Inflation Could Return To the World of Fashion

by EVAN CLARK with contributions from ARNOLD J. KARR
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- To The Point: A Digest of Recent Earnings Results

Life is getting more expensive in the fashion world, and consumers could get stuck with some of the bill.

“The era of apparel deflation is now over,” said Richard Noll, chairman and chief executive officer of Hanesbrands Inc.

Cotton prices are up more than 50 percent from a year ago, labor and transportation expenses are rising and factories that closed during the recession remain dark, keeping a cap on supply as demand perks up. To top it off, Chinese officials have become more willing to allow the yuan to appreciate against the dollar, which could make goods made in the country even more expensive.

“You’re starting to see price increases come through the entire supply chain, not just from commodity costs, but also from a supply and demand imbalance,” Noll said. “There is no question that costs are working their way through the supply chain and you will see a broad-based increase, I think, in retail prices for apparel in 2011.”

The industry is also working on tighter inventories and pushing suppliers for quicker turns. Noll said his company had spent $15 million more on air freight so far this year to bring in goods from Central America and Asia. “When you’re running with such short lead times, you need to speed it up and air freight is just a lot more expensive than ocean freight,” he said.

In that vein, Columbia Sportswear Co. also said Thursday it had incurred increased costs to “expedite production and delivery of fall orders to customers.”

Retailers and vendors would like nothing more than to pass the additional expense on to consumers. That will be a tall order given an unemployment rate of 9.5 percent, a sharp downturn in consumer confidence over the past month and what Eric Wiseman, chairman and ceo of VF Corp., described as an apparent “pause” in the recovery.

Still there’s a growing sense that the pressures building in the supply chain will sooner or later make their way to the consumer. It could be a rude awakening after more than a decade of shrinking price tags.

According to Commerce Department figures, apparel prices hit their high in 1992 and have fallen each year since with just two exceptions, including last year when prices inched up 0.6 percent. Even with the increase, apparel in 2009 cost a staggering 20.4 percent less than it did 17 years earlier.

“It does feel like perhaps we are at an inflection point where the consumer will likely see some pricing increases,” Bob Shearer, VF Corp.’s senior vice president and chief financial officer, told WWD. “The cost side is a little more certain than the pricing. Pricing will be part of our equation as we look into 2011 and see higher costs.”

Vendors and retailers have always wrangled over price and in many cases carried negotiations through the season and beyond as retailers come back to suppliers looking for markdown money to compensate for lines that did not perform as well as expected.

VF, the country’s biggest producer, is relying on its brands, scale, network of owned factories and broad base of suppliers to mitigate cost pressures building in the supply chain. Less than 25 percent of the firm’s goods come from China, where the changing labor dynamic has pushed prices up significantly.

The company said costs will be down this year versus last year, but will begin to inch up a few percentage points in 2011.

“The cost of cotton and the ultimate cost of denim, for us, yes, it’s a factor,” Shearer said. “The cost of copper and the cost for zippers for us is a factor.” Materials account for 50 to 60 percent of VF’s product costs, while labor accounts for about 20 percent.

Shearer said investors are closely watching the cost of cotton, which has risen about 53 percent over the last year to 76 cents a pound. But he said general inflation in China spurred on by higher labor costs was the bigger factor for VF.

“We’re seeing everything happen at once,” said David Bassuk, managing director at AlixPartners’ retail practice. “There’s rising prices, but what we’re also seeing and hearing very strongly from the consumer that she’s not willing to pay more. The retailers and the brands are seeing it from both sides. Only the strong will survive. There will be more and more players not making it through this and that’s retailers, brands and factories.”

“This is essentially going to affect everyone,” said Scott Tuhy, debt analyst at Moody’s Investors Service. “At the end of the day, higher prices will probably need to be passed on to the consumer. The question is how will the consumer react to it. We’ve had years of apparel deflation, trying to move prices up is going to be a challenge. If the consumer psyche improves and people are willing to move up, that’s an environment that’s a little bit easier.”

The renewed focus on costs came as VF reported second-quarter earnings that beat estimates and lifted its guidance Thursday, which Hanesbrands did as well following the close of the markets on Wednesday. Reporting after market Thursday, Columbia beat estimates but reported a wider loss for the quarter.

Buoyed by encouraging earnings news in and out of the apparel and retail sectors, the S&P Retail Index staged a 2.9 percent rally, retaking the 400 mark and landing up 11.47 points at 404.62. It was the first 400-plus close for the index in a week.

The major indices advanced strongly, although all fell short of the retail index’s percentage gain. The Dow Jones Industrial Average added 201.77 points, or 2 percent, to close at 10,322.30. Like VF and Hanesbrands, companies outside the sector — including Caterpillar Inc. and AT&T Inc. — both beat estimates and raised guidance, although Amazon.com Inc. shed more than 10 percent of its share price in after-hours trading following an after-market earnings miss.