

Assessment of industry risk is an essential part of credit rating process. The industry risk assessment sets the ceiling for ratings of individual entities within a given industry. It focuses on the degree of cyclicity and the strength of competitive forces along with the extent of capital intensity, vulnerability to technological change, level of regulatory interference and energy sensitivity. All these factors are assessed on a scale ranging from High to Low to assign an overall risk level to each industry. Industry risk categorization for different industries is available on our website under Sector Updates “Industry Risk Analysis” (<https://docs.vis.com.pk/docs/Industryrisk062021.pdf>).

This document explains VIS approach to assess industry risk of Textile sector of Pakistan.

Textile sector has been classified in three sub-sectors as follows:

Spinning

Spinning is the process of twisting together of drawn out strands of fibers to form yarn.

Weaving

Weaving segment refers to the process of conversion of cotton yarn into raw fabric. In basic weaving, two distinct sets of yarns or threads are interlaced at right angles to form a fabric or cloth, commonly known as Grey Cloth.

Composite

The composite mills are vertically integrated mills covering the full array of textile processing operations such as spinning, weaving, dyeing, printing and finishing.

The textile sector contributes nearly one-fourth to industrial value-added segment and 8.5% to the country’s GDP, with an estimated market size of Rs. 3.8tr (FY20: Rs. 3.3tr) in FY21. Barring seasonal and cyclical fluctuations, textiles products have maintained an average share of about 60% in national exports. Given post pandemic sustained economic recovery and diversion of export orders to Pakistan, export revenues from textile segment (as per PBS) stood at USD 15.4b (FY20: USD 12.5b; FY19: USD 13.6b) in FY21, registering a sizeable year-on-year growth of ~23%. The similar growth trend has been noted in the ongoing year with exports reaching at USD 6.0b during 4M’FY22, up by 27% vis-à-vis SPLY. Knitwear, Readymade and Bed wear segments continued to contribute higher than other segments, with a cumulative contribution of more than 60% in textile exports. While primarily a volumetric driven growth, the exports also received a boost from higher prices (excluding Knitwear). During the year, while average volumes increased by ~20-30% in various segments as compared to the lock down period, average prices increased by ~8-10%.

OVERALL INDUSTRY RISK

High
High to Medium
Medium
Medium to Low
Low

Table 1: Segment wise Textile Exports (In value terms)

Segments	Value (US\$ millions)		YoY(Δ)
	FY21	FY20	
Knitwear products	3,816	2,785	37%
Readymade Garments	3,033	2,549	19%
Bed wear	2,772	2,149	29%
Cotton Cloth	1,921	1,830	5%
Cotton Yarn	1,017	987	3%
Towels	938	711	32%
Made-up Articles	756	591	28%
Art, silk and synthetic textile	370	314	18%
Tents, canvas and tarpaulin	110	98	12%
Others	667	487	37%

Going forward, sector dynamics are favourable as Pakistan continues to receive export orders from global economies as competing regional countries remain hampered by the pandemic. Given the surge in demand, the industry is currently operating at full capacity and going through expansion and up-gradation to cater for additional demand.

Apart from demand and supply scenario in both domestic and international markets, cotton prices are also affected by the expectation of crop during and in the next season, Minimum Support Price (MSP) fixed by the Government, and by the prices of the polyester fiber/ yarn. For companies engaged in cotton fabric manufacturing, the susceptibility of profitability margins to any adverse movement in the raw material (yarn) prices remains low, as majority fabric manufacturers generally procure cotton yarn on need basis because of its ready availability throughout the year. For a cotton garment manufacturer also, the susceptibility to any adverse fluctuations in the raw material (fabric) cost remains low as most apparel manufacturers undertake manufacturing against confirmed orders, where prices are fixed as per the prevailing market prices of the fabric.

Cyclicality risk is assessed as medium for all subsectors of the industry. A quantitative analysis of the textile industry over time depicts volatility in margins and financial performance of players closely driven by the inherent cyclicality of cotton crop levels and variations in cotton prices. However, the variability is evident across sub sectors and therefore based on the commoditized nature of business, cyclicality risk is assessed as medium for the sector.

To determine competition risk, barriers to entry, availability of substitutes and risk in growth trends is evaluated. The entire cotton textile value chain is highly fragmented in nature, having both small and large players operating, thereby making the industry highly competitive. Sales of apparel retailers, particularly, remain vulnerable to the consumers' changing tastes and preferences, and competition from branded as well as unbranded segments. Barriers to entry for the textile sector are considered low for the spinning and weaving sector and relatively higher for the composite or value added segment. Entry does not require huge capital outlay relative to other industries, and factories can be set up with workers with relatively low skills. In addition, there are no extraordinary regulatory requirements to comply with. However, entry in the value added segment may require higher investment in technology and labour expertise. Therefore, the risk of effectiveness of barriers to entry is assessed as high for spinning and weaving and medium for composite sector.

The risk of substitution for cotton fibre is extremely low, as there is a natural lack of an alternative raw material for the manufacture of textile products. However, internationally developments have been made for more sustainable innovations in the industry, that also provide alternatives to cotton fiber, e.g., Hemp fiber, stinging nettle fiber, coffee ground fiber, pineapple fabric piñatex, banana fiber and lotus fiber. Therefore, the risk of substitution is considered medium.

Risk of growth trends also impacts the competitiveness of the industry. The textile industry is a mature sector of the economy, and its revenue growth has generally shown to outperform the GDP growth rate of the country. Moreover, government support and favourable incentives for the value added segment supports low risk in growth trends for the weaving and composite segments and medium for the spinning sector. Based on the risk of new entrants, substitution and growth trends, overall competition risk is medium for the textile industry.

Compared to some other industries, capital requirements in the textile industry are low with a reasonable payback period and relative ease of financing. However, the need to invest in advanced technology and processes including compliance with environmental regulations and effluent standards for sustainable growth has increased the capital requirements of the industry over time. Therefore capital intensity has been assessed as medium risk for the low value added sub sectors and high for the higher value added.

In the textile industry, progress in technology and products has been enormous. New materials and technologies, such as attractive polymers in combination with new spinning methods, three-dimensional (3D) textile formation, environmentally friendly finishing, and computerized patterning continue to impact the industry. New research can lead to development of similar products with higher environmental sustainability and lead to product obsolescence over time. Therefore technological risk for textile industry has been assigned as medium.

On regulatory front, textile industry in the past has and is expected to continue to receive significant support from the government in the form of concessionary borrowing and lower energy prices due to its contribution to the country's GDP and exports. Initiatives are also being undertaken in order to increase production and yield of cotton to support the industry. Given the strategic importance of the sector, the sector has been assigned a low risk profile in the regulatory factor.

Energy accounts for around 35% of conversion costs in the textile value chain, and therefore competitive pricing of exports is very overly sensitive to energy pricing. Energy prices in Pakistan, though subsidised by the Government, remain higher than compared to other regional players from India, Bangladesh and Vietnam which impacts the competitiveness of industry players. Therefore, on account of high energy costs and limited availability energy sensitivity has been assigned medium risk factor for all sub-segments of the textile industry.

Based on the above industry risk factors, overall industry risk for textile industry is assessed as Medium.

Table 2: Summary of Industry Risk Factors

TEXTILE									
Cyclicality	Competition				Capital Intensity	Technology Risk	Regulatory Framework	Energy Sensitivity	OVERALL RISK
	Risk of Effectiveness of barrier to entry	Risk of Substitutes	Risk in Growth Trends	Overall					
Spinning									
Medium	High	Medium	Med to Low	Medium	Medium	Medium	Low	Medium	Medium
Weaving									
Medium	High	Medium	Low	Medium	Med to Low	Medium	Low	Medium	Medium
Composite									
Medium	Medium	Medium	Low	Medium	High to Med	Medium	Low	Medium	Medium

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