Risks and Rewards of Sourcing Cotton for the Retail Market & What Should Keep US Cotton Industry Leaders Up at Night

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Key Challenges for the Cotton Industry

- The biggest customer—China—has been actively discouraging the use of cotton
- The (misguided) customer perception that cotton is environmentally UNFRIENDLY
- Industry mistakenly equates brand recognition with brand efficacy
- Tendency to be focused on volume rather than value

**SOLUTION:**
CHANGE ATTITUDES and BECOME OBSESSED with customers’ needs.
The U.S. cotton industry often uses the WRONG DATA SET to evaluate its performance.

Cotton and manmade staple fibers: Mill use on the cotton spinning system (1965-2010) Unit: 480-lb bale equivalents

The U.S. spinning system does not provide an accurate snapshot of cotton’s performance. Cotton’s share in the cotton spinning system is at 88% in the United States... but what about GLOBALLY?

The U.S. Census Bureau discontinued its data reporting in 2010. Did they stop publishing the data because the news was so bad?

The GLOBAL MARKET is what MATTERS

Market Share of Cotton in World Textile Fiber Consumption

Cotton’s market share in global textiles is **down to 30% and is DECLINING**

China adopted a national policy that discouraged the use of the cotton and encouraged the migration to petroleum-based fibers

- In 2013, the Chinese government set cotton prices at 20,400 RMB/ton ($1.52/lb)—this is 168% of the world price (90 cents/lb).
- This higher cotton price in China means that all low-value apparel produced in China will NOT be cotton, but made from man-made fiber.
- China mills can import YARN, but not FIBER. This further discourages use of cotton for low-value apparel products in China.

In the first 8 months of the 2011-12 season, the Chinese National Cotton Reserve Corporation (CNCRC) accumulated over 3 MILLION TONS of domestic cotton and at least 1 MILLION TONS of foreign cotton, UP 61% from 2010-11.
When looking to CUT BACK on COSTS, the first place the production team looks to save money is the FABRIC COST—the single biggest cost component in production of a garment.

Example: heavy weight sweat shirt

<table>
<thead>
<tr>
<th>Component</th>
<th>Original</th>
<th>Revised</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fabric</td>
<td>$3.25</td>
<td>$2.54</td>
</tr>
<tr>
<td>Trim &amp; Packaging</td>
<td>$1.00</td>
<td>$1.00</td>
</tr>
<tr>
<td>Duty</td>
<td>$0.94</td>
<td>$0.82</td>
</tr>
<tr>
<td>Embellishment</td>
<td>$0.75</td>
<td>$0.75</td>
</tr>
</tbody>
</table>

What does the merchant do when asked to CUT COSTS?

The merchant will cut fabric costs by REDUCING COTTON CONTENT.

Garment cost: $6.49

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The allure of fiber substitution—a strong financial incentive to USE LESS COTTON.

Now let’s look at what happens when the production team CUTS OUT COTTON altogether—garments are 20% cheaper despite higher duties for MMF.

<table>
<thead>
<tr>
<th>Component</th>
<th>87% Cotton 13% Elastane</th>
<th>100% Polyester</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fabric</td>
<td>$3.25</td>
<td>$1.63</td>
</tr>
<tr>
<td>Trim &amp; Packaging</td>
<td>$1.00</td>
<td>$1.00</td>
</tr>
<tr>
<td>17% Duty</td>
<td>$0.94</td>
<td></td>
</tr>
<tr>
<td>Embellishment</td>
<td>$0.75</td>
<td>$0.75</td>
</tr>
<tr>
<td>Freight</td>
<td>$0.30</td>
<td>$0.30</td>
</tr>
<tr>
<td>Cut, Make &amp; Trim</td>
<td>$0.35</td>
<td>$0.35</td>
</tr>
<tr>
<td><strong>Garment cost</strong></td>
<td><strong>$6.49</strong></td>
<td><strong>$5.24</strong></td>
</tr>
</tbody>
</table>

Again, to CUT COSTS, merchants CUT COTTON.

$1.25 CHEAPER despite higher duty.

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Brand Recognition ≠ Brand Equity

Being a household name does NOT mean customers will pay a premium for your product. Examples: SEARS, K-MART, Levi’s

<table>
<thead>
<tr>
<th>1996</th>
<th>10 YEARS LATER...2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ 63 U.S. manufacturing plants</td>
<td>▪ No U.S. manufacturing plants</td>
</tr>
<tr>
<td>▪ 37,000 employees</td>
<td>▪ 9,635 employees</td>
</tr>
<tr>
<td>▪ Revenues = $7.1 billion</td>
<td>▪ Revenues = $4.1 billion</td>
</tr>
</tbody>
</table>

- Not focused on younger customers or inventory controls
- Not fashion oriented
- Focused on large-scale production rather than flexible production
- Did not innovate - it didn’t think that it was important - after all, Levi’s was the world’s biggest, most recognized brand

- Youth market brands (Wet Seal, TOO) took away new customers
- Designer jeans cut into their market share at the higher end in Department stores (Calvin Klein, POLO)
- Specialty Mass Merchant Private labels (Wal Mart’s Faded Glory, J.C. Penney’s Arizona) created new price pressure
- Retailers (GAP, American Eagle, A&F) further eroded market share
Now let’s look at Cotton—where is cotton at today?

Retailers are telling production to use as little cotton as they can get away with to bring the cost down. The end customer doesn’t care. So why should the retailer?

Amazon search for “men’s contemporary clothing”
Some top sports brands seem to have abandoned cotton

Today it is hard to find ANY 100% cotton garments at an ADIDAS or PUMA store.

Lululemon’s signature fabric “Luon” has NO COTTON IN IT, but aims for a “cottony-soft” feel.

Under Armour no longer denigrates cotton, but it uses very little of the fiber.
If customers consult the web for information about COTTON VS. POLYESTER, the search results are NOT encouraging.

**Whats the difference between polyester and cotton? - Yahoo Answers**
answers.yahoo.com › ... › Home & Garden › Cleaning & Laundry
Jun 28, 2009 - Does polyester clothing lose color or shrink? ... last longer, how many jeans do you have from the 80's versus poly pant left over from disco.

**Polyester vs cotton sweater?**
7 answers Oct 11, 2013

**Difference with Polyester Vs.Cotton?**
1 answer Feb 8, 2013

**Polyester vs Cotton...?**
3 answers Jan 20, 2013

**Cotton vs polyester?**
2 answers Dec 6, 2007

More results from answers.yahoo.com

**Cotton Vs Polyester  What Should I Choose? - Top Dog Screen**
www.topdogapparelinc.com/.../cotton-vs-polyester-what-should-i-choos...-Nov 15, 2013 - When choosing a garment to decorate, our customers are continuously asking “What is the difference between cotton and polyester, and what...

**Is Cotton Better Than Polyester? - Ask.com**
www.ask.com › Q&A › Business › Advertising and Marketing...- terms of retaining heat. Cotton has a high rate of durability unlike polyester, Cotton tends. ... What is Better Polyester or Cotton Bedding? ... Cotton Vs Polyester.

**Polyester  Breathability vs. Wicking? - Style Forum**
www.styleforum.net › Forums › Men's Style › Classic Menswear-Jul 17, 2007 - 15 posts - 14 authors
But if polyester is so unbreathable is the trade-off for wicking worth it? Should I be looking at polyester undershirts that wick rather than cotton ...
The cotton industry needs to focus MORE on VALUE, NOT VOLUME. End the Commodity mentality.

For generations focused on yield—bales per acre—not price per pound.

This had led to a downward spiral for the cotton industry.

That needs to change. High quality cotton is always in demand.

Just look at the top end sports apparel Lululemon—almost no garments are made from 100% cotton.
Many customers believe that cotton is environmentally UNFRIENDLY—and some of the best known brands (in this case, H & M) have reinforced these views.

Challenges in the life of a T-shirt...

- 10% of all pesticides in the world are used in cotton production.
- Conventional cotton used in a T-shirt needs as much as 15 bathtubs of water to grow.
- 4 m² of agricultural land has been used. The space required to produce 100 T-shirts is enough to grow 700 kg of potatoes.
- 36% of its climate impact occurs when it is washed and tumble-dried at home.
- 5% of all waste in US landfills is textiles. Enough to fill 32,750 Boeing 747s.

...and ways to tackle them

- Choosing organic cotton means zero pesticides.
- H&M’s current organic and Better Cotton usage means over 140,000 kg fewer pesticides used in 2012 alone.
- Better Cotton requires 20% less water.
- Recycled materials do not need to be grown on any agricultural land.
- Switching from 60 to 40 degrees when washing saves 41% of the energy used. With an average of 3 wash loads per week, German households could save more than 440 million euros each year.
- 95% of all textiles can be recycled.

Source: http://about.hm.com/content/dam/hm/about/documents/en/CSR/reports/Conscious
Another example: Nordstrom’s organic cotton brochure

Most cotton is not as environmentally benign as you might expect.

More chemicals are NOT THE ANSWER

Chemicals give cotton a BAD NAME.

Cotton is seen by more affluent customers as linked to chemicals in production (pesticides) and processing (water and chemicals) and now in finishing (coatings). Some, especially chemical manufacturers, think that the cotton industry strategy is MORE CHEMICALS, therefore DEEPENING this negative image.

End users have abandoned environmentally unfriendly and cruel practices. The cotton industry needs to wake up and move on.

- **THE WOOL INDUSTRY:** Mulesing is a cruel practice that is rejected by customers. Not a single U.S. brand wants to be associated with Australian wool.
- **THE COTTON INDUSTRY:** End users have abandoned harmful chemicals. Cotton producers need to understand that they have LOST THE BATTLE ON TOXIC CHEMICALS.
Is the cotton industry ready to adapt to the rising customer resistance in chemicals? Brands are...

Greenpeace issued its “Toxic Threads” Report in November 2012 targeting chemicals used in major clothing brands.

Many brands have pledged to to zero discharge of hazardous chemicals from its ENTIRE supply chain. This pledge will require drastic changes in the use of chemicals that are widely used to treat cotton textiles.

Without these chemicals, some processing cannot be done on cotton. Is the cotton industry ready with GREEN substitutes?

Source: http://www.greenpeace.org/international/en/publications/Campaign-reports/Toxics-reports/Big-Fashion-Stitch-Up/
Don't be in denial and stay happy with the status quo. Be LEAN, MEAN and LOOK TOWARDS WHAT IS NEXT

Arrogance and denial will lose you the lead. Look at Blackberry. Forrester Research industry analyst Ted Schadler says former co-CEO Mike Lazaridis missed many boats:

“I just remember standing up in front of their analyst meeting, with holding my little iPhone in 2008 going: So, Mike, what are you going to do about this computer that I'm carrying around in my pocket?

And he just basically laughed me out of the room. He was like: What are you talking about? Nobody cares about that. Like, yes, they do. It's a computer. It does everything. I can get on the Internet right here. Look. And he was like, yeah, that's not what we do. Like, well, boy. Then you're going to be in trouble.”

Source: http://www.npr.org/2012/01/23/145656650/rim-announces-management-shake-up
What is the cotton industry’s trump card?

The DIRTY SECRET that no one will address is this—CUSTOMERS UNDER AGE 30 DO NOT KNOW THAT...

So called “PERFORMANCE FABRICS” are made ENTIRELY from PETROLEUM

Young customers don't know this.
Why doesn’t USDA allow funds collected from producers and importers for research and promotion to educate the customers on this fact?
What is cotton’s future?

Customers are moving towards “natural” products, and the USDA now has labels for certified biobased products.

USDA Certified Biobased Products Label
To increase the purchase and use of biobased products for Federal agencies and contractors, the BioPreferred® program was created in the 2002 Farm Bill (Farm Security and Rural Investment Act of 2002) and is managed by the U.S. Department of Agriculture.

Consumers and contractors can look up what products are “BioPreferred”

97% of this fire resistant t-shirt is biobased—and the shirt includes merino wool
Is the cotton industry strategy Aligned with the customer’s DNA?

- The boards that approve promotion efforts are NOT CLOSE TO cotton’s end users who are young and mostly female.

- The cotton industry needs to have a RELENTLESS focus on understanding the apparel CUSTOMER DNA and constantly update its strategy and tactics to ensure that it stays close to the customer.

- The new wool innovators have set a great example.
Examples of intelligent ENGAGEMENT with high value customers

The iconoclast innovators in merino wool have been successful at reinventing how an “old industry: is perceived among young affluent audience.

Result: a total transformation of perceptions about wool.
Examples of intelligent ENGAGEMENT with high value customers

Understanding the “Micron”

The smaller the micron gauge, the finer the wool fiber. That’s what makes Ibex wool ultra-soft and comfortable.

Fibers are selected for specific levels of performance long before they are knit into the fabrics you rely on for function.

- **24.5-Outer layer**: On top. Shortest days.
- **21.0-Midlayer**: Second layer. Chilly days.
- **18.5-Baselayer 2**: Next-to-skin. All year.
- **17.5-Baselayer 1**: Next-to-skin. All summer.

Diameter of wool fiber *before* it’s spun into yarn

Human hair

YOU
The further away companies are from the COTTON FIELDS, the WEAKER the emotional ties with cotton.

In 2009, LIZ CLAIBORNE, the legendary pioneer in global sourcing and production, signed an exclusive contract with Li & Fung. The Production team in New York and nearly all the in-house team was eliminated. Tommy Hilfiger and other companies followed suit.

As brands cut back product development and a Chinese trading company like Li & Fung becomes the sole sourcing office, the positive attitude about farming and cotton is further eroded. Few or none of these leaders have been on a farm. Emotional ties to cotton are weakened further.

Cotton vs. Man-Made is a decision made on the basis of cost—a challenge ahead for the industry.
The further away companies are from the COTTON FIELDS, the WEAKER the emotional ties with cotton.

Uniqlo is in Japan
H&M in Sweden
Tommy Hilfiger (production team is now with Li & Fung in Hong Kong)

There are NO COTTON FARMS in those countries, hence much WEAKER connection to cotton.

Cotton then becomes just another FIBER, not a WAY OF LIFE.
Celebrate USA cotton’s fantastic success

World class classing

Reliable traceability

You can know EXACTLY where the cotton comes from – even at a spinning mill in Bangladesh
But be realistic about risks & rewards for cotton users

**Risks**

- Price volatility of cotton VS. price stability of MMF (polyester)
- Cotton prices higher than MMF
- Cotton more costly to process relative to MMF
- Perception that cotton is environmentally unfriendly (water, pesticides, etc.)
- Brand equity of cotton eroding. “Performance" fabric seen as GOOD instead of seen as 100% made from chemicals from an OIL WELL
- Cotton is soft (chemical engineering and advertising have eaten into cotton’s advantage in this area).
- Customer preference is eroding with younger customers because young people live in cities and far away from farms

**Rewards**

- More customer affinity toward cotton (grown in nature, not chemically engineered)
- Better image of cotton (renewable, biodegradable)

When this equation and variables are adjusted, extra COST of cotton will be OFFSET by the advantages of cotton.
Thank You

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