

# GREAT AMERICAN GROUP ADVISORY & VALUATION SERVICES

## Textiles and Apparel Monitor June 2011 - Volume 2

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### Introduction

Welcome to the second issue of the *Textiles and Apparel Monitor* from Great American Group Advisory & Valuation Services (“GA”). This publication will provide you with market value and industry trends for a variety of textile and apparel products. The enclosed information represents a composite of GA’s industry expertise, well-respected industry publications, liquidation and appraisal experience, and contact with industry personnel. Due to the commodity nature of certain textile products, as well as the commodity nature of inputs used in synthetic fiber production, timely reporting is necessary to understand an ever-changing marketplace. GA strives to contextualize important indicators in order to provide a more in-depth perspective of the market as a whole.

Increasing spreads between market prices/acquisition costs and inventory costing during the first quarter of 2011 led to gross recovery increases of zero to five points during the first months of the year compared to the prior year and the previous six months; however, these increases have been mitigated in many cases by updated inventory standards and a leveling-out of market prices. Gross recovery fluctuations in other engagements have been largely the result of other indicators, including weeks of supply, inventory mix, and gross margin compression or expansion. Within the apparel industry, many manufacturers have been successful in passing along price increases to retailers, although GA has noted short-term margin compression in some cases. While some indicators have been mixed, inventory cost per unit has increased in nearly all engagements.

The *Textiles and Apparel Monitor* relates information covering most textile and apparel products, including industry trends, market pricing, and their relation to the valuation process. GA provides our customer base with a concise document highlighting the textiles and apparel industry. Please feel free to utilize our contact information shown in this and all *Textiles and Apparel Monitor* issues. GA welcomes the opportunity to make our expertise available to you in every possible way.

### Trends in Recovery Values

Within the textiles segment, year-over-year comparisons for collateral updates have shown modest recovery value gains, which may be largely attributed to rising market prices for inputs, as current market prices have superseded inventory at cost for raw materials in many cases.

### Trend Tracker

NOLVs: **Increasing**

Sales Trends: **Increasing**

Gross Margin: **Mixed**

Inventory: **Increasing**

Pricing: **Increasing**

GA internally tracks recovery ranges for cotton fabrics and apparel, greige goods, specialty textiles, synthetic fibers such as nylon and polyester, and a wide variety of apparel in all price points, but we are mindful to adhere to your request for a simple reference document. Should you need any further information or wish to discuss recovery ranges for a particular segment, please feel free to contact your GA Business Development Officer.



## ABOUT GREAT AMERICAN GROUP

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Great American Group is a leading provider of asset disposition solutions and valuation and appraisal services to a wide range of retail, wholesale and industrial clients, as well as lenders, capital providers, private equity investors and professional services firms. In addition to the *Textiles and Apparel Monitor*, GA also provides clients with industry expertise in the form of monitors for the metals, building products, food, automotive, and chemicals industries, among many others.

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## EXPERIENCE

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GA has been involved in the liquidation of select industrial manufactures and wholesalers such as Atlas Textiles, Garment Services, Seatco, and Textile Alliance, store locations for Jo-Ann Fabrics, Hancock Fabrics, and A.C. Moore, and numerous apparel retail stores such as Kids Mart, Clothestime, Mervyns, and Eddie Bauer. GA has worked with and appraised numerous companies within the apparel and textiles industry, including industry leaders within each category. While our appraisal clients remain confidential, GA's extensive list of appraisal experience includes:

- One of the world's largest integrated producers of synthetic fibers, with annual net sales exceeding \$3.0 billion.
- A wholesale distributor of imprintable apparel, including t-shirts, fleece apparel, sports shirts, headwear, and athletic wear, with net sales exceeding \$700 million annually.
- An industry leader in textile and chemical products, which include denim, dyed fabrics, and flame retardant fabrics for use in apparel and home furnishings.
- One of the U.S.'s foremost producers of retail fabrics, specialty fabrics, and craft products, manufacturing goods in a wide variety of synthetic fibers.

GA also maintains appraisal experience involving more regionalized and specialized companies, allowing for the utmost depth in our valuations:

- Textile spinning mills producing fabric for the apparel, automotive, and home textile industries.
- Distributors of fabrics for furniture, apparel, and other applications.
- Manufacturers and distributors of apparel, rugs, and other woven fabric products.
- Manufacturers and distributors of polyester, nylon, and acrylic fibers and specialty fabrics for various industries.
- Retailers of textile products and apparel.

In addition to our vast liquidation and appraisal experience, GA maintains contacts within the Textile and Apparel industry that we utilize for insight and perspective on recovery values.

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# OVERVIEW

The textile market continues on a stable if otherwise unremarkable path, which is currently characterized by moderate growth in the wake of extraordinary price increases for key raw materials. While the industry produced positive gains during the first quarter, textile production has fallen into a similar trajectory of industrial production as a whole. Total U.S. industrial production increased 5.0 percentage points year-over-year in April 2011, while textile and product mills generated a 4.2 percentage point gain on a cash basis.

Textile and product mills also followed in a stream similar to industrial production on a monthly basis, as a 2.8 percentage point decrease month-to-month in March was offset by a 2.4 percentage point increase in April and positive production indicators in February. The ebb and flow of textile production is endemic of overall U.S. production, as the index reading for textile and product mills has increased only 1.3 percentage points since August 2010, while producing four months of gains, two months of declines, and three months of inertia.

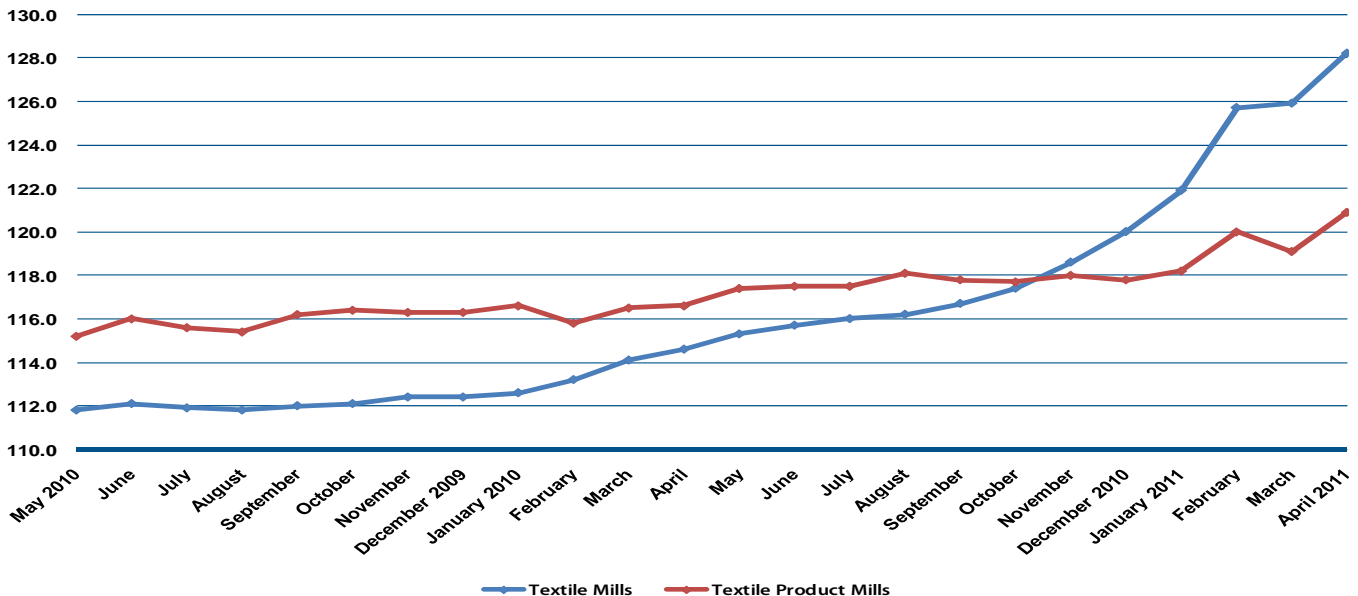
Rising input prices are the main culprit for production increases, as the Federal Reserve's production index is price-rather than unit-based. However, as a result of surging input prices, profits have taken a hit in recent months. Competitive pricing pressures will assuredly keep margins in check in coming months, and profit declines are expected throughout 2011.

According to research firm Global Insight, profits are estimated to decline more than 30% for the year. However, corrections in the Chinese market will have a stabilizing effect on the domestic front, as imports from Asia will continue to decline as a result of increased labor and freight costs.

Production and profit in the apparel sector has followed a similar pattern to that of textiles, as apparel and leather production increased from an index reading of 62.4 in August 2010 to 64.1 in April 2011. A production decrease in March 2011 was offset by increases in February and April. Apparel price indexes from industry sources have remained relatively flat over the past two years, in contrast to input costs that have risen significantly, particularly in recent months. As a result, margins have been compressed significantly. According to Textile World, apparel margins are expected to fall approximately 20% in 2011.

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:

**Producer Price Indexes  
Textile Mills versus Textile Product Mills  
May 2010 through April 2011**



# RECENT APPRAISAL TRENDS

## TEXTILES

Within the textile industry (including domestic fabric and yarn manufacturers, as well as distributors of imported textile products), recoveries are largely dependent on the inventory mix of a given company, as the percentages of raw materials, finished goods, and work-in-process impact the overall blended rate of recovery. On the whole, GA has seen modest increases of zero to five points in recoveries both on a year-over-year basis and as compared to the prior six months, due to an increased spread between raw materials inventory cost and the current market, as well as decreases in slow-moving inventory and more favorable inventory mixes.

With consistent upward trends in raw materials prices for fibers like cotton, polyester, and nylon, as well as input chemicals like terephthalic acid and ethylene glycol, GA has found the spread between market price or acquisition cost compared to the cost of inventory to be substantial in many cases. GA understands that in other cases, this trend is often mitigated by prices leveling out, updated standard costs, or through revaluations of inventory. As many manufacturing companies update standards in December, the spread between market price and inventory cost should be lower in many cases, leading to less severe fluctuation in recoveries. As always, GA recommends the lender monitor these trends both in terms of raw material recovery rates and how these same trends affect gross margins, and thus finished goods recoveries.

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 modest decreases of two to three points to more substantial increases of five or more points on an annual and semiannual basis, 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.



## APPAREL

Fluctuations in recoveries across the apparel industry (including manufacturers, wholesalers, and distributors) have been modest, and results have been mixed year-over-year and compared to the previous six months. In a market of increasing costs for both natural and synthetic fibers, nearly all products have increased on a cost-per-unit basis, and inventory levels have risen across the industry. While GA has observed mixed results, it appears as though companies have been successful in passing along price increases in a timely manner, and gross margin has remained stable to slightly higher in some cases. Any margin compression has been in large part short-lived in nature, and it appears the majority of retailers have accepted price increases. All indications point to these price increases being passed along to the consumer.

As mentioned, gross margin levels have been stable overall; however, GA continues to recommend that lenders look to the most recent months and going forward to monitor how price increases have been accepted by retailers across the industry, as well as to observe the fully realized effects of a higher cost of inventory.

GA has observed that although overall consumer demand on the whole has seen modest increases, levels of slow-moving and aged inventory have been mixed. GA recommends that lenders continue to monitor levels of slow-moving inventory as a percentage of total available inventories, as high levels of slow-moving inventory may offset potential gains in recovery rates resulting from strong sales performance. Additionally, GA has noted that overall weeks of supply have been stable or decreasing. Subsequent changes could potentially impact recovery values to a significant degree.

## MONITORING POINTS

Monitoring Point	Impact
Monitor current 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.

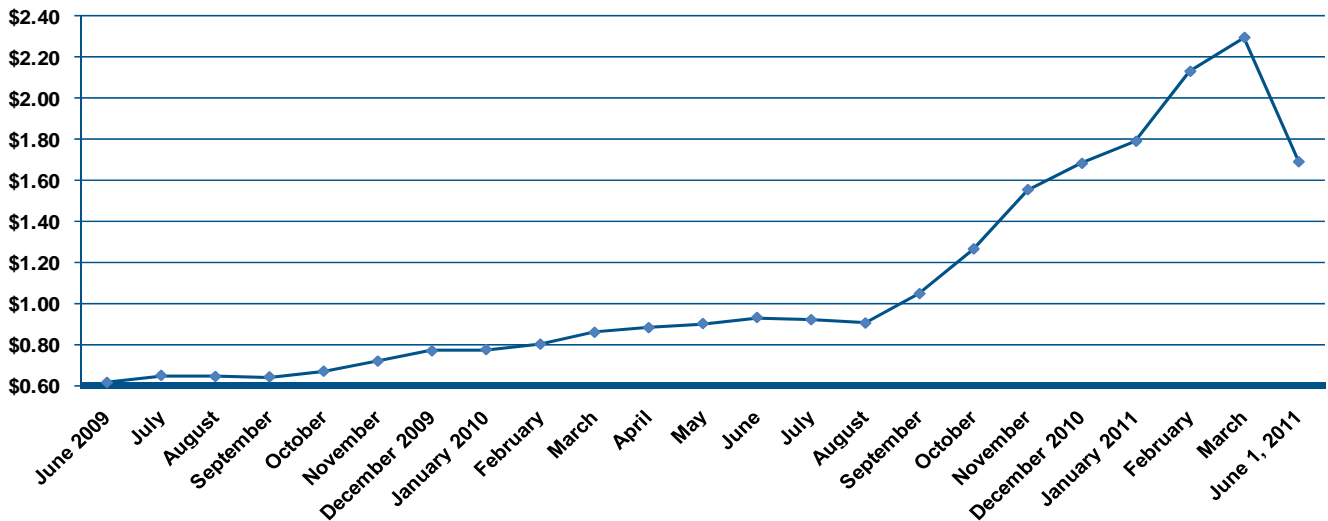
# PRICING TRENDS

## COTTON

The cotton market in China has been made to cope with shrinking profits in recent months, in large part due to Indian competition. Industry sources quote profit margins at less than 20%, with half of all smaller enterprises experiencing declining profits, despite a 15% export tax rebate. Furthermore, widespread closings among smaller Asian operations has led to consolidation within the market. With annual salaries for cotton workers increasing an average of 50% and cotton yarn prices increasing 25% on the Chinese market, the Chinese juggernaut may be loosening its grip on the worldwide cotton market.

The seemingly unshakeable U.S. cotton market of 2010 and early 2011 has lost footing in recent weeks. While Plexus Cotton Ltd. reports that sales for the 2011 and 2012 season grew by 74,600 bales during the first month of May 2011, to total 5.7 million statistical bales, order cancellations have also run rampant due to falling demand, and it is unlikely that the U.S. will hit USDA export quotas. In fact, export sales have declined over the course of the year, as cancellations totaling 49,300 bales offset new sales of 44,200 running bales. As a result of the poor export market, cotton futures on the New York market for July delivery dropped 50 cents to approximately \$1.47 per pound in early May. The Cotlook A Index fell precipitously throughout May in lockstep with falling oil prices, which caused a domino effect throughout commodity markets, as traders moved from commodities to the relative safety of cash and bonds. The Cotlook index represents the average of the five cheapest quotations for principal upland cottons traded on the international market:

**Monthly Average Cotlook "A" Index Pricing Trend**  
**June 2009 through June 1, 2011<sup>1</sup>**  
**Dollars per Pound**



Note:

(1) Monthly averages for April and May are unavailable.

Growing negative sentiment regarding the export market has led to low levels of purchasing from mills. Textile World reports that domestic inventories are down 35% from 2007 levels. Cotton futures are expected to continue their slow descent back toward historical levels. Current prices have fallen a similar path downward since the Cotlook "A" reached an all-time high of \$2.44 per pound on March 8, 2011. Cotton prices declined more than 22% in April, and continue to search for a bottom in the wake of news that the worldwide estimate of cotton demand has been reduced by nearly a quarter of a million tonnes.



# PRICING TRENDS

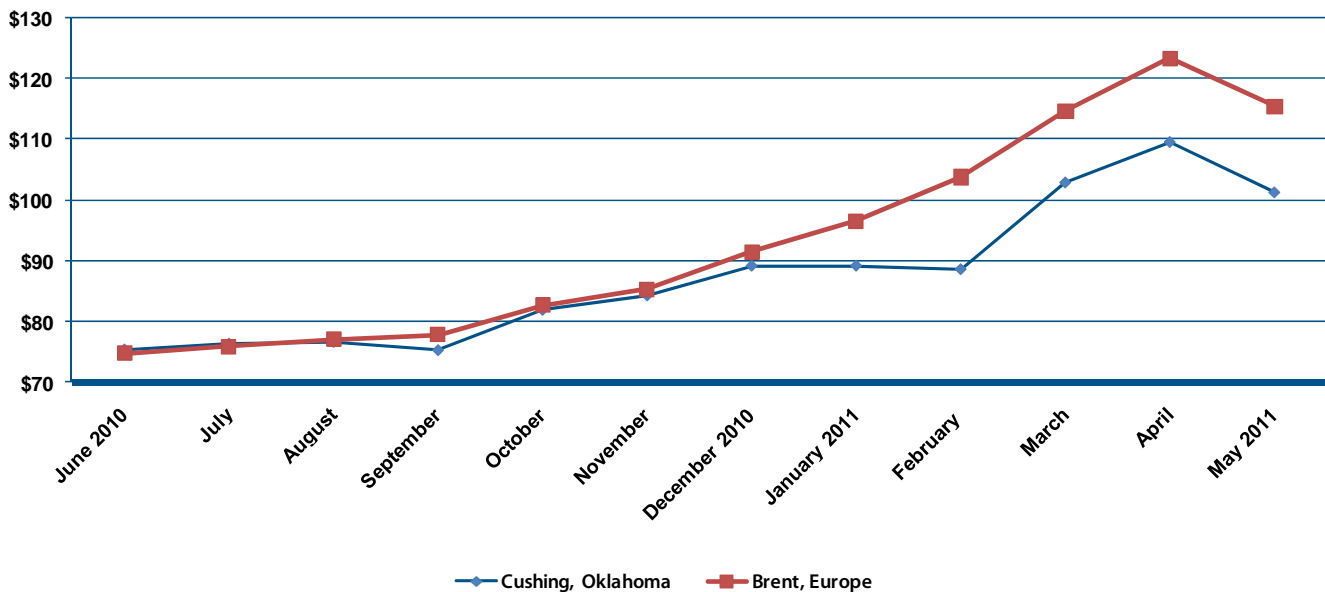
## SYNTHETIC FIBERS

As stated, the recent fall in crude oil prices had a domino effect on most commodities, including cotton. Synthetic fibers, the majority of which are produced with feedstocks from oil, were no different. However, the short term decline in prices belies the overall upward trend for both cotton and synthetic fibers over the past year. Products such as polyester staple fiber remain well above historical pricing levels due to the upward pricing trends for both oil and cotton during the fourth quarter of 2010 into the first quarter of 2011.

While feedstocks and export demand have historically played larger roles in price fluctuations for synthetics, the price of cotton has been just as important of a driver for products such as polyester stable fiber, as manufacturers continue to seek more cost effective alternatives to cotton. However, the relationship between synthetic fibers and crude-based feedstocks cannot be overstated. PCI Fibres cites a 45% increase in feedstocks for polyester, including purified terephthalic acid and monoethylene glycol. Other factors influencing pricing for these products are weather related, including the tsunami in Japan, which resulted in the closure of two out of three paraxylene manufacturers, and tornadoes in the Midwest United States, which caused several plant shutdowns domestically. However, the consequences of these natural disasters have not had significant impacts on pricing.

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. Market prices for nylon fibers are most impacted by benzene, polymide, and caprolactum, while polyester's major inputs are purified terephthalic acid, paraxylene, and monoethylene glycol. As the majority of these raw materials may be traced to crude oil and natural gas derivatives, rises in market prices during the first quarter of 2011 led to higher feedstock costs.

**Crude Oil Monthly Spot Prices**  
June 2010 through May 2011  
\$ per Barrel



# PRICING TRENDS

## APPAREL

Rising labor costs in Asia, combined with skyrocketing freight and raw material costs for overseas manufacturers, are beginning to allow for more competitive domestic apparel prices. Furthermore, a greater number of small-scale operations in the United States allows for better capacity when it comes to customization. As a result of production shortages in Asia, lead times from these producers have been lengthened, and manufacturers, particularly larger Chinese firms, are less enthusiastic about filling apparel orders for smaller U.S. operations.

As the cost of domestic fibers begins to level off and drift back toward historical levels, a more localized supply chain will increase the attractiveness of domestic apparel production. In addition, the closed-loop supply chain model of certain U.S. apparel manufacturing operations allows for greater transparency and accountability, as well as a lower degree of variability between products, as international producers often source raw materials through brokers far removed from fiber manufacturing.

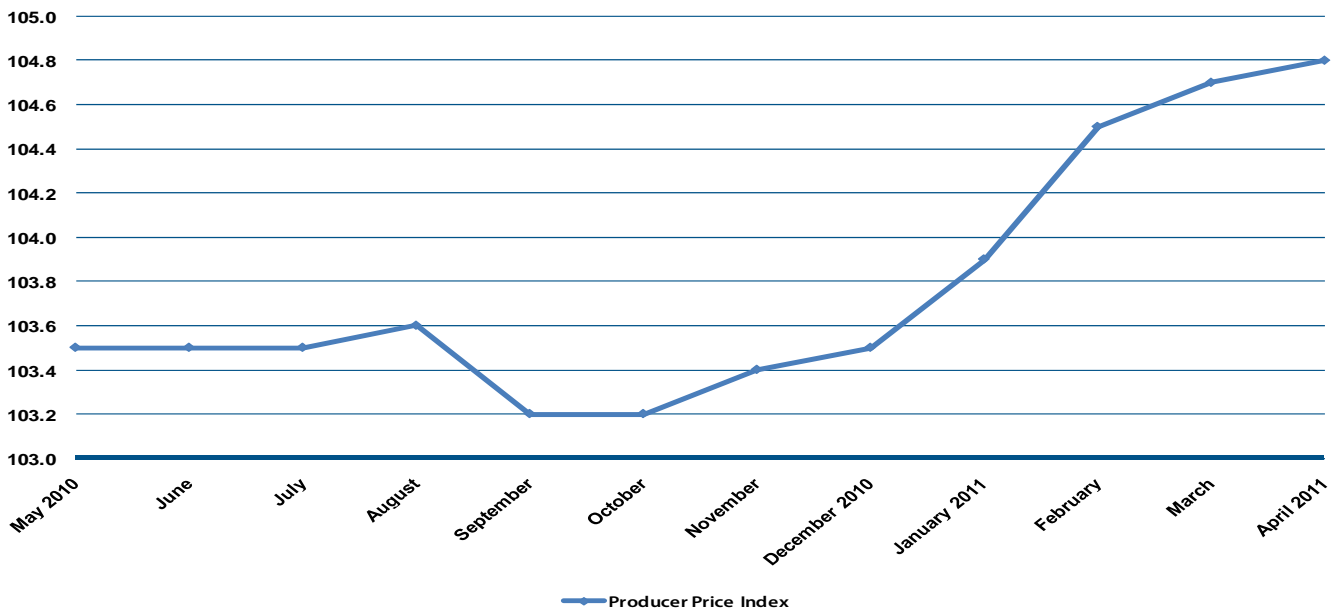
However, despite rising costs in the Chinese market, domestic producers have reached a limit in terms of absorbing rising production expenses. Many domestic producers have outpaced Chinese competition in terms of selling price increases, which have ranged from 3% to 10% for cotton-based products.



While Chinese price increases will slow Chinese exports, the U.S. will continue to import, though at perhaps subdued levels, as countries such as Vietnam, Cambodia, and Bangladesh remain far below domestic pricing.

The pass-through of rising costs has landed in the collective lap of apparel retailers worldwide. According to a recent study by research firm AlixPartners, average apparel inflation has averaged approximately 17.4% for global retailers, with inflation rising over 30% in some areas. Retailers have worked to resist price increases, albeit unsuccessfully, while others have sacrificed product breadth, complexity, and quality.

**Apparel  
Producer Price Index  
May 2010 through April 2011**



# TEXTILES AND APPAREL REFERENCE SHEET

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Pricing trend changes for the first quarter 2011 versus the fourth quarter 2010 are as follows:

	% Change
<b>Cotton</b>	72%
<b>Paraxylene</b>	50%
<b>Feedstocks</b>	
Oil	16%
Natural Gas	2%