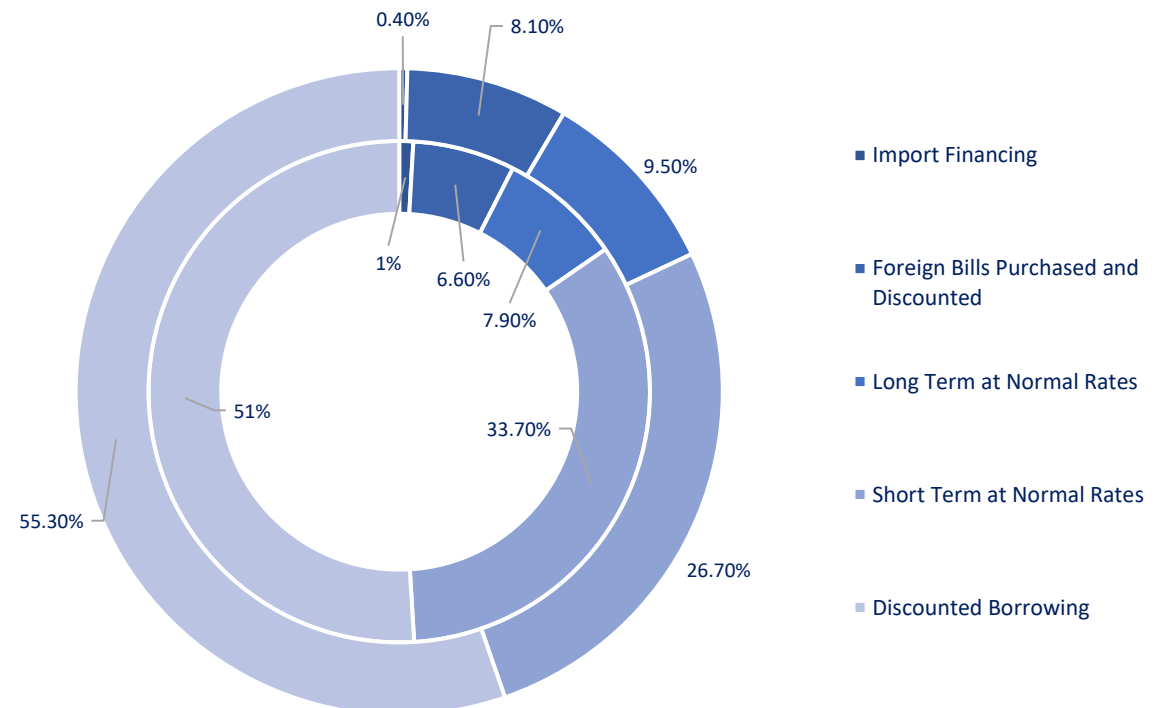


- The towel sector’s average working capital cycle (FY18-22) stands at ~125 days. Inventory is the largest contributor to working capital of which finished goods inventory has the highest share of ~41% while raw material and work-in-process inventory occupy ~28% and ~31% shares, respectively. There was a decrease in the sector’s average working capital cycle with net working capital days clocking in at ~96 days in FY22 as compared to ~126 days in FY21.
- Most notable is the significant decrease in working capital days in 2QFY23 compared to the 2QFY22 period of ~79 days. Stabilization in local and export sales is the strongest possible reason for the decrease and justifies, a) the increase in sales revenue by ~5.7%, b) slower payments by Trade Payables and c) the cost of production increasing by ~7.7% as at End’2QFY23 period compared to SPLY.
- In addition, the receivable days decreased during the 2QFY23 period (as against 2QFY22) by ~33 days as both domestic and foreign customers were paid their outstanding payments.

Financial Risk | Borrowing Mix

- The total borrowing for towel sector in May'23 stood at PKR~166bln as compared to PKR~172bln in Nov'22.
- In May'23 the largest component within borrowings of the Towels sector comprised discounted borrowing, amounting to ~55% of the total borrowing. This includes Export Finance Scheme (EFS), and Long Term Finance Facility (LTFF). It is pertinent to note that these two rates have been revised upwards to ~19.0% in Jul'23.
- The total discounted borrowing amounted to PKR~92bln as at End-May'23 (EFS: PKR~64bln, LTFF/TERF: PKR~28bln). In Nov'22, discounted borrowing was PKR~88bln (EFS: PKR~60bln, LTFF/TERF: PKR~28bln).
- The sector's short-term borrowing at normal rates accounts for ~27% of total borrowing and stood at PKR~44bln as at the end of May'23.
- The average leveraging for the towel sector in FY22 was moderate at ~36%. In 2QFY23, average leveraging was recorded at ~40% and remained consistent with SPLY.
- As of March'23, the total non-performing loans (NPLs) of the textile industry stood at PKR~169bln while the infection ratio was recorded at ~8.5% (Dec'22: ~8.1%). Textile NPLs continue to remain above the total infection ratio of ~7.8% of the private sector banking credit indicating higher level of financial risk.

Borrowing Mix* | Nov'22 (Inner) and May'23 (Outer)



Note: Average leveraging is estimated from ~3 Listed/Rated Players and 1 unlisted PACRA-rated client

*Borrowing figures are representative of 'Manufacture of Other Made-up Textile Articles'.

Regulatory Framework

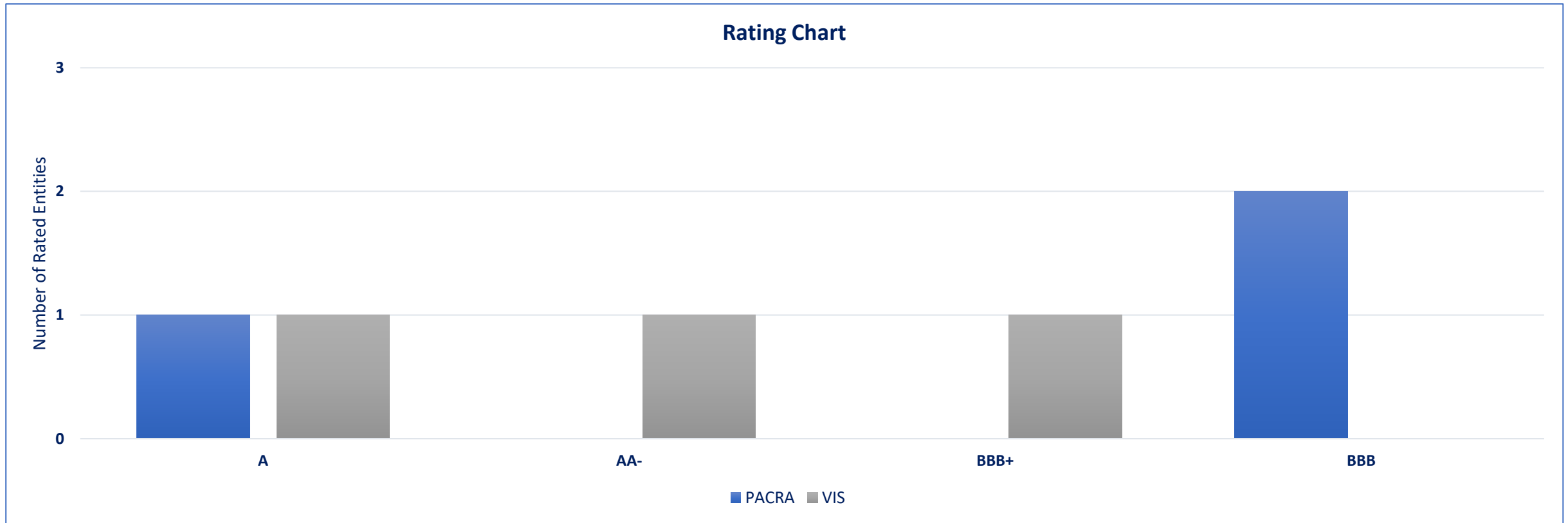
- With respect to Income Tax, the textile industry, including the towel sector, falls under the Normal Tax Regime (NTR). Furthermore, the general rate of minimum tax under Section 113 is currently ~1.25% of the gross turnover. FY24 Budget proposed a reduced rate of ~1% for companies listed on Pakistan Stock Exchange.
- Additionally, sales tax is applicable on both the raw material, i.e., cotton and finished goods i.e., yarn. The sales tax was increased from ~17% to ~18% in Feb'23. 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 recent Budget for FY24 imposes an additional tax on profit arisen due to any economic factor (such as fluctuation in foreign currency) that resulted in unexpected income whether or not disclosed in the financial statements. The tax is leviable in addition to any tax already charged. The sector receives discounted financing from SBP under the Export Finance Scheme (EFS) and the Long Term Financing Facility (LTFF). In Dec'22, the SBP announced that the two mark-up rates for the two aforementioned rates will be linked to the policy rate such that the difference between the former two, on the one hand, and the latter, on the other, is equal to ~3%.
- In response to the COVID-19 pandemic, SBP introduced several measures intended to provide relief to the industries. These measures included loan extension and refinancing, loan for payment of employee salaries and wages and facilitation of new investment, expansion and BMR activities through the Temporary Economic Refinance Facility (TERF) with a ten-year maturity loan facility. While the TERF scheme has been withdrawn by the SBP, corporate loans under this facility have not yet matured and continue to be reported on the financial statements of sector players.
- In Jun'23, the SBP increased the monetary policy rate by 100bps to 22% in an emergency meeting, citing greater risk of inflation due to upward revisions in taxes and duties in FY24 budget and withdrawal of import restrictions. The upward revision in rates has served to increase sector borrowing costs and linked EFS and LTFF markup rates. However, in Jul'23, the SBP announced no further hikes in interest rates owing to expectations that inflation will follow a downward trend.

Duty Structure

PCT Code	Description	Custom Duty		Additional Custom Duty		Regulatory Duty		Total	
		FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
52.01	Cotton, not carded or combed	0%	0%	0%	2%	0%	0%	0%	2%
52.03	Cotton, carded or combed	0%	0%	0%	2%	0%	0%	0%	2%
52.04	Cotton sewing thread, whether or not put up for retail sale	16-20%	16%	0%	4%	0%	0%	16-20%	20%
52.05	Cotton yarn (other than sewing thread), containing 85% or more by weight of cotton, not put up for retail sale	11%	11%	0%	2%	0%	0%	11%	13%
52.06	Cotton yarn (other than sewing thread), containing less than 85% by weight of cotton, not put up for retail sale	11%	11%	0%	2%	0%	0%	11%	13%
52.07	Cotton Yarn (other than sewing thread) put up for retail sale	11%	11%	0%	2%	0%	0%	11%	13%
58.02	Terry towelling and similar woven terry fabrics	11%	11%	0%	2%	0%	0%	11%	13%
63.02	Table, bed and kitchen linen (including towels)	20%	20%	0%	6%	10%	10%	30%	36%

Rating Chart

PACRA rates three entities in the towels sector with a long term rating bandwidth ranging within A and BBB.



SWOT Analysis

- Availability of raw material and cheap labor
- Government support in the form of favorable duty structure
- Strong sector association resulting in significant lobbying power



- Decline in local cotton production resulting in greater reliance on imports
- Geographical export concentration towards the USA

- Significant competition from regional players in export market
- Exchange rate volatility
- Fluctuations in raw material prices
- Rising LTFF and EFS borrowing costs
- Climate change posing a threat to the viability and quality of cotton crops.

- Subsidized cost and financing structure provides competitive advantage
- Special Economic Zones provide incentives to the sector
- Opportunity to increase efficiency and improve quality through technological upgrade

Outlook: Stable

- The Textiles Industry is a crucial contributor to Pakistan's GDP (nominal) of PKR~79.3trn in FY23, with a significant share (~18.2%) in the Large Scale Manufacturing (LSM) Index. Within the textile industry operates the towel sector which, in 11MFY23, garnered USD~912mln (SPLY: USD~1,020mln) in export revenue for Pakistan, contributing ~6% to national textile exports. During FY23, towel exports declined by ~12.9% YoY in volumetric terms to ~177,966MT.
- During May'23, the sector's export revenue amounted to PKR~25bln (May'22: PKR~18bln), yet exports declined by ~3.3% in volumetric terms compared to SPLY. Moreover, towel exports contributed ~6.6% to monthly textile exports. Towel export revenue can be expected to increase according to sentiments of industry players. This uptick can originate from an increase in towel exports quantitatively, as future for towel exports looks positive according to Jun'23 figures.
- In Jun'23, foreign bills purchased and discounted increased by ~11.4% to PKR~205bln, compared to PKR~184bln of May'23. The textile and wearing apparel sector alone made up ~82% of the total foreign bills purchased and discounted in Jun'23. This was reflected in towel exports for Jun'23 increasing to ~18,398MT from ~16,987MT of May'23, an increase of ~8.3% MoM in volumetric terms.
- There was a significant decrease in the sector's working capital cycle of ~79 days in 2QFY23 compared to SPLY. This was largely due to stabilization in local and export sales revenue and a delay on behalf of paying creditors their accounts. Despite being towards the end of the textile value chain, the towel sector is significantly linked backward to the agriculture sector given its high dependence on the quality of cotton crop. Any climate-related event which impacts the cotton crop therefore has a direct influence on the quality of local and/or demand for imported cotton. This fact can be seen in terms of devastating monsoon flashfloods; cotton harvest declined by a hefty ~34% YoY in Apr'23 falling to ~4.9mln bales. This will force manufacturers to import more cotton in a tie of fluctuating exchange rates.
- According to NEECA's 2020-23 strategic plan, Textiles accounts for ~27.6% of the overall electricity consumed by industries and ~40% of the Natural Gas consumption. Furthermore, ~75% of the textile industry is reliant on gas-based electricity as supply from national grid is inconsistent. The withdrawal of RCET has increased energy costs for the industry. Meanwhile, a higher policy rate has also rendered LTFF and EFS interest rates being revised upwards, making borrowing costlier.
- Innovative techniques and new efficient machinery is needed to ensure that towel sector remains competitive, and on par with regional players like India, China and Bangladesh. Since towel sector is a value-added segment of the textile chain, cost increases can be passed onto customers in form of higher prices yet at the risk of shifting export orders to other competitors. However, factors like export demand, secure energy supply and technological upgradation is necessary to ensure that Pakistan remains a key player in the global towel market. Future outlook for the global towel market appears promising due to growing demand from the hospitality sector since resumption of travel and tourism after the pandemic. Moreover, infrastructure expansion in Asian countries could also provide a substantial market for towels from newly built resorts, hospitals and fitness clubs.

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