

TEXTILE INDUSTRY

Sector Update - June 2010

The global textile and garment industry also has been hit hard by the global financial crisis. The impact on the textile garment, leather and footwear sectors has been dramatic. Since June 2008 over 8,200 factories have been closed and an estimated 11.8 million workers have lost their jobs. Further 3 million jobs are estimated to be at risk worldwide.

Demand for textile and garments dropped considerably during some quarters (2008 & 2009), especially in USA, Europe and Japan due to falling consumer confidence and rising unemployment figures. Many consumers are now focusing on prices and are shifting demand to low priced products and/or postponing consumption. With the exception of few export oriented nations of clothing –namely Bangladesh and Vietnam most are suffering from strong reductions.

Trade has become more liberal over the last fourteen years with the elimination of quotas, but this has made the market more competitive.

The 3rd quarter of 2009 confirmed the strong rebound of the global textile production. Both yarn and fabric production rose modestly in almost all regions, especially in South America, while North America recorded stagnant output.

World yarn production rose in the 3rd quarter 2009 by +1.3% confirming the impressive rebound of the 2nd quarter (+22%). With the exception of North America (-2.3%) all regions recorded increases, especially South America (+5%), Europe (+4.5%) and Asia (+1.2%).

Fabric production also grew worldwide by +1.2% in the 3rd quarter of 2009. Global fabric production increased or remained stable in all regions. Europe on the other hand recorded a slight increase of 0.9%, while fabric production in South America surged by 18.1%.

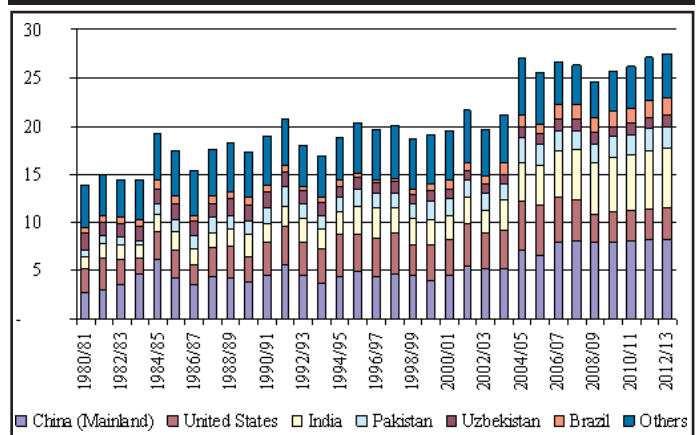
Major Textile Producers and Consumers

The global textile industry is highly dependant on the world cotton industry, as cotton provides the main raw material for textiles. Hence, textile production and consumption patterns follow cotton production and consumption trends worldwide.

Much of the growth of cotton production since the end of the Second World War (WWII) was due to improved yield (output per hectare more than quadrupled between 1945/46 and 2006/07, from 0.2 tons per hectare (t/ha) to 0.8 tons per hectare, according to the International Cotton Advisory Committee - ICAC), rather than to expanded area (cultivated land increased by only 35% over the 1945/46-2006/07 period, expanding from 22.3 million hectares to 34.8 millions). In 2007, cotton was grown in 90 countries. In 2006/07, the four

main producing countries were China, India, the USA and Pakistan and accounted for approximately three quarters of world output.

World Cotton Production (million tonnes) by main countries (1980/81 - 2012/13)

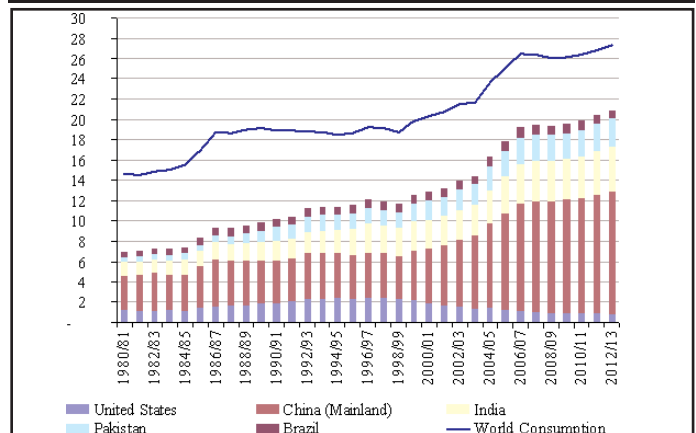


Source: International Cotton Advisory Committee (ICAC) statistics

Since the beginning of the 1940s, world cotton consumption has increased at an average annual growth rate of about 2% (roughly the same as production). Growth in the demand for cotton was comparatively higher in the 1950s and 1980s, with an average growth rate of 4.6% a year during the 1950s and 3% in the 1980s. Developing countries accounted for approximately 78% of global cotton consumption between 1981 and 1999; since 2000 this ratio has been above 80%; according to projections based on ICAC figures, in 2010 they would absorb almost 94% of global cotton output.

The main cotton producing economies also account for a large part of consumption. According to ICAC data, China,

Cotton Consumption (million tonnes) by main countries (1980/81 - 2012/13)



Source: International Cotton Advisory Committee (ICAC) statistics

the United States, India, and Pakistan as a whole have accounted for approximately more than 55% of global cotton consumption over the period 1980 to 2008. Their overall consumption has risen considerably in volume (see figure below). For example, consumption multiplied by 3 in China and by more than 3 in India. Pakistan has had the largest increase in volume (which multiplied by 6 between 1980 and 2008) in order to respond to export-driven demand for textiles.

Global Trade in Textiles

World textile and clothing trade grew by 5% to US\$ 612 billion during 2008 (latest data released by WTO in November 2009). This rise is comparatively lower to growth of 13.5% in 2003, 12% in 2004, 5.2% in 2005, 10% in 2006 and 10.6% in 2007.

However, India, Turkey, Pakistan, Indonesia, Thailand and Mexico all rank among the top 15 textile exporters, according to WTO trade statistics. Overall, Asia accounted for 45.1% of world textiles exports. The EU and the US are the biggest importers of textiles, followed by China, which needs fabric for its large garments industry. For clothing, the EU is the biggest exporter (including intra-EU exports), followed by China with a 24% share of world garments exports. Although all other countries lag far behind, Turkey, Mexico, India, Indonesia, Bangladesh, Thailand, Vietnam, Tunisia and Pakistan all feature among the top 15 clothing exporters. Overall, Asia accounted for 46.8% of world clothing exports. The major importers of clothing are the EU and the US, with Japan trailing in third place.

Textile Industry in Pakistan

Pakistan is the fourth largest cotton producer in the world. Because of its indigenous cotton supply, the textile industry is central to the Pakistani economy and is both a source of employment and a source of exports. The country's textile exports are expected to remain strong while employing approximately 6.2 million people. In Asia, Pakistan stood amongst the top 10 exporters of textile based trade.

Importance of Textile Industry 2009-10 (July-June)	
Share in total exports	53.2 per cent
Share in manufacturing*	46 per cent
Share in employment*	39 per cent
Share in GDP	15 per cent
Textile exports	\$ 10,313.2 million
Investment in textile*	\$ 7.0 billion
<i>Source: Economic Survey of Pakistan, JCR-VIS Research (*2008 stats)</i>	

Pakistan's industrialization began in the 1950s with the textile industry at its center. Today, textiles account for 38 percent of total manufacturing and 8 percent of GDP. Pakistan relies on importing engineering and manufacturing expertise and purchases most of its equipment abroad. Recognizing the importance of the textile industry to the nation's economy, the Pakistani government began taking steps in 2005 to rebuild the competitiveness of this critical industry.

The Pakistani textile industry depends on domestic agriculture to supply its raw materials, thus the success of the

cotton crop is critical to the health of the textile industry. Cotton accounts for 14 percent of land under cultivation in Pakistan. Pakistan has suffered from a number of cotton failures over the years, beginning in the early 1990s. These crop failures drove up the price of cotton, and this coupled with a market recession and tightened financial regulations led to a weakened textile industry.

Industry Sectors

The spinning sector is where the majority of Pakistan's textile industry is concentrated. Over the years, spinning expanded while weaving declined. The rapid expansion of the spinning sector was hastened by access to cheap raw materials - cotton and cheap labour. This sector's profitability was furthered by a protectionist fiscal policy and export subsidies. In keeping with increased spinning capacity, cotton production has increased tremendously. The textile industry's weaving sector is comprised of towels, bedding and hosiery and has been adversely affected by tariffs and inflation over the years. The garment sector has undergone considerable modernization and has developed great export potential.

- Spinning capacity of over 1.5 million tonnes of yarn;
- Weaving capacity of over 4.0 billion square meter of fabric;
- Finishing capacity of over 4.0 billion of square meters;
- Production capacity of 670 million units of garments.

Textile Industry: Over the years

When Pakistan came into existence there were only two textile mills with 80,000 spindles and 3,000 looms only which were capable of producing 8% of the domestic demand at that time. The organized development of cotton textile mills started in the late 50's. Pakistan industrial development corporation was formed in 1952 which started its operations in 1953 with the inauguration of the Vatika Textile Mill at Karachi. By mid 60's there were about 180 units of textile bleaching, printing and processing units. A number of spinning units comprising of only 12,500 spindles were set up. Newly established mills were based upon imported technology but there was lack of technical staff and shortage of capital.

In the late 60s there was reduction in the production capacity. By 1970-1971 there were 113 textile units and the industry had 2,605 spindles and 30,000 looms. After the separation of East Pakistan, Cotton Export Corporation of Pakistan was established.. The textile industry suffered heavy losses because the export cotton controlled by CEC, and the import of machinery was made difficult due to shortage of foreign exchange.

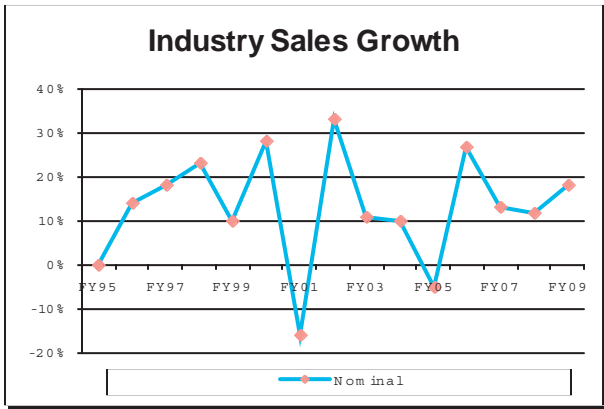
The 80's decade brought a relief to the textile industry. There was rapid growth in the spinning sector. Till 1980-81 spinning continued to expand to 4033 thousand spindles in 203 spinning units, and working capacity amounted to 2833 thousand spindles. Machinery for producing garments and made-ups was also freed from import duty. As a result, a huge expansion in the spinning sector took place in the first five years of the 1990s.

World demand for good quality, wide width fabrics grew and replacement and a modernization process started. With

these developments, production and export value-added items such as bed-sheets and home furnishing started. Structural changes with the replacement of obsolete machinery and modernization in the industry still continued in view of world competition

Industry Dynamics:

The graph below exemplifies the nature of sales growth in the textile industry. There has been a sharp negative sales growth in FY01 and FY05. Textile sales have grown at fluctuating rates depending on factors such as GDP growth, export potential, as well as the global economic conditions. The steady growth in demand will likely continue on account of increase in consumer spending as the world recovers from the global recession. Textile commodity prices are expected to remain attractive, thus encouraging manufacturers to increase production.

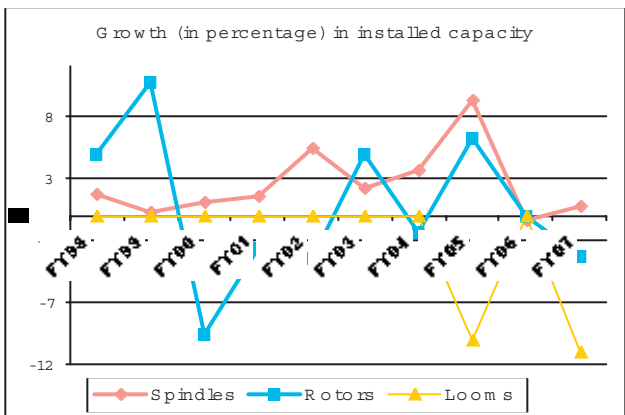


Source: Federal Bureau of Statistics, JCR-VIS Research

Established capacity

The textile industry of Pakistan has a total established spinning capacity of 1550 million Kgs of yarn, weaving capacity of 4368 million square metres of fabric and finishing capacity of 4000 million square metres. The industry has a production capacity of 670 million units of garments, 400 million units of knitwear and 53 million Kgs of towels.

The industry has a total of 1221 units engaged in ginning and 442 units engaged in spinning. There are around 124 large units that undertake weaving and 425 small units. There are around 20600 power looms in operation in the industry. The industry also houses around 10 large finishing units and 625 small units. Pakistan's textile industry has about 50 large and 2500 small garment manufacturing units. Moreover, it also houses around 600 knitwear-producing units and 400 towel-producing units.



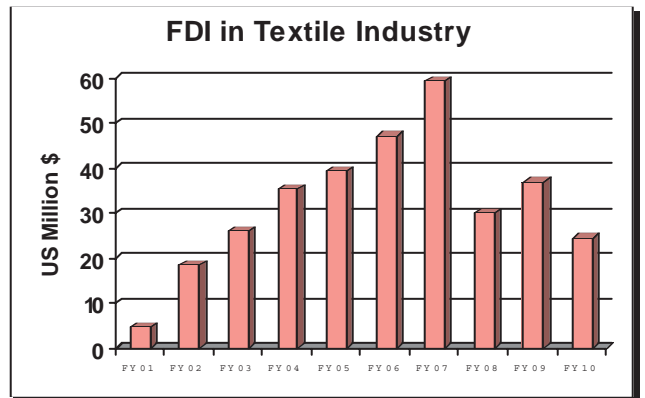
Source: Federal Bureau of Statistics, JCR-VIS Research

The graph above shows the growth, in percentage, in the number of spindles, rotors and looms in the textile industry. The number of spindles has shown an overall positive trend whereas the capacity of looms and rotors has not increased considerably over the years.

Investment Dynamics

The industry is moderately capital intensive with fixed assets on an average constituting 46% of total assets of the industry from 1990 to 2008. Of this major share comprise of plant and machinery.

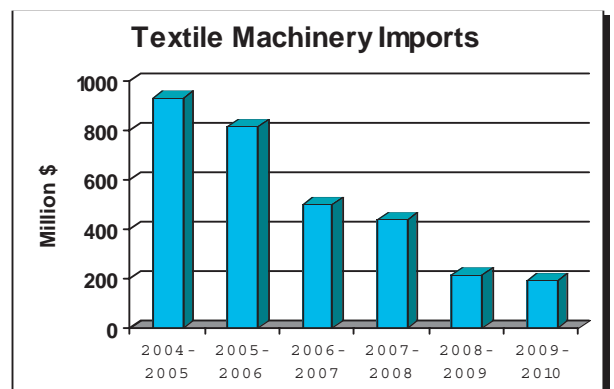
During last few years, capital expenditure increased significantly on account of expansions undertaken by some textile mills. Long term debts in the industry increased with the increase in capital expenditure during the period 1995-2009. Correlation between the two stood at 0.837, and indicates that the capital expenditures have been undertaken using long term financing. While short term debt indicates the financing of stock in trade in the industry, the correlation between the two stood at 0.987.



Source: Federal Board of Revenue, GoP, JCR-VIS Research

Foreign direct investment (FDI) in Pakistan's textile and clothing sector declined by 49% during the fiscal year 2008, partly due to political turmoil in the country. The slump was blamed on increased costs of raw materials, shortage of energy, high inflation, shortage of skilled manpower, together with political turmoil over the past eight months. The country attracted US\$30.1m in textile and clothing FDI during the year, compared to US\$59.4m during the previous year, according to the statistics released by the State Bank of Pakistan (SBP).

Pakistan's textile sector has made considerable advances in production capacity and capability in the last seven years. Over the last seven years this sector has invested \$ 7.0 billion in modernization and higher value addition.



Source: Federal Board of Revenue, GoP, JCR-VIS Research

Import of textile printing and finishing machines decreased from \$ 928.6 million in 2004-05 to only \$ 212 million in 2008-09, thus showing decline of 77%. However, Pakistan's textile industry has again started to invest in the textile machinery and the imports of textile machinery for the month of February 2010 were \$23.1 million, an increase of 190% as compared to the imports of machinery in February 2009 of \$7.99 million. The remarkable growth in February 2010 indicates that the recovery is a recent phenomenon correlating with the higher cotton and yarn prices in the recent months. It is also a sign of the resilience of Pakistan's textile industry which has managed to survive in the post quota regime in the face of formidable competition from textile producing countries such as China, India and Bangladesh, some of whom have enjoyed much better market access in the US and the European Union than Pakistan.

Research and Development

During (FY07 & FY08), the government has provided Rs. 19 billion as research and development (R&D) support to the textile sector. Furthermore GoP allowed 6% compensatory rebate to readymade garments, 5% to home textile and 3% to fabric related as research and development support in 2006-07. In 2007-08, the support declined to 3%.

Industry Financials

Over the past few years, a declining trend can be observed in the Return on Assets (ROA) for the textile industry. This can be explained by the heavy expenditure on assets in the past years with profit levels remaining almost the same leading to a fall in ROA.

As observed in the following graph, industry's margins, over a period of a decade, show an overall downward trend.

Gross margins have declined over the years. The cost factors - gas, power, labour cost have increased substantially in last couple of years which have increased the cost of production of textile products. The textile industry is unable to pass on the increase to its buyers due to the tough competition on one hand and price war on the other.

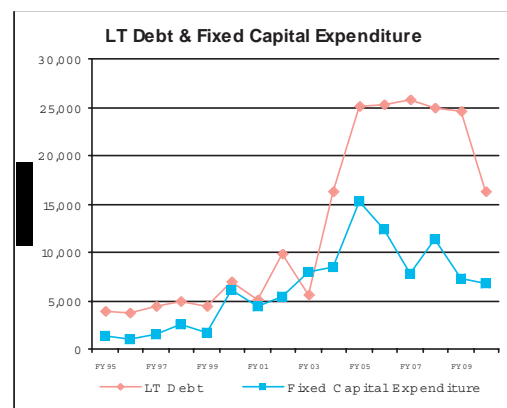
Net profit margin showed an increasing trend for the last decade; however, it slumped in FY09. Textile sector went through a tough time during last year with exports declining by eight percent owing to international financial crisis and domestic energy shortages. The global financial crisis, which hit the developed countries last year, has wreaked havoc with their economies. As a result the purchasing power of the consumers took a hit and demand for textiles and apparels plummeted. The EU and US-major importers of local textiles - are still trying to grapple with the deep-rooted economic problems. Surge in financial charges, up 53 percent to Rs 3.6 billion caused a severe dent in segment's performance.

Although the size of the industry has increased over the years, the sales are not growing and a level linear trend can be observed over the period. Fluctuations in sales are due to changes in export demand as well as supply driven factors which are dependant on raw material production. A good cotton harvest will lead to higher textile production and sales. However, in years of poor harvests, textile production and sales are hampered considerably.

In the textile industry, cash growth trends are far more erratic than the sales growth. Incorporating a one year lag in the accumulation of cash results in a 0.103 correlation between the growth in sales of the industry and the growth in cash balances which suggests a weak link between cash build-up and boom phases in the textile industry cycle. Margins are highly dependent on the production for the year and thus cash flows experience severe volatility on yearly basis.

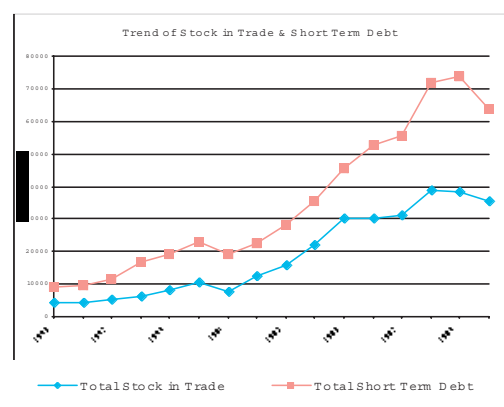
Over the period, long term debt of the industry increased with a steady pace, however, in FY04 and FY05, a significant increase can be observed on account of capacity expansion undertaken by major textile mills. Although, a growing trend can be observed in FDI till FY07, FDI has considerably declined during the past three years reflecting reduced confidence of foreign investors in the industry.

Long term debts in the industry increased with the increase in capital expenditure during the period 1995-2009. The correlation coefficient between the two stood at 0.837. This primarily indicates that the capital expenditure has been undertaken using long term financing.



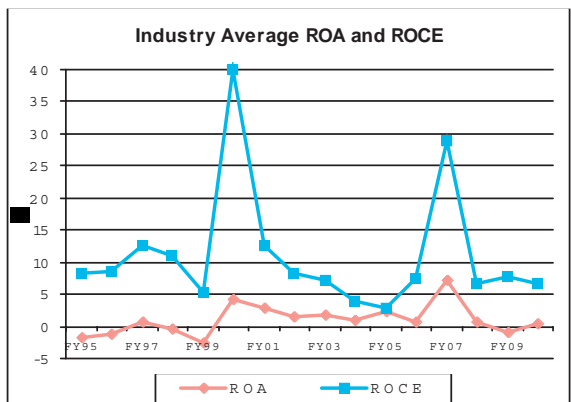
Source: Vista Plus (VIS), JCR-VIS Research

As shown in the graph below, Stock in Trade and Short Term Debt have registered a continuously rising trend over the past years. . The correlation between the two stood at 0.987, indicating that the financing of stock in trade in the industry was mainly undertaken by short term debts.



Source: Vista Plus (VIS), JCR-VIS Research

The return on capital employed for the textile industry displays extremely erratic trends. Year to year changes are large and significant. ROA and ROCE follow similar trends over the years with the correlation coefficient between the two at 0.67.



Source: Vista Plus (VIS), JCR-VIS Research

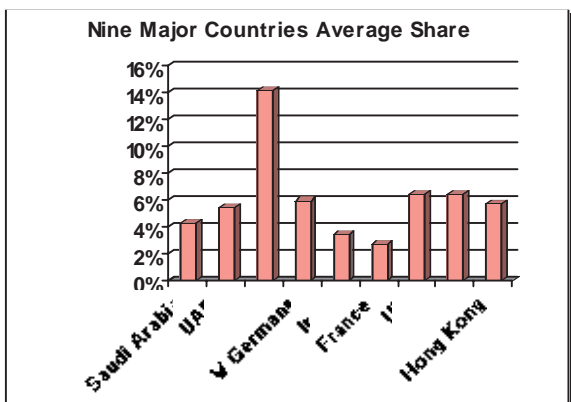
Backward and Forward Linkages

Backward linkages have been successful in the large scale textile mill sector. For example, a large number of weaving units have acquired spinning units to make themselves self-sufficient in cotton yarn, the major input for the weaving sector. There are no further backward linkages because ginning is a completely different type of activity. However, further backward linkage into ginning can be visualized in the not too distant future. The driving force for such linkage would be the present low quality of ginning. The Chinese government has recently offered to help with modern technology in ginning by setting up new ginning units with latest technology and equipment.

While the textile mills have opted for forward linkages by going into production of garments, knit-wears, bed-sheets and towels, the traditional clothing sector has not been able to go for backward linkages into weaving or spinning. Some companies have made the effort, with varying degrees of success, but most do not have the required finance for the very huge investments that are involved in spinning or weaving.

Export Potential

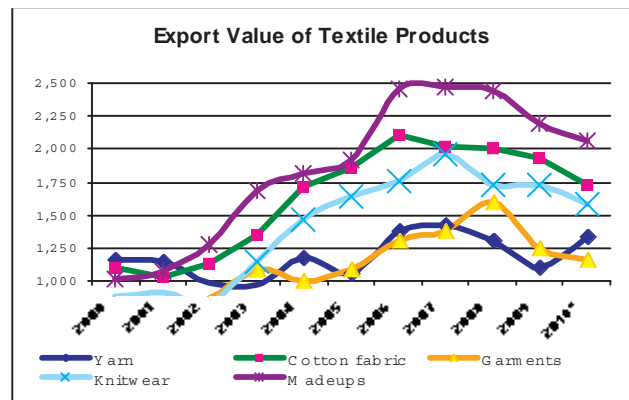
Pakistan's exports are undiversified since its inception with only a few countries comprising a major share. The entire export base of Pakistan can be divided into nine major countries which include Saudi Arabia, UAE, USA, West Germany, Italy, France, U.K, Japan and Hong Kong.



Source: Economic Survey of Pak., JCR-VIS Research

The current trend of textile export on made-ups, including bed-ware, upholstery and knitwear have increased the value of exports in the last few years, while export of ready-made garments and yarn have been stagnated. Locally made

yarn is thick and short, which is most suitable for made-ups but not always fitting for garments. Therefore, made-ups from Pakistan are internationally competitive using local yarn, while garments, using imported yarn, face severe competition in the world market.



Source: Trade Development Authority of Pak. (* July – May)

The global trade in woven fabric can be classified into two broad categories, cotton and blended fabrics and synthetic and artificial fabric, commonly referred to as man-made fabric. Asia is fast emerging as a major source of exports, especially of textiles, to the USA, EC and other countries of the world. Pakistan has emerged as one of the major cotton textile product suppliers in the world market.

About 45% of the fabric exported from Pakistan is in unprocessed form. Dyed fabric is only 15% of the total fabric exports. Export of fabrics in unprocessed fabric results in low unit value realization. Major markets for Pakistan's fabric are Turkey, Italy, Bangladesh, USA, Sri Lanka, Germany and Belgium.

Challenges

The stiff competition put up by the competitors in the global markets dented the Pakistani textile sector, which became uncompetitive in its traditional markets due to high tariff slabs on Pakistan's textile goods in comparison to its competitors like Bangladesh and Vietnam, which have greater market access by enjoying preferential treatment in the European and American markets.

Furthermore, the chronic issues of high financing cost, power and gas shortage coupled with their high charges domestically had devastating impact on textile goods when compared with China and India, which gave concessions and incentives in the shape of subsidies on power and financing.

The economic survey (2008-09) says that the textile sector being an export oriented industry of Pakistan and more prone to international demand shocks is under severe stress amid a global recession, however, textile production has declined slightly, by 0.7 per cent over the same period last year. Textile sector was badly hit by power shortage and weak external demand. Both cotton yarn and cotton cloth industries, which have the largest shares in the textile sector, posted negative growth of 0.3 per cent and 0.3 per cent respectively.

The data available with the All Pakistan Textile Mills Association (APTMA) shows negative growth in most of the textile sub-sectors. The textile sector has closed around 350 factories in two years eliminating hundreds of thousands of

jobs The textile ministry has acknowledged closure of 90 big units in 2008 alone. Each company employed a minimum of 1,000 workers.

Government Initiatives

In 2005, the Pakistani government created a special textile sub-committee in order to formulate new strategy and policy in the hopes of revamping the textile industry. The sub-committee submitted a report entitled "Textiles Vision 2005" which included a number of recommendations including improved product quality, equipment upgrade, developing human resources, aggressive targeting of new markets and development of high-powered leadership for the textile sector.

The first ever National Textile Policy was announced in 2009 and sets an ambitious target of achieving \$ 25 billion over the next 5 years as compared to exports of \$ 9.6 billion achieved during last fiscal year.

The hefty package for the sector carries special duty-drawback rates, besides repayment of earlier research support, subsidy on long-term financing loan and development and other subsidies.

The government addressed all sub sectors of this industry separately with special emphasis on the value added sectors. The policy provides many measures to address the falling trend of textile exports, but the most notable are as under:

1. The availability of export refinance at 5%.
2. Relief on existing long term loans.
3. Zero rating of exports.
4. Tax free import of machinery.
5. Rs87 billion cash subsidy to the textile and clothing sector to boost exports
6. The textile industry has been exempted from load shedding. It will also enjoy priority in gas allocation like the fertilizer sector.
7. An amount of Rs44 billion as special drawback rates will be provided to value-added textile exports for two years -- Rs17 billion in 2009-10 and Rs27 billion in 2010-11.
8. Another Rs5.4 billion has been earmarked for earlier refunds of research and development subsidy for the sector.
9. In order to encourage women's participation in the industry, the government will pick two regulatory costs to employers -- social security and EOBI. The cost of this measure is estimated at Rs2 billion for the current year.
10. A textile investment support fund and technology upgradation fund (UTF) will be set up. An amount of Rs1.6 billion has been allocated for the UTF for the first year. However, this fund will go up to Rs17 billion by 2014. Under UTF for capital intensive projects, the government will pick up 50 per cent of interest cost of new investment in plant and machinery with a maximum of five per cent. For small investments, government will contribute up to 20 per cent of capital cost as a grant.
11. An amount of Rs1 billion has been earmarked for infrastructure development for 2009-10 in public-private partnership. More industrial estates will be established, besides

developing clusters.

12. An amount of Rs1 billion has been allocated for skill development initiatives. A comprehensive training plan will be worked out.

13. A legal framework will be developed to specify standards and testing requirements, prescribe disclosure requirements and other matters relating to practices and methods relevant to the sector

14. Market access will be increased through free trade agreements.

15. The government will provide necessary support for branding, grading, labelling and other activities that would add value to the textiles chain. An insurance scheme will be introduced to protect local exporters from unforeseen losses and help the industry in IT-related issues.

The policy will focus on certain sub-sector issues from fiber to garments, including ginning, spinning, weaving, knitting, processing, fashion designs, handloom and handicrafts, carpets, technical textiles. Specific schemes will be launched, mostly on public-private partnership basis, to upgrade and improve these sectors.

Major Listed Companies (Textile Composite)

1. Al-Abid Silk Mills Limited
2. Azgard Nine Limited
3. Chakwal Spinning Mills Limited
4. Chenab Limited
5. Fateh Textile Mills Ltd
6. Fazal Textile Mills Limited
7. Gul Ahmed Textile Mills Limited
8. Hala Enterprises Limited
9. Husein Industries Limited
10. Kohinoor Mills Limited
11. Kohinoor Textile Mills Limited
12. Masood Textile Mills Limited
13. Mohammad Farooq Textile Mills Ltd
14. Mubarak Textile Mills Limited
15. Nakshbandi Industries Limited
16. Nishat Mills Limited
17. Paramount Spinning Mills Ltd
18. Safa Textiles Limited
19. Sapphire Fibres Limited
20. Sapphire Textile Mills Limited
21. The Crescent Textile Mills Limited
22. The National Silk & Rayon Mills Limited
23. Towellers Limited
24. Yousaf Weaving Mills Limited

Jahangir Kothari Parade (Lady Lloyd Pier)

Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose genrosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs).

Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.



Jahangir Kothari
Parade

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International Reach**

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the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

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