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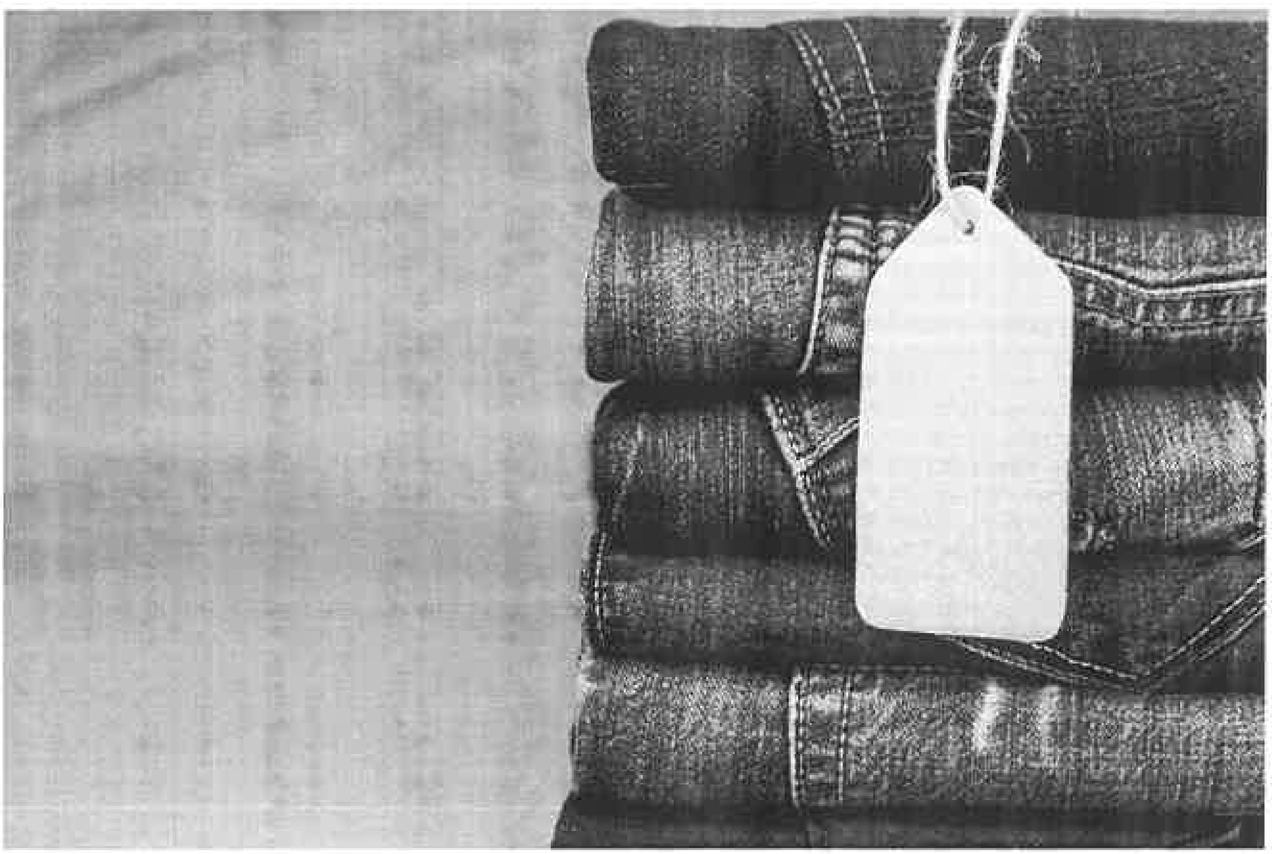
Raw Material Price Pressures Are Rattling Through the Supply Chain

By Arthur Friedman



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Raw material prices are up almost across the board, imposed tariffs are adding additional costs and uncertainty reigns in trade–all of which, unsurprisingly, is causing concern throughout the supply chain.

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For the first times in years, fiber and fabric companies are trying to figure out ways to hold price increases down and brand executives are telling their customers they have little choice but to pass along the increased costs.

The average global price for cotton, as measured by the Cotlook A index was at 89.4 cents per pound at the beginning of the year before rising to a high of $101.7 in mid-June before and then settling down to still-high 94.7 cents by the end of the July. The price increase was primarily caused by real and proposed threats of tariffs in the U.S.-China trade war, strong demand and increased trading in forward contracts in anticipation of crop failures.

Polyester prices increased at the beginning of the first quarter this year due to high oil and raw material prices, Lenzing Group noted in a recent market analysis. At the end of May, falling oil prices and weakening demand pushed the price below beginning of the year levels. However, compared with the first half of 2017, polyester prices still increased by an average of 23 percent.

Brands pinched

On a recent conference call discussing second quarter earnings, Hanesbrands CEO Gerald W. Evans Jr., said the company's international gross margin was in part offset by higher input costs. In the quarter, the company experienced $11 million in raw material inflation, Evans noted.

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"We're no longer a cotton-dependent company as many people often think we are, and this is not just a cotton question," he said. "This is general inflation that comes with a strong economy and the pressure on input costs, and you see it coming across oil, you see it coming across packaging materials and you see it coming across cotton. This is natural inflation, and so, it will touch all the products. That's why our retailers are seeing it come through their own supply chains, as well. And so, we are pricing to offset that."

For Gildan Activewear, it's been a similar story of increased costs.

Discussing margins with analysts, Gildan president and CEO Glenn J. Chamandy, acknowledged that input costs are higher, but "it's a function of working with our partners," and realizing that the sourcing landscape is changing, he said.

"As you look at what's happening in China, what will end up happening is that there's going to be significant inflation in areas where people will go to," Chamandy added, noting that Vietnam or Bangladesh or Myanmar, might have lower wage rates, but they also have a less structured business environment than China that leads to higher costs.

At Columbia Sportswear Co., with 38 percent of its sales outside the U.S., CEO Timothy P. Boyle said the company is "not directly impacted by U.S.-China trade barriers."

"We rely on a diversified sourcing base mostly across Asia and have considered our diverse and flexible supply chain to be one of our strengths," Boyle said. "In 2017, China represented less than 20 percent of our total imported value into the U.S. To date, newly announced tariffs in the U.S. have not targeted our primary product categories. In addition, because a high percentage of our fall 2018 products will have been shipped in the coming weeks; if tariffs are raised on our primary categories, the impact would likely be felt mostly in future years."

However, Columbia will face climbing costs related to some accessories, and Boyle said the company is projecting "immaterial" costs increased for construction related efforts and fixturing thanks to steel and aluminum tariffs.

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"That said, the escalating global trade battles have the potential to be very disruptive to our business, as well as our vendors, our customers and to many of the countries where we do business, including the United States," Boyle said. "Apparel and footwear products already carry some of the nation's highest tariffs, averaging in the double digits. To add to those high tariffs with additional punitive measures would not only have a detrimental impact on our business, it would represent a significant tax on American consumers."

China, however, continues to be an important market for both manufacturing and sales. Columbia has a long history of sourcing in China and Boyle said the company remains committed to maintaining its key partnerships there.

"We will continue to monitor trade debates closely and engage with policymakers to seek constructive solutions," Boyle said.

Impacts at the fiber level

Looking down the supply chain, Kevin Hall, chairman and CEO of Unifi Inc., said, "Given our top-line performance and initiatives to counter the recent rise and acceleration of raw material costs, we were able to make some progress on normalizing profitability, even as significantly higher raw material costs remained a substantial headwind. Crude oil prices were 50 percent higher in the fourth quarter of 2018 compared to the end of fourth quarter 2017...We have more work to do over the next couple of quarters for pricing to catch up to the high level of input costs."

In its U.S. business, Hall said, Unifi has made improvements despite the ongoing market headwinds led by increased raw material costs and ramped up regional competition. These factors considered, Unifi was still able to produce another quarter of overall revenue growth on polyester, which was up 3.4% compared to the prior-year period.

"There's a growing recognition in the conversations that costs have gone up," Hall told analysts. "And when we were first out, there was, I think, a real desire to just push back on that and for that not to be true. But I think now everybody sees that it's a higher cost environment, so everybody is working through this now, and I think that's part of our partnership role, to really work with our customers and figure out how to navigate our higher cost environment."

Speaking to the tariff wars, Hall said, "There is great uncertainty in this space, but we haven't seen strong evidence that current proposals and negotiations will have a material impact on either our overall cost structure or our competitive position. However, we are still assessing the impacts that current proposals and trade negotiations might pose on both in the short and long-term, and we are preparing to take appropriate action should any impacts materialize."

Lenzing, the wood-based fiber producer, also sees challenging market conditions for the second half of 2018. In addition to the price pressure on standard viscose, the prices of some key raw materials, like caustic soda, are still at a very high level, and exchange rates continue to be volatile.

Reporting in its recent earnings, Lenzing said earnings before interest, taxes, depreciation and amortization fell 28.1% to 194.8 million euros ($225.75 million) in the first half of the year, mainly due to price increases for key raw materials and higher energy prices. Prices for standard viscose were volatile in the first half, rising 3.2% primarily resulting from the announcement of new capacities in the current year. Prices for wood-based specialty cellulosic fibers like lyocell and modal "continued their positive development as demand remained strong," Lenzing said.

So far, the price pressures in the market either haven't fully made their way through the supply chain or they're being absorbed before they reach the consumer.

The Bureau of Labor Statistics reported in its Consumer Price Index that July retail apparel prices fell 0.3% from a month earlier. Women's apparel prices declined 2 percent, girl's clothing prices were down 0.7% and prices for boys' apparel fell 3 percent. Men's wear bucked the trend with a 1.7% increase.

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