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- EXECUTIVE Summary -

FEASIBILITY STUDY – TARTOUS PROJECT, SYRIA

prepared for

United Nations Industrial
Development Organization

(UNIDO)

by



DOCUMENT INDEX

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1.

RECOMMENDATIONS

The feasibility results for the proposed Tartous Textile Mill show a positive viability for the project, provided certain criteria are met:

1. The mill is able to work **8,600** hours a year (**360** days) with a rotating shift system.
2. The machines, equipment and supplies are sourced through direct negotiation with selected suppliers and bought by Letters of Credit.
3. The levels of machine utilisation reach international standards
4. The levels of labour productivity meet international standards
5. Standard international marketing activities are employed.

1. It is understood, however, that regulations do not permit 8,600 hours annual working. (7,200 hours, the usual practice in Syria, is insufficient) although this problem could be overcome, we are advised.
2. The law does not permit Public Sector companies to buy directly from selected suppliers. Procurement is restricted to tendering.
3. and 4. These levels of utilisation and productivity have not been achieved within Public Sector companies and we do not have the confidence to believe that the new company would achieve this either.
5. No public sector company has the pro-active marketing skills required.

CONSEQUENTLY, WE TAKE THE VIEW THAT THIS PROJECT SHOULD NOT BE RECOMMENDED AS A PUBLIC SECTOR MILL.

If the first two criteria were to be met, we recommend that a joint-venture partner should be sought to invest in the project together with the Government and that the partner should manage the business exclusively.

Issues 1 and 2 are considered to be fundamental problems that place the new Syrian textile plant at a strong international cost disadvantage. Gherzi has discussed these issues at Ministerial level and all parties involved are aware of our opinion. We recommend that these issues should be addressed before proceeding with the project.

The Final Feasibility Study Reports assume that both of these problems will be overcome and that the project will be free to operate for 360 days per annum and to purchase all required Plant and Machinery by Letter of Credit following direct negotiations.

The background to these two basic issues are described in more detail in the following chapters 2.1 (Working Hours) and 2.2 (Procurement Methods)

This report summarises the final project results and gives Gherzi's opinions as to the remedial measures that need to be in place to support the project and to ensure its future viability. It has also been decided to restructure the final project report to cover **two** very specific future project options which are most likely to be of interest.. These are:

OPTION 1 – Vertical Textile Study (Spinning to Processing)

OPTION 2 – Full Vertical Study (Spinning to Garmenting)

2.1**Annual Working Hours**

It was originally proposed that the plant would operate for only **300** days a year (7,200 hours). Today it is standard practice in the competing textile countries that textile plants operate around the clock and have 8,600 annual hours available for production. The restricted working hours in Syria place the plant at an 18% - 20% disadvantage against competitors in terms of what it could produce.

For capital intensive projects, where maximum output is required, (Spinning, Weaving and Processing) limited working hours are considered as a very negative factor compared to international competitors. Profitability would be restricted as production costs would be excessive.

Following discussions with GOTI and the Ministry of Industry, it was agreed that the plant should operate for **360** days with appropriate shift patterns to compete with best practice mills internationally on a pilot basis. This assumption has been adopted and used in the Feasibility Study.

2.2**Purchasing by Tender**

Extensive efforts were made in preparing the study report to obtain a wide range of machinery quotations from international machine producers in order to determine at what price they would deliver machines to the Public Sector in Syria.

Syria, almost uniquely today proposed to buy the required equipment by Tender, a method which has two very significant disadvantages.

Firstly, the machine suppliers indicated that previous Syrian tender requests had very restrictive conditions that caused high risks for them. Machine suppliers are wary of bidding against the tenders as their past experience has been so problematic and they will bid only with premium prices. Some important suppliers were not prepared to enter into a Tender purchase agreement with Syria at any price. The consequence of this was that the machine prices quoted for this project were much more expensive than they should have been. This view is based on our long experience of evaluating similar textile projects.

Today, almost all other customers for textile machinery world-wide make these purchases by using Letters of Credit. When paying by this method, suppliers are much more willing and flexible when it comes to price negotiations. We estimate that the Tender prices quoted could be reduced by **at least 40%** for machinery and **30%** for auxiliary equipment by using this method and the normal negotiating process.

The second major disadvantage of the tender procedure inevitably means that the project might not get exactly the required machinery from the best suppliers for the new mill. Under the tender procedure the new mill is not free to enter the open market negotiating procedure. However, some suppliers will refuse to enter bids for sales by tender, so the mill is obliged to accept machinery from what is offered and which may not be the most suitable machines.

For these reasons, we have strongly recommended that the Plant and Machinery purchases for the new mill should be made by Letter of Credit (LC). This is the traditional method for procurement of machinery in the textile industry and will help ensure that the project gets the required machines from the best suppliers at the best possible price.

GOTI and the Ministry of Industry have agreed that the project should be based on the assumption of LC purchasing procedures. The result of not implementing this change but to continue buying by the Tender process has been measured in the sensitivity analysis in each of the two final study modules.

We also recommend that when the mill is established it should be free to purchase supplies such as dyestuff and chemicals by Letter of Credit. Failure to do this will result in higher than necessary stocks, reduced flexibility and longer delivery lead times which are contrary to today's market expectations.

As stated in the recommendations, the project should only be considered as a joint-venture (JV) public private partnership when the first two structural problems of Working Hours and Procurement Methods are resolved. In determining which would be the better of the two project concept modules for a JV in Syria and how the project should proceed, some important points need to be considered at this stage. The selection of the most suitable option may not be based solely on the one showing the highest potential profitability. Careful consideration needs to be given to factors such as:

- Garment Sector Limitations
- Availability of Marketing skills
- Strategy for the Textile Sector

According to the evaluation work carried out to date, the project should be concentrated on the production chain from spinning through to the processing of finished fabrics. Garmenting should be excluded even though, on paper, it looks attractive. The reasons for the selection are summarised in the following chapters.

Today's global garment industry is on the brink of a major consolidation driven by changes arising at the ending of the Multi Fibre Arrangement (MFA) on 1st January 2005.

Garment buyers will demand increasingly greater quality consistency, shorter lead-times, improved servicing levels and more competitive prices. The major retailing chains are driving these changes. It is not uncommon for some retailers to change their product ranges up to **10** times per year. This means their suppliers have to be more flexible and to respond very quickly to the changes in market demand. Increasingly buyers are placing business with garment suppliers who meet these stringent service demands and not just with those who offer the lowest prices. Heavy penalties are applied in the case of late shipments and quality faults leading us to the conclusion that garment production would be too risky for the government when the decision taking procedures are too cumbersome.

Under the present conditions these demands would be difficult to fulfil in Syria. The supplies required by a fashion garment producer are wide-ranging in terms of fabrics and accessories. Many of these still need to be imported to give this full flexibility.

3.1 Garment Sector Limitations (Cont.)

Successful garment companies need highly developed contacts with their main markets and customers. At the present time this strong market knowledge and the contacts are missing in Syria and will take time to develop

The need for flexible garment manufacture has resulted in the setting up of small to medium sized units in the private sector. Development of the garment sector in Syria should be encouraged to generate the maximum value addition employing the greatest number of persons, preferably based on locally produced fabrics. The proposed new mill should provide the required ranges of quality fabrics, competitively price, to foster expansion of the garment sector.

3.2 Availability of Marketing Skills

From the work undertaken by Gherzi on the project for Textile Value Chain Analysis, it is clear that one of the major problems facing Public Sector textile enterprises in Syria is a lack of marketing skills and contacts.

The companies sell either directly to merchants visiting the mill or through the state marketing organisation SENDOS. Neither method of selling is satisfactory as the companies do not have their own marketing plans to sell their capacities and do not sell pro-actively. If the merchants and SENDOS do not place orders the companies have no sales. The opportunities for garment manufacture in Syria has resulted in the setting up many small to medium sized units in the private sector. These units already generate more than 90% of garment exports. (SP 8,979 mn in 2002).

Encouragement should be given to further growth of the private garment sector in order that the maximum value addition to local cotton can be achieved. This will contribute to increased foreign currency earnings and in the creation of jobs.

The final shape of the project must take into account the wider future strategy for the textile sub-sector as a whole.

The Tartous project should also be seen as part of that wider textile sub-sector investment strategy to ensure that the project will fit with a future plan for the industry as a whole. Evidence to-date shows that the garment unit must be in the private sector. Preliminary evaluation of the public sector textile companies highlights the many problems that contribute to their poor financial results. These problems include under-utilisation of state of the art machines that have been installed as part of modernisation programmes, weak management organisations, over manning and limited sales activities.

The result of the modernisation programme has been that several plants have oases of modernised departments that are surrounded in many cases by obsolete or semi-obsolete sections. Before further programmes are implemented, it is recommended that an assessment of each company be made to develop an overall strategic plan for the Public Sector Companies.

Such an assessment could, for example, highlight the fact that there is available already within the Public Sector sufficient excess processing capacities to cover the planned Tartous weaving production.

4

Pilot Plant Concept

This new proposed vertically integrated textile project is perceived as a pilot plant to demonstrate how future textile investments on a JV partnership could be made in Syria. It may also be used as an example to show how some of the existing public sector textile capacities could be restructured and upgraded.

4.1

Public / Private Joint Venture

Gherzi strongly recommends that this new project, if it were to proceed, should only do so as a full joint-venture partnership between the Public Sector and the Private Sector. The State Holding Company would act as a Board of Directors overseeing the company's operations whilst the Private Sector would form the management board and assume full responsibility for the daily operations according to financial targets set out and agreed with the Board of Directors. The private partner should be an equity participant in the project.

Only the public sector in Syria has the resources and strength to finance the project. However, we very firmly believe that the true market and technical skills required to extract the maximum benefit and added-value from the project lies very firmly with the private sector. The Private Sector's strengths are their abilities to take decisions rapidly, matching buyers demands and adjusting production to meet market demands.

4.2

External Plant Management

Gherzi believes that it will be essential for the private Joint-Venture partner to provide a professional management team to manage the project with full operational responsibility for running the completed plant.

The skills required to operate a plant to the critical quality, delivery and efficiency levels required do not exist within the Syrian Textile Public Sector companies.

It is important that the joint-venture partner and their management team are involved with the project from the start as they will contribute much to shaping the project and the specifications for machinery etc. Such a JV team would be integral to ensuring the commercial success of the project.

For the last 30 years, the major part of world trade in textiles and clothing has been conditioned by the Multi Fibre Arrangement (MFA), introduced in the early 1970s, to afford protection to the textile and clothing industries in the higher cost countries, especially the EU and the USA. Under the MFA many of the world's lower-cost, textile and clothing exporting countries had their exports restricted by a series of quotas set annually by the importing countries. The purpose of the quotas was to control the rate of decline of the industry in the higher- cost countries by giving protection, on a reducing basis, to their industries.

Under the Marrakesh Agreement of 1995, that was the last step in the Uruguay Round, it was agreed by participating nations that all residual MFA quotas would be finally withdrawn on 1 January 2005 and that thereafter there would be a return to liberalized trade under the World Trade Organization (WTO).

Such a change is having a seismic impact on the patterns of world trade that have been established over the past decades. The following significant changes in world trade patterns are projected for the next couple of years:

§ Higher cost countries

- More textile companies (spinning, weaving and fabric processing) will close. The residual capacities will be for niche products only
- More clothing companies will close as they become less competitive
- Imports of yarns and fabrics will be less and less as there will be only a limited garment sector demand for these products
- Imports of ready-made clothing will increase very significantly
- Exports of clothing will reduce considerably. (Note: Until now the EU has been the world's largest exporter in the world - still larger than China)
- Retail buyers in the EU, Japan and the USA will continue to be the major decision takers in terms of orders placed for clothing as their purchases will continue to exceed 80% of global foreign trade in garments.

§ Lower cost countries

- Textile and clothing manufacturing capacities will increase to fulfil the global demand of the clothing, household textiles and industrial and technical textiles markets.
- Textile exports will increase to meet the demands of clothing companies in the lower cost countries.
- Textile exports will increase to meet the demand for industrial and technical textiles
- Clothing exports will increase to meet the growing import demands of the higher cost countries and all WTO members
- Household textiles exports (bed sheets, towels, etc) will increase to meet the growing import demand in the higher cost countries and all WTO member countries

§ Strong competition between exporters

Competition between exporters will be intense; the weaker companies, even those that have had quota allocations for many years, will fail unless they satisfy buyers' requirements. Stronger companies, even newer entrants will succeed, provided they meet the requirements of buyers and serve their customers.

It is essential that the basis on which the Tartous project is based is clearly defined and for this purpose a detailed *Market Survey* is proposed, as discussed in the following paragraphs.

Capital investments carry risks for stakeholders. The risks associated with the Tartous project need to be minimized as much as possible before the investment is finally approved, so that the stakeholders can have confidence that the project is established on a solid basis. A techno-economic feasibility study is an essential tool for understanding the viability of the project. There is a need, however, to clearly identify the market opportunities and the means of attaining and retaining shares of the country/ product markets before undertaking the detailed feasibility study.

OBJECTIVES:

The objective of the market survey is to answer the following questions:

- o To which markets does Syria have special or open market access (e.g. Arab Free Trade Area – 22 countries, EU)? What arrangements are available for cumulation of fabric sales to garment producers in other member countries ?
- o Who are the possible customers in these markets and who are the buyers?
- o How do these companies source their requirements? Do they buy directly, through agents or through wholesalers?
- o What is the business of these companies?
- o How much do they buy in a year and what are their reputations?
- o What are the specific products presently being bought and under what conditions?
- o How frequently do they buy and under what terms?
- o What do the companies expect of their suppliers? Credit terms, product development, ready stocks held available in market or at factory
- o Who are the present suppliers? What are their respective strengths and weaknesses? What trends are expected in changes in suppliers and why?
- o What does Tartous need to enter the markets in the first place and to retain its position in the second place?
- O What should be the proposed product mix, target customer list, order sizes, prices, commercial terms, market entry strategy and manufacturing strategy?**

METHODOLOGY:

The recommended approach to the *Market Survey* is as follows:

- Ø Identify the best market access opportunities by country and possible customers through desk research from published documents as well as the internet. Identify the preferred markets from an analysis of the data. (desk research)
- Ø Obtain market information from the Trade Officers posted in Syrian Embassies overseas commercial information relating to the particular countries of special interest, including published trade information (desk research).
- Ø Determine from the available literature who the target customers could be and what their outline profiles are (desk research).
- Ø Prepare a marketing brochure of Tartous for use during customer visits and a library of samples (own products or from others to show fabrics to be made (desk research).
- Ø Prepare a practical visit programme of the latest customers, determine who is to make the visits; Write a questionnaire for completion during the customer visits and make reservations (desk research).
- Ø Prepare a budget for the market survey and identify the sources and availability of funds (desk research).
- Ø Undertake the field visit programme to the target customers, taking care to document all the information (and samples) collected in a systematic manner (field work).
- Ø Analyse the results of the field work visit programme and prepare options (say 3 options) of a product mix profile, prices and potential customer lists (desk research).
- Ø Discuss the options in a management meeting and agree one of the options. Prepare the full feasibility study.
- Ø Thank all companies visited during the field work, in writing, and plan to visit them again when Tartous has something to offer.

The two final variants of the Pre-Feasibility study reports, namely:

OPTION I - Vertically Integrated Textile project Spinning to Processing - This option should be considered in conjunction with free processing capacity that may be available now in the Public Sector. (to be determined by an audit of the Public Sector companies).

OPTION II - Full Vertically Integrated study excluding garmenting option - This option is not recommended as garmenting should be in the private sector.

The results of the OPTION I study are summarised in chapter 6.1. The results of the OPTION II study are summarised in chapter 6.2 of this Executive Summary.

In each case we have made a direct comparison of the study results based on the optimal practice for Operating Hours (8,600) and Procurement by LC. This option is shown as Sensitivity Option VIII as a variant to the BASE CASE scenario.

These results are also compared to the prevailing practice in Syria. This is based 7,200 annual Operating Hours and Procurement by Tender. The purpose of this analysis is to show the importance of making new arrangements for working hours and procurement methods.

RESULTS OPTION I : Vertically Integrated Plant Excluding Garmenting

The results show that the BASE CASE situation, with 8,600 operating hours and with machinery purchase by L/C, gives a viable project. The IRR at **12.4%** is still more than **3** times higher than the Cost of Finance (4%). The return on investment at **9.1%** is also attractive relative to the cost of capital. The gearing has dropped slightly to **5.8:1**. Although this is still a relatively high ratio the debt is well covered by earnings, as the the project has a Debt Service Coverage Ratio (DSCR) of **1.86**.

Gross Profit margin at **36.2%** is also good as is the annual Pre-Tax Profit of almost **6** Mio. US \$.

However, with the restricted 7,200 production hours and the present purchasing methods by Tender the project becomes non-viable generating an IRR of only **3.8%**. Under these conditions the project has Pre-Tax Losses **(2.2) Mio US \$**, a very high gearing of more than **11:1** and debt payments cannot be covered from Cash Flow.

KEY PARAMETERS	Base Case	Restricted Hours & Tender Purchasing
Internal Rate of Return (IRR)	12.4 %	3.85 %
Return on Investment (ROI)	9.1 %	1.8 %
Average D.S.C.R	1.86	0.93
Cash Break-Even Point	33.7 %	52.7 %
Break-Even Point	63.2 %	109.0 %
Gross Profit as (% of Sales)	36.2 %	33.4 %
PBITD	9.1 Mio. \$	2.6 Mio. \$
Profit / (Loss) before Tax	5.96 Mio. \$	(2.2) Mio. \$
Debt : Equity Ratio	5.8 : 1	10.3 : 1

RESULTS OPTION II : Vertically Integrated Plant Including Garmenting

The results show that the BASE CASE situation, with 8,600 operating hours and with machinery purchased by LC, gives a viable project. The IRR at **15%** is almost **3.75** times higher than the Cost of Finance (4%). The return on investment at 12% is also attractive at 12%. Although the gearing is still high at **6.25:1** this debt is well covered by earnings as the the project has Debt Service Coverage Ratio (DSCR) of **2.17**.

Gross Profit margin at **38%** is also good as is the Pre-Tax Profit of 9.6 Mio. \$/PA.

However, when the existing restricted hours of **7,200** and the present purchasing methods by Tender are reintroduced one can see that the results again deteriorate dramatically and the project becomes non-viable generating an IRR of only **5.3%**. Under these conditions the project has a very small Pre-Profit **0.2 Mio \$**, a very high gearing of **9:1** and debt payments that are barely covered from Cash Flow.

KEY PARAMETERS	Base Case	Restricted Hours & Tender Purchasing
Internal Rate of Return (IRR)	14.9 %	5.3 %
Return on Investment (ROI)	11.9 %	3.4 %
Average D.S.C.R	2.17	1.07
Cash Break-Even Point	34.8 %	51.2 %
Break-Even Point	57.4 %	94 %
Gross Profit as (% of Sales)	38 %	34.7 %
PBITD	13.0 Mio. \$	5.2 Mio. \$
Profit before Tax	9.6 Mio. \$	0.2 Mio. \$
Debt : Equity Ratio	5 : 1	9 : 1

For the reasons stated in this Executive Summary, we would recommend only considering the Vertical Textile Study excluding Garmenting. As shown in the results, it is vital that the the project operate for 8,600 hours per annum and that the required machinery and equipment is purchased by means of Letters of Credit and through direct negotiations with suppliers.

If either of these conditions should not be available we would not recommend building the mill under any circumstances.

The study proves that in principle a financially viable textile production project can be developed in Syria if the strict state of the art performance parameters can be met.

The first important step in the chain will to undertake a Market Study. This is required to refine important information such as :

- Target Markets
- Level of Competition
- Product Price Bands
- Service Levels
- Selling Methods

This Feasibility Study is based on a sample range of typical products which could be produced from Syrian Cotton and Cotton/Polyester blends. The range of yarns counts produced is wide ranging from Ne 16/1 (Cotton) to Ne 45/1 (Co/PES). The range of fabric weights and end uses is also quite diverse. A Market Study of the type proposed is required to define more specifically the correct product focus for the project from a market perspective.

The results of this would focus the shape of the Final Project in terms of the precise Technical and Engineering inputs required. These inputs coupled with the latest market study information can be used to update a Full Feasibility Study financial and economic results to ensure these still remain favourable. The management company should be appointed at this stage..

The process of negotiating with short-listed suppliers for the preferred machinery can now start be initiated with the aim of securing the best machinery at competitive prices.

Finally the suppliers should be selected and contracts awarded. An Engineering contractor should be appointed and execution of the project should commence.

Although the Garmenting operations contribute positively to the overall project results, as discussed in chapter 3 of this Executive Summary, the integrated textile option (from spinning through to processing) has the least risk.

The results show that both options are viable but the garmenting adds only a further **2.5%** to the final IRR. The textile only project is more in keeping with the existing public sector skills base, and will provide a range of saleable fabrics which can help to foster subsequent private sector garment projects.

As outlined in chapter 5, we would strongly recommend undertaking a Market Survey to support the Pre-Feasibility study findings. Such a study will focus the Product Mix and determine the shape of the final project. The results will under-pin the study findings from the market perspective.

The results show that it is vital to operate for 8,600 hours per annum and procure equipment by means of L/C. Failure to achieve either of these goals would have a strongly negative impact on the project's financial results. We recommend that the project should not be executed unless both of these conditions are guaranteed.

An export orientated textile project of this type could act as Pilot Plant and provide a blueprint for how other public sector plants in Syria could be operated in future. We recommend that the project be implemented as a Public / Private sector cooperation, with an external management team employed to manage the plant, taking care of all technical, operational and marketing decisions. This approach would eliminate the major project obstacle, filling the skills gaps existing in the Syrian textile public sector. The management will have responsibility for marketing the company's products locally and in the export markets.

The project should take full advantage of the advantages of a plentiful local cotton supply, very competitive labour and power costs and an attractive cost of project capital.

The final critical consideration to be made before investing in this project is to ensure that it is developed as part of a wider strategy covering the needs of the entire textile sub-sector in Syria. From our initial review of existing public sector textile plants it is clear that there should be an audit of the sector, particularly regarding processing capacities.

The Tartous investments should only be considered as part of a wider sub-sector strategy and NOT as a stand-alone project. This sub-sector strategy does not so far exist.

The study results show that the Tartous project can be economically viable when it adheres to modern performance criteria which are missing today in the Public Sector in Syria. The support measures needed to support this large investment are summarised in the diagram below.

ELEMENTS TO SUPPORT THE TARTOUS PROJECT

