

Shoppers won't get break from cotton price dip

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(Reuters) - U.S. shoppers who bought jeans, T-shirts and socks lately have had to shell out more cash. They'd better get used to it.

Even as cotton prices recede from all-time highs set in the spring, retailers and clothing makers are set to keep most of the price rises they implemented earlier in the year, when they sought to contain the damage to margins. And most will only offer discounts when they face pressure from their rivals.

Store chains and their suppliers avoided raising prices as long as they could, fearful of a backlash from consumers still dealing with high unemployment and gasoline prices. But just as they did not pass on all their cost increases, retailers and clothiers won't hand over all their savings.

In fact, many will try to hang on to any margin gains next year as a cushion against other rising costs, betting that shoppers are growing used to paying a bit more after a decade with little clothing inflation.

"The reality is that we American consumers have enjoyed low prices on apparel for some time," Robert Shearer, chief financial officer of VF Corp,

told Reuters in an interview on Monday. VF makes the moderately priced Wrangler and Lee jeans brands.

VF's gross margin, which measures the profitability of goods sold, shrank 1.2 points to 45.3 percent in its most recent quarter, due entirely to its jeans business, which only makes up a quarter of company sales.

Gap Inc in May said product costs would go up 20 percent in the second half of 2011, and it could not increase prices enough to make up for that.

Cotton futures trading on ICE Futures U.S. surged to a record high in March after climbing nearly three times in value from the previous year, when the spot cotton contract sat roughly around 80 cents per pound. The contract has since dropped by more than half, but is still 40 percent above levels of two years ago.

How much prices rise depends on the item and how much cotton is in it. But NPD Group's chief retail industry analyst Marshal Cohen estimates that basic socks, underwear and jeans prices have gone up by 10 percent or so.

An extra \$3 on a pair of jeans may not seem like much, but on a \$30 pair of Wranglers, it is noticeable -- and can be a hardship for shoppers who also have to shell out 23 percent more on average to fill a tank with gasoline than a year ago.

VF said Monday that U.S. jeans sales were up slightly in dollar terms, thanks to moderate price increases, but it sold fewer pairs, illustrating the fine line clothes makers and stores must walk.

AlixPartners managing director David Bassuk estimates that retailers were at best able to pass off half of their higher costs to shoppers, sharing the hit to margins with suppliers for the rest.

Now VF, Gap and other companies that sell clothes using a lot of cotton -- like American Eagle Outfitters Inc and Nike Inc -- are telling investors that their gross margins should improve starting in the second half of 2012.

"The benefit from cotton costs going down is going to be reflected in margins. They are not going to lower the prices," said NPD's Cohen.

And Perry Ellis International Inc Chief Executive Officer George Feldenkreis pointed out that cotton isn't the only cost that has risen: labor costs in China, where most clothing bought by U.S. consumers is made, are up, and higher gas prices have raised the costs of getting products to stores.

Given the nine-month-to-a-year lead time in the supply chain, prices will in fact continue to increase gently into the spring. After that, they should stabilize at higher levels.

"There won't be a drop in retail prices, but price increases will stop" said Nate Herman, vice president of international trade of the American Apparel & Footwear Association, which represents some 700 U.S. clothing companies.

NO ESCAPING COTTON

One thing that may help rein in prices for consumers, to some extent, is competition. Consumers can buy basics like blue jeans from any number of vendors, making higher cotton costs scary for retailers and manufacturers.

Jones Group Inc for one is currently trying to get out of jeanswear, a business which stagnating sales and lower margins has made no longer worth pursuing.

Some companies like Levi Strauss & Co and HanesBrands Inc are experimenting with organic fiber, made of flax and hemp, to contain cotton costs.

But so far, such efforts are rare in the apparel industry.

VF looked into different fabrics but ultimately decided it had to stick to cotton only.

"Consumers, when they pick up a pair of Wrangler jeans or Lee jeans, have certain expectations," VF's Shearer said. Experimenting with how jeans feel would "harm the brand."

But there is another factor that could push prices back down: continued weakness in the U.S. job market and overall economy.

Unemployment is still high and retail sales in recent months have shown only slight growth, meaning some retailers might have to cut prices again, especially if sales in the upcoming holiday season were tepid and rivals panicked.

"The economy and the lack of a recovery will be more likely reasons for prices coming down," NPD's Cohen said. "Retailers are going to get competitive on motivating the consumer."

<http://www.reuters.com/article/2011/10/25/us-usa-retail-cotton-idUSTRE79O66B20111025>