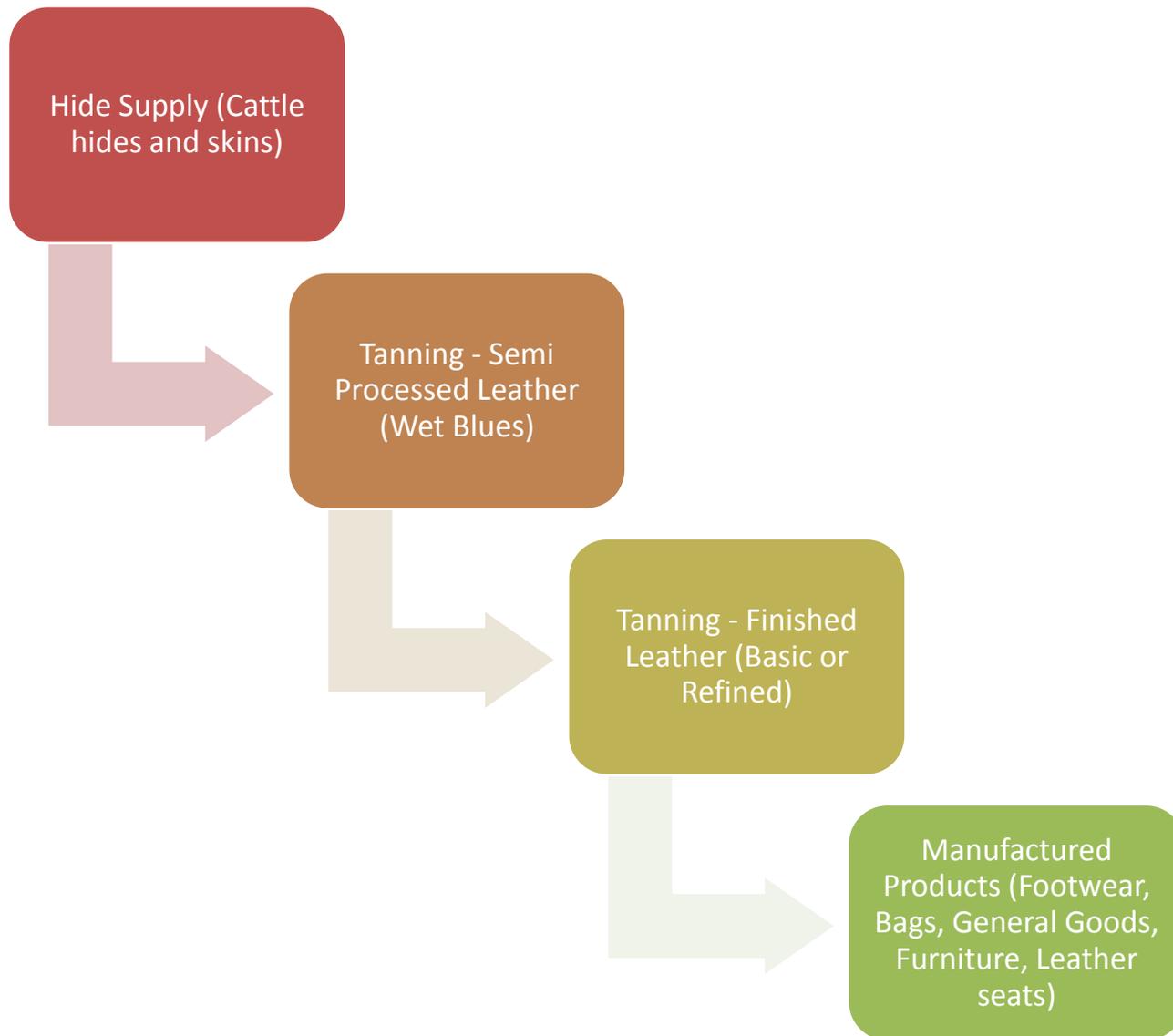


LEATHER

August, 2020

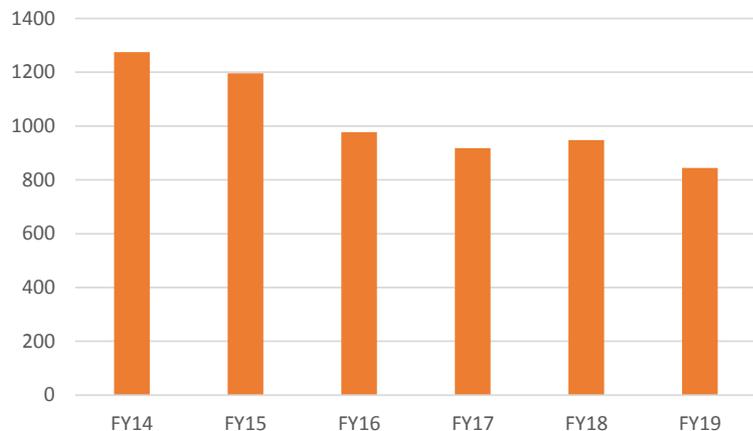


Value Chain of Leather Sector



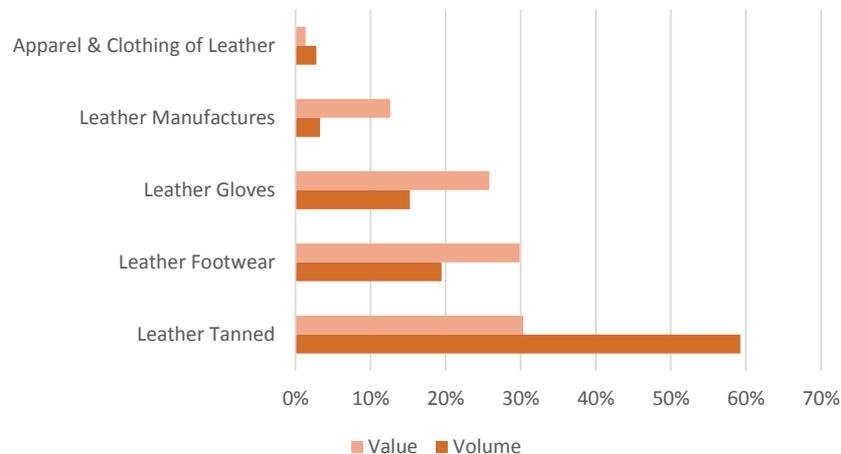
Demand Dynamics

Total Leather Exports (US\$m)



Source: Pakistan Tanners Association

Leather Exports Composition in FY19

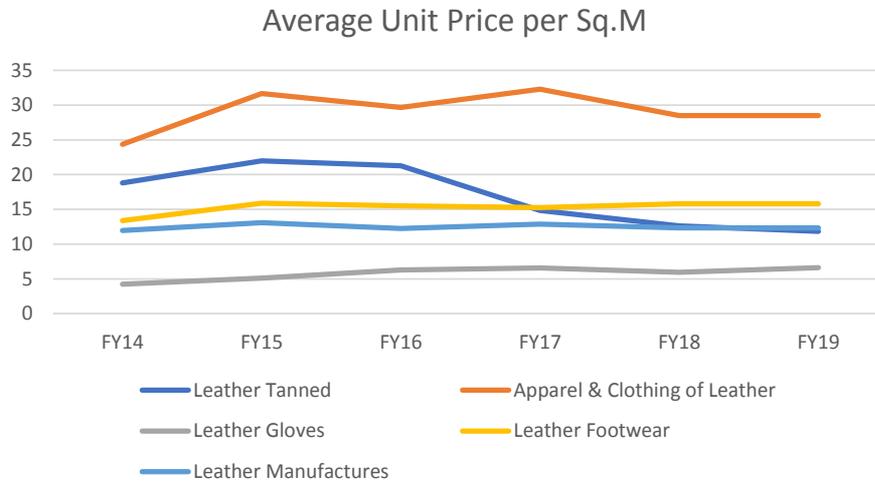


Source: Pakistan Tanners Association

- Although tanned leather forms the largest proportion of exports (~60%) in terms of volume, it accounts for ~30% of exports in value terms. The remaining value of exports is represented by leather footwear (~30%), leather gloves (~26%) and other products.
- Pakistani leather exports have followed a declining trend since FY14 due to slowdown in demand from European countries. Moreover, a shift in leather demand has been observed from Europe to Asia. As of 2019, the share of leather industry in Pakistan's exports is 4.3%.
- The major potential markets are Italy, Hong Kong, China, India, Vietnam, Bangladesh, Korea, Spain, Germany, Indonesia, South Africa, UAE, Japan, Thailand, USA, Netherlands, Turkey, France and Portugal.
- The domestic leather prices are dependent on availability of leather in the domestic market and are subject to significant volatility. However, as export realization is not linked to domestic leather prices, margins are susceptible to adverse price movements in export and domestic markets.

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Supply Dynamics



Source: Pakistan Tanners Association

City	#	%
Sialkot	250	31%
Kasur	230	29%
Karachi	140	18%
Gujranwala	51	6%
Multan	35	4%
Sheikhupura	35	4%
Lahore	20	3%
Sahiwal	8	1%
Faisalabad	7	1%
Peshawar	6	1%
Sargodha	5	1%
Other	11	1%
Total No. of Tanneries	798	100%

Source: Pakistan Tanners Association

- Leather is exported from Pakistan to different countries in the form of wet blue, crust, finished leather and leather goods.
- Leather industry is characterized by presence of large number of small to medium sized players. Pakistan does not have enough number of internationally recognized brands of leather products. According to a State Bank of Pakistan report, ATS Synthetic (Pvt) Ltd, Al Muqet Enterprises, Amin Feroz Group, Jafferjees Leather Goods, Leather Expressions and AZ Group are some of the key players in the leather sector.
- Local firms have to compete not only with other domestic players, but also with Chinese, Indian and Bangladeshi manufacturers in the overseas market.
- Around 80% of Tanneries are in Sialkot, Kasur and Karachi.
- Due to the lack of investment in the leather processing industry, most of the tanneries produce low-to-average quality leather and as such the country cannot manufacture and export highly value-added leather products in large quantities. This keeps the average per-unit price of both tanned leather and leather products low.
- Manufacturers of leather products do enjoy some incentives in the form of duty drawback and export rebate but their claims of duty drawback remain stuck with the government. This makes it difficult for them to invest in the latest technologies required for modernising leather manufacturing processes.

Business risk factors for Leather Manufacturers

Scale and Operations

- Firms with a larger scale of operations can achieve cost and manufacturing process efficiencies.
- Scale also supports diversification across products.
- Water availability in Pakistan is a key issue. Firms with better water availability fare better.

Diversification

- Diversification can be measured in terms of product (share of higher value added products), customer (concentration towards top ten customers) and geography (distribution of export sales across countries).
- Product innovation can enable firms to improve their pricing power and expand customer base.
- In case of tanned leather, usage of different chemicals and processes has enabled some companies to diversify their product base.
- Given the slowdown in Europe, companies are also trying to focus on getting more business from Asian countries.

Brand Strength

- Companies with a strong reputation in terms of quality tend to have better brand strength.
- Players with strong brand strength have better pricing power, which supports their margins.

Covid-19 is expected to exert pressure on leather sector revenues

- Covid-19 has had a significant impact on major export markets of leather sector with a number of countries under partial or complete lockdown. Given the closure of large retail stores, and in turn, lower demand for leather goods, risk of withheld shipment and future orders, delays or extension of payment timelines, and even cancelled orders remains.
- As currently practised, leather production is also linked to some serious sustainability issues. This has led to the emergence of environmentally friendly alternatives to leather. In some countries, such as Bangladesh, an export ban has also been imposed in the past.
- In order to cope with the challenging operating environment, some leather companies are focusing on product innovation and improving cost management. Product innovation is being achieved through either diversification towards value added products, variation in finishing of the tanned leather.
- Given the expected slowdown in demand, VIS views that players with strong financial profile, and sizeable orders booked in hand for at-least the next 6 months, will be better placed to operate in the current situation.
- Post crisis period the export players may witness a surge in demand owing to the relief packages being planned by the foreign governments to boost consumption in European and American markets.

Covid-19 is expected to exert pressure on leather sector revenues

- While rate of spread and timing of the peak of the Covid-19 outbreak are still uncertain in Pakistan, VIS expects varying degree of stress on financial profile of its rated leather entities which will continue to be monitored as the situation evolves. Regulatory relief from the central bank and recent cut in discount rate should provide some respite to leather companies in these challenging times.

Analyst's Contact

Muhammad Ibad Desmukh

Manager

ibad.deshmukh@vis.com.pk