Market Trends for Textile & Apparel Products

Source: New Cloth Market

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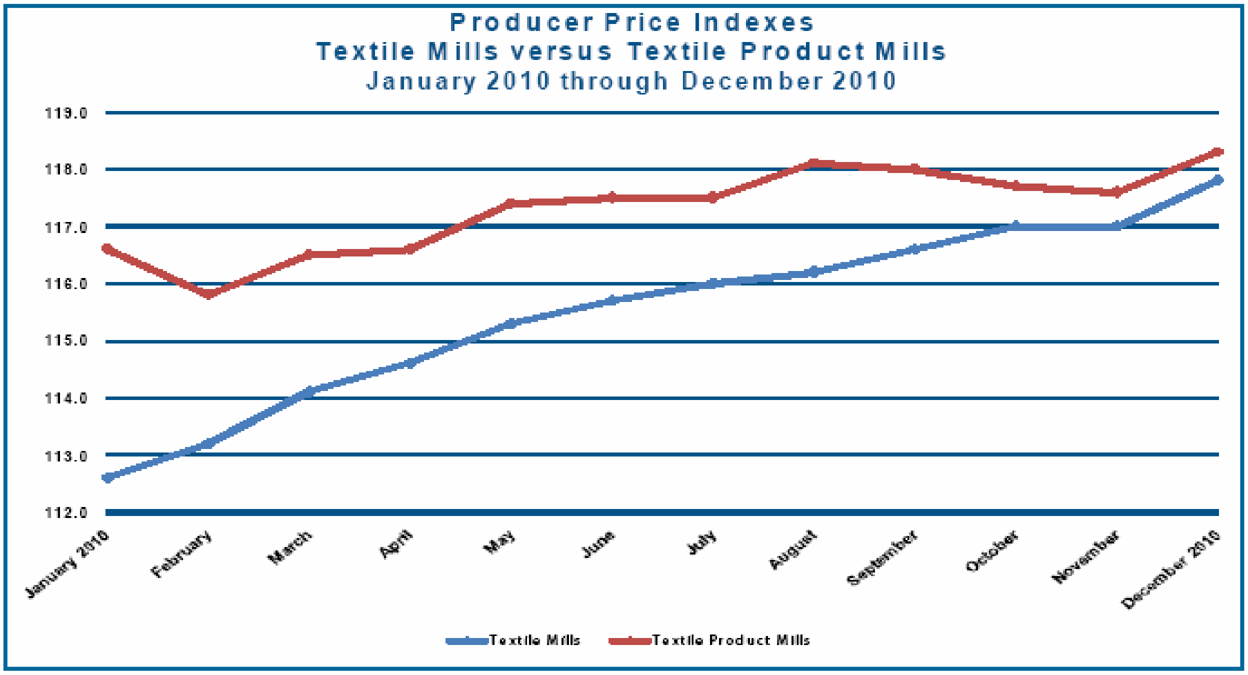
Overview

The outlook for the textile market for 2011 is positive according to most industry analysts, who cite production slowdowns and a resulting lack of supply as cause for continued elevated pricing. According to the Federal Reserve, although the U.S. experienced increases in overall industrial production over the last three months of 2010, industrial production in the textiles sector has fallen each month since August 2010, dropping 3.6 percentage points over that period. Despite the low production levels during the recent quarter, textile production was still up 3.1 percentage points year-over- year as of December 2010 due to particularly active mills during the second and third quarters of 2010.

Although less-optimistic analysts note that decreased export demand has led to the production slowdowns, more optimistic market insiders assert that declining export demand is a result of the continued level of elevated pricing, as producers are resistant to discounting their remaining short supply.

The primary beneficiary of low supply levels has been cotton, but we have seen similar gains in market pricing for synthetic fibers, as more downstream producers opt for relatively cheaper alternatives. Production of apparel has followed an inverse pattern to that of textiles, as historical factors such as increased production before the holiday season, as well as more stabilized textile prices have worked to increase capacity utilization from 75.4% in July 2010 to 81.6% in December. Despite higher domestic production rates, apparel price indexes from industry sources have remained relatively flat over the past two years, in contrast to input costs that have risen significantly. The main culprit for pricing pressures has been importation of apparel, particularly from China. According to Textile-World, textile and apparel imports from China in 2010 ran approximately 30% above 2009 levels. A bill that has yet to be passed by the U.S. Senate calls for the establishment of tariffs on any nation undervaluing its currency. However, critics of the bill say that, although the bill would allow tariffs, the imposition of punitive tariffs would not be required by law.

The following figure illustrates the producer price index, which denotes the selling prices received by domestic producers for their output, for textile mills versus textile product mills. Textile mills include a variety of processes such as yarn spinning; primary textile products manufacturing; intermediate yarn processes such as carding, combing, texturing, twisting; fabric and thread weaving and braiding; and production of nonwoven fabrics and textile finishing for both cotton and synthetic fibers. Textile product mills include carpet and rug mills; curtain and drapery mills; various household textile product mills; canvases; cordage mills; and other downstream textile processes and products:



Recent Trends

Textiles

Within the textile industry (including spinners, weavers, and fabricators, among others), recoveries are largely dependent on the inventory mix of a given company, as the percentages of raw materials, finished goods, and work-in-process all impact the overall blended rate of recovery. With the consistent upward trends in raw materials prices for cotton, polyester, and nylon, GA has found the spread between market price or acquisition cost compared to the cost of inventory to be substantial in many cases, leading to gross recovery increases of five to 10 points for key raw materials, led by substantial gains for cotton fibers. Depending on the method of costing inventory and frequency of costing updates, this spread may be even larger, as some companies analyzed by GA have held high levels of severely undervalued inventory on hand, resulting in gross recovery increases of over 10 points, especially in the case of cotton. However, should costs begin to stay consistent with market prices, a reduction in recovery values would be likely. In GA's experience, these same rising costs have led to compression in gross margin for finished goods, as selling price increases to customers lag behind rising input costs in most cases.

Furthermore, GA has noted that weeks of supply and sales have fluctuated on a company-by-company basis, as operations tend to demonstrate high variability from business to business. As a result, gross recoveries for finished goods have experienced swings from negative five points to positive five points, depending on the aforementioned factors. Unlike the apparel industry, which is segregated into manufacturers, distributors, and retailers, the textile industry contains a higher level of specialization for numerous downstream and upstream processes. GA will continue to monitor the industry, reporting and analyzing these trends as they develop.

Monitoring Points

Monitoring Point	Impact
Monitor input costs such as cotton, polyester, and nylon versus the current cost of inventory.	Depending on the cost methodology of a company, including the frequency with which it updates standards, the spread between the cost of inventory and current market prices can lead to large swings in the value of the underlying collateral.
Monitor gross margin and pricing to customers.	Increases in pricing can often take a quarter or longer to implement, while rising input costs take effect almost immediately. This lag leads to compression in gross margin and lower recovery values for finished goods.
Monitor downstream and upstream activity, as well as production capacity and export demand.	While rising market prices have been largely attributed to export demand, other market factors, such as poor retail activity, low production levels, and an uptick in overseas inventories, would put downward pricing pressures on inputs.
Monitor weeks of supply and inventory aging.	Despite increased production and upticks in consumer demand, companies may continue to carry inventory with high weeks of supply, which would maintain minimal demand.

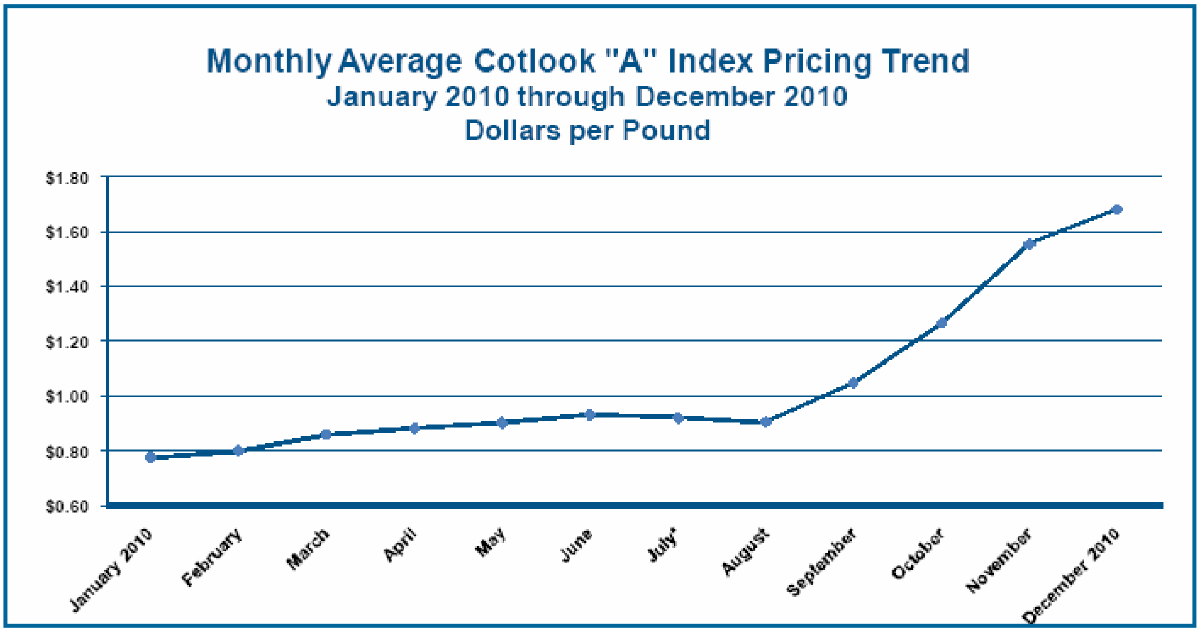
Apparel

Fluctuations in recoveries across the apparel industry (including manufacturers, wholesalers, and distributors) have been modest, and results have been mixed. GA has observed a wide range of performance results, but no extreme trends in either direction. While cost increases lagged behind those of textile producers mentioned previously, they have arrived in recent months. GA anticipates a higher prevalence of margin compression within the industry, as companies struggle to increase prices to recoup cost increases. Retailers are typically reluctant to accept increased prices and often attempt to pass these along to consumers. GA has observed that although overall consumer demand has increased, levels of slow-moving and aged inventory have remained fairly consistent. GA recommends that lenders continue to monitor levels of slow-moving inventory as a percentage of total available inventory, as high levels of slowmoving inventory may offset potential gains in recovery rates resulting from strong sales performance. Additionally, GA has noted that overall weeks of supply and sales have been flat over the past year, and subsequent changes could potentially impact recovery values significantly.

Pricing Trends

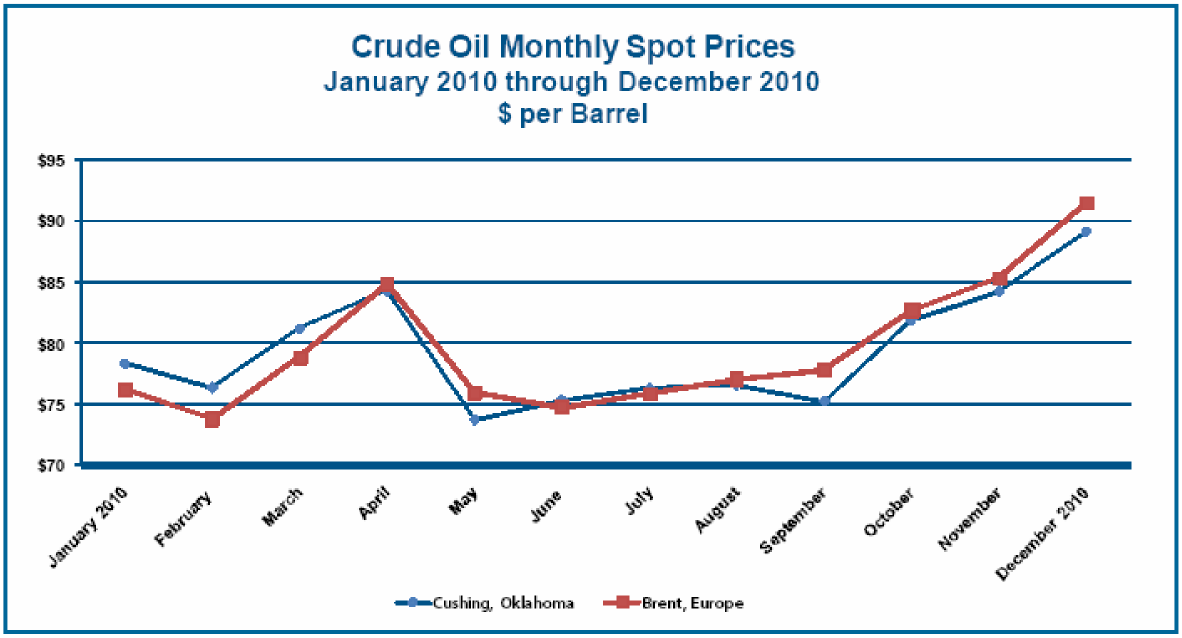
Cotton

As stated, worldwide cotton inventories remain low, and production has not icked up in order to support high demand levels. Poor crop outputs from major suppliers such as China and Pakistan, combined with steadily improving demand levels as a result of a rebounding world economy, worked to kick-start major rallies for cotton during the second half of 2010. Despite an estimated increase in worldwide production of 14 million bales, the 2010/2011 global output of 115 million bales is projected to fall well short of the forecasted demand level of 117 million bales. All signs point to end-of-year stocks decreasing for the fourth straight year to 42 million bales, bringing the stock-to-use ratio down to 36%, as reported by *TextileWorld*.



Recent flooding in Australia further depressed inventories and kept prices buoyed during a period in which futures seemed poised for a descent back towards historical levels. According to the International Cotton Advisory Committee, only about 10% of the projected world trade of 8.3 million tons is still available for purchase. In fact, U.S. domestic commitments are now estimated at 18.1 million bales, while the projected 2010-2011 crop is estimated at only 18.27 million bales. Into late January 2011, the Cotlook "A" Index reached over $1.90 per pound, with experts unsure of price movements in the near future. The Cotlook index represents the average of the five cheapest quotations for principal upland cottons traded on the international market.

Although cotton prices were projected to remain high through the duration of 2010, the extent to which low inventories drove up prices could not be overstated.



While the ICAC Price Model forecasted a 12% increase in the Cotlook "A" price index over 2009, the actual 2010 year average ended nearly 65% over 2009's index reading. The tight supply situation is evidenced by the difference between the "A" Index and the spot futures market; the "A" Index typically trades less than $0.10 over spot futures, but the spread has increased to approximately $0.30 in recent months.

Synthetic Fibre

As a result of surging cotton prices, synthetic fibers have become an even more attractive input option for fabric and apparel producers. In particular, low-margin fibers have experienced resurgence in the United States, while European demand has been centered upon higher margin imports from China. Increases in the U.S. light automobile market have led to capacity improvements and expansions throughout the industry. In particular, INVISTA recently increased capacity of nylon 6,6 for use in airbags at its U.K., Canada, and China plants. The number and size of air bags in light vehicles caused an upsurge in demand in the North American and European markets, while developing markets such as China and Brazil are forecasted to experience record-high sales volumes.

Synthetic fiber usage has not been limited to just air bag production, as an overall increase in light vehicle capacity has lifted spirits of fiber and fabric producers industry-wide. However, improvement in fibers used in light vehicle production has been partially offset by decreases in fabrics used in home furnishings capacity industry-wide, as generally depressed levels of residential construction have severely curtailed demand. Market prices for these fibers are not typically tracked, as these goods are normally monitored at the chip level, and market prices for synthetic fibers vary widely as a result of a multitude of inputs.

However, based on market insight from industry insiders, prices for synthetic fibers have followed a similar trend to cotton, albeit not in as drastic of a fashion. Market prices for nylon fibers are most impacted by benzene, polymide, and caprolactum, while polyester's major inputs are purified terephthalic acid ("PTA"), paraxylene, and monoethylene glycol. As the majority of these raw materials may be traced to crude oil and natural gas derivatives, recent rises in market prices have led to higher feedstock costs.

Low producer inventories are likely to offset flat demand in the nylon market, as the industry is experiencing low levels of benzene, polyamide, and caprolactum, which have been replenished cautiously by manufacturers. Similar to nylon, market prices for polyester inputs have been rising rapidly, particularly on the heels of rising crude prices. Recent surges in paraxylene markets due to production stoppages have led to rising prices for not only paraxylene, but terephthalic acid, as producers have not budged with tight pricing.

Apparel

Although apparel pricing to consumers held relatively consistent throughout 2010, producers may have reached a limit in terms of absorbing skyrocketing production expenses. Several apparel producers have suggested selling price increases of 3% to 10% in the near term, primarily aimed at cottonbased products such as denim and other cotton basics. Certain specialty items will also feel the brunt of cost increases, as these goods are typically less price-sensitive to more essential pieces. A yarn spinner interviewed by industry insider Jim Phillips of Textile World noted, "We all know that prices have escalated tremendously at the manufacturing and distribution levels for the past few months, but consumers have not felt the sting of it in their pocketbooks. They will very soon, as the higher-cost goods are beginning to hit the shelves. We are all kind of holding our collective breath to see what happens." The consumer price hikes are necessary yet risky, particularly considering recent indicators that show heightened consumer confidence. According to MasterCard Advisors' SpendingPulse, retail apparel sales increased 8.4% year-over year during the period from November 5 to December 24, 2010. Major categorical gains were experienced in menswear and women's apparel, increasing 10.5% and 5.6%, respectively.

Retailers with lagging sales will benefit from rising selling prices but must take caution not to dampen consumer traffic. In addition to rising consumer prices, retail customers may also note a shift among retailers and apparel producers toward more manmade fibers such as rayon, acrylics, and polyester. Despite the aforementioned price increases for these

Textile & Apparel Reference Sheet	
Pricing trend changes for the fourth quarter 2010 versus the third quarter 2010 are as follows	
Item	**% Change**
Cotton	61%
Paraxylene	20%
Oil	14%
Natural Gas	13%

inputs, synthetics remain a more price-effective option for manufacturers looking to reduce production costs. Other steps many producers have taken to reduce expenses include a shift in production locations from China to countries with even lower labor costs, such as Vietnam, Cambodia, and Bangladesh.

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Image Courtesy: logicimpex.com