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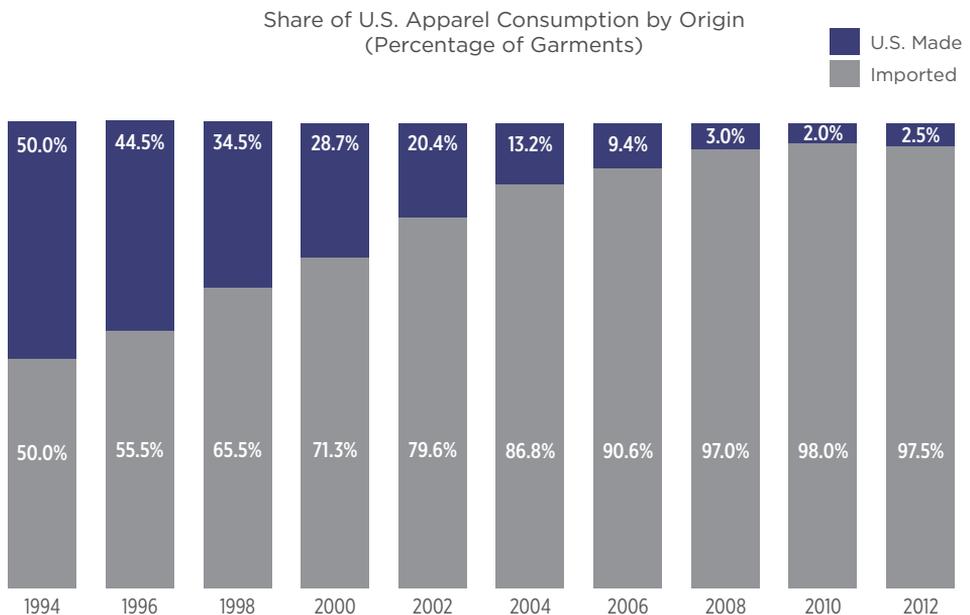
MADE IN THE USA?

American apparel manufacturing writ large may be a thing of the past, but brands and investors should take notice of pockets of life in key niche spaces

Unless you're a grandstanding politician, the notion of American apparel production may feel like it was declared dead years ago. And there is some truth to that way of thinking: Our share of domestically manufactured apparel has dropped from 50% in 1994 to 2.5% in 2012.¹ (See Exhibit 1.)

This trend shows little sign of reversing, as market forces like labor costs, capacity and specialized capabilities conspire to keep the vast majority of apparel manufacturing overseas.

EXHIBIT 1: Domestically Manufactured Apparel Has Fallen Significantly



Source: American Apparel & Footwear Association

But despite this gloomy diagnosis, not all apparel categories will fare equally when it comes to re-shoring. In fact, we believe some types of clothing manufacturers can build compelling business theses for bringing manufacturing back home—and

breathing new life into smaller corners of the American apparel manufacturing space.

We estimate that domestic apparel manufacturing will grow at an annual rate of 4% to 6% through 2017, building on a small uptick in momentum that started post-recession

EXHIBIT 2: Best Candidates for Re-Shoring

Consider Domestic Production

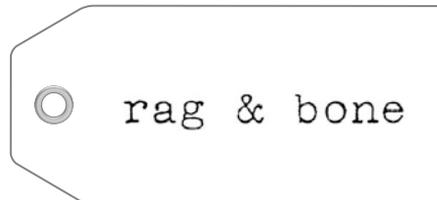
Size: Small to mid size

Desired speed to market: Fast

Categories: Higher-end contemporary fashion, premium suits and dress wear, premium denim, accessories, localized and specialized products (e.g., dance or cheer apparel, sports team- or college-branded apparel)

Exceptions: Large businesses that may benefit from a select “Made in USA” product line

Examples:



There are two big reasons American-based production makes good sense for select categories: positive consumer reception and operational efficiencies.

and a growing demand for higher-quality, American-made products and faster fashion. This growth in volume will come despite a likely continued decrease in manufacturing facilities, which decreased 12% from 2009 to 2012,ⁱ suggesting an increase in efficiency.

The vast majority of this manufacturing growth is projected to come from a few select categories that can benefit most from moving production closer to the consumer: small or mid-sized contemporary fashion and premium denim, accessories, and specialized or localized products. Think dance or cheer apparel and sports team or college paraphernalia. (See Exhibit 2.)

There are already several American-made success stories in these categories. High-end menswear, especially suits, is an area of particular focus. For example, in 2013, Men's Wearhouse acquired American clothing brand Joseph Abboud for \$97.5 million in an effort to expand its "Made in the USA" collection. Also in 2013, premium menswear brand Samuelsohn bought high-end suit maker Hickey Freeman's Rochester-based production facility and license based on the belief that the company can grow 50% in three to four years while remaining 100% American made.

The domestic premium denim market is experiencing similar growth. For example, True Religion is seeing a significant sales

bump, driving its 51% employee growth between 2009 and 2012. High-end brand rag & bone is also experiencing a surge in demand behind its continued store rollout.

In the accessories space, Walmart recently announced that it is expanding its "Made in the USA" program by investing \$28 million in existing production facilities to produce No Nonsense leggings, tights and socks. Also in 2014, Renfro Corporation invested \$14 million in U.S.-based production capacity for sock manufacturing. And preppy clothier Vineyard Vines produces its ties, tote bags and belts in the United States and, thanks to significant sales growth in 2013, will be increasing its local production capabilities to meet this new demand.

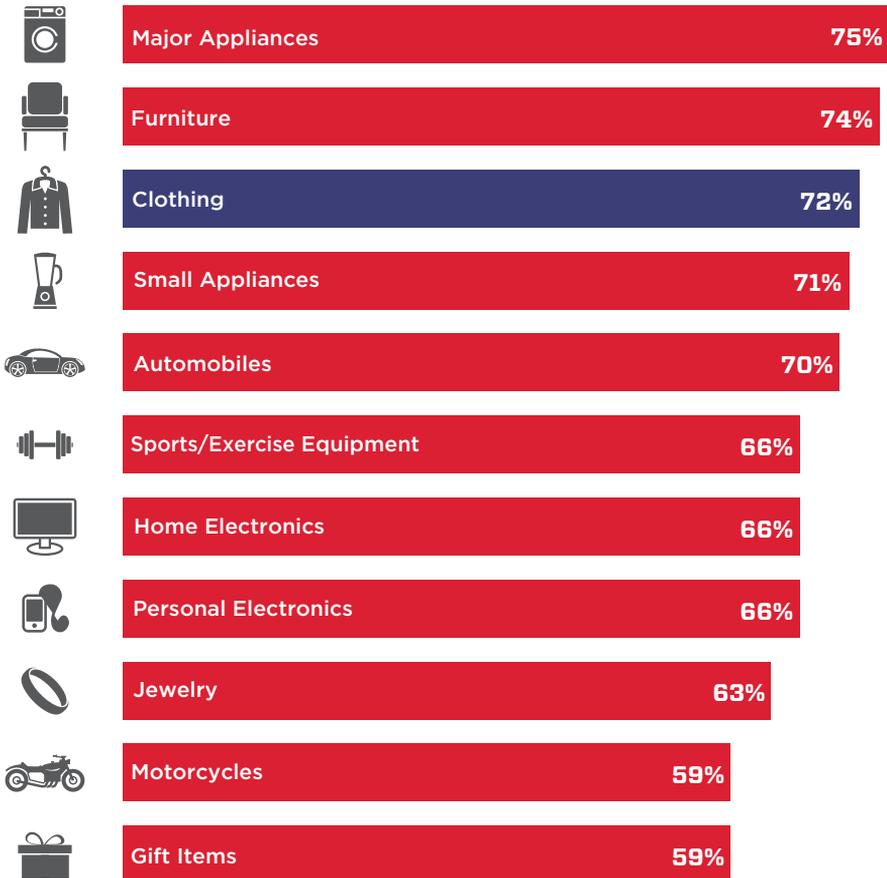
What's driving all this growth? There are two big reasons American-based production makes good sense for select categories: positive consumer reception and operational efficiencies.

Positive Consumer Reception

The "Made in the USA" stamp helps boost sales. In fact, 72% of Americans said it was important or very important that their clothing be made in the United States.ⁱⁱ And apparel was the third most important category for "Made in the USA" products, as shown in Exhibit 3.

EXHIBIT 3: Almost 75% of Americans Prefer Buying American-Made Apparel

Importance of Purchasing “Made in the USA” Product by Category
Percentage of Respondents Selecting “Important” or “Very Important”



Source: December 2012 Harris Poll

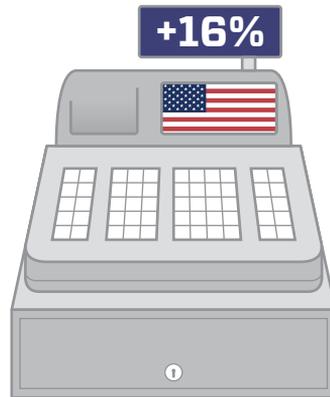
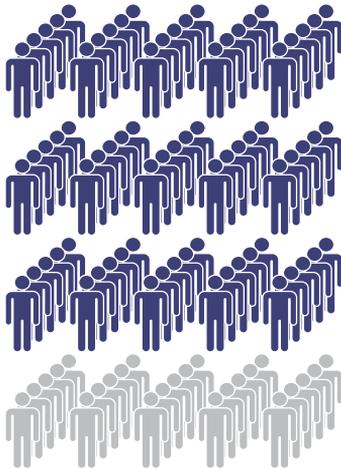
Not only do Americans say that buying American-made products is important to them, they are often willing to pay more to do it. In fact, 75% are willing to pay a premium for “Made in the USA” products, and 60% say they do just that every month.ⁱⁱⁱ (See Exhibit 4.)

And while this patriotic sentiment can be expected at the tail end of a recession because it translates into U.S. jobs, we

believe the “Made in the USA” trend is here to stay, as consumers perceive American-made goods to be of higher quality and more authentic.

These sentimental reasons also suggest that there are cases when it may make sense to produce select American-made product lines for the positive brand image (think Levi’s), even though a brand may not be a great fit operationally for re-shoring.

EXHIBIT 4: Many Americans Willing to Pay More to Purchase Local



75% willing to pay an average premium of **16%** for American-made products

Source: Made in USA Foundation, industry reports

Operational Efficiencies: Speed, Accuracy and Quality

Moving production back to the States has the potential to dramatically improve the right company's entire supply chain and production cycle.

Starting with product development, re-shoring lets brands review and turn samples more quickly by moving the factory significantly closer to the designers, speeding up the design process.

From there, re-shoring enables a brand to place smaller orders that may be deprioritized or rejected by large international factories. For example, School House, a high-end university-licensed clothing company, recently moved production back to the United States due to its low priority with large Sri Lankan factories. Small or mid-sized companies that may have trouble reaching minimums and gaining leverage with overseas factories should benefit the most here.

Re-shoring also facilitates improved quality control by allowing for greater oversight, perfect for higher-end products. And shorter

lead times can help high-fashion brands capitalize on emerging trends. "It's so convenient ... you can react so much faster to the market," says a rag & bone designer. Plus, re-shoring helps specialized products companies efficiently meet short-term demand while carrying less inventory and reducing markdown risk. Domestic production can easily save six to 11 weeks on average out of a 39-week process for basic woven apparel. These savings take on heightened importance in today's retail industry, as consumers are now accustomed to speedy, easy access to a constant stream of new products.

Yes, labor is more expensive in the United States, but wage increases in China (106% from 2008 to 2013^{iv}) have made the country less competitive and driven brands to look elsewhere. And when factoring in reduced shipping, inventory holding and markdown costs, American production starts to make increasing sense for some brands, as illustrated in Exhibit 5.

EXHIBIT 5: American Manufacturing Isn't That Much More Expensive



Materials



Trim and Hardware



Labor



Duty



Shipping

Illustrative Cost Breakdown for Premium Cotton Garment

UNITED STATES



ASIA



Comparisons do not include:

- > Costs of holding inventory
- > Opportunity cost related to missed sales related to longer lead times
- > Lower markdown risk

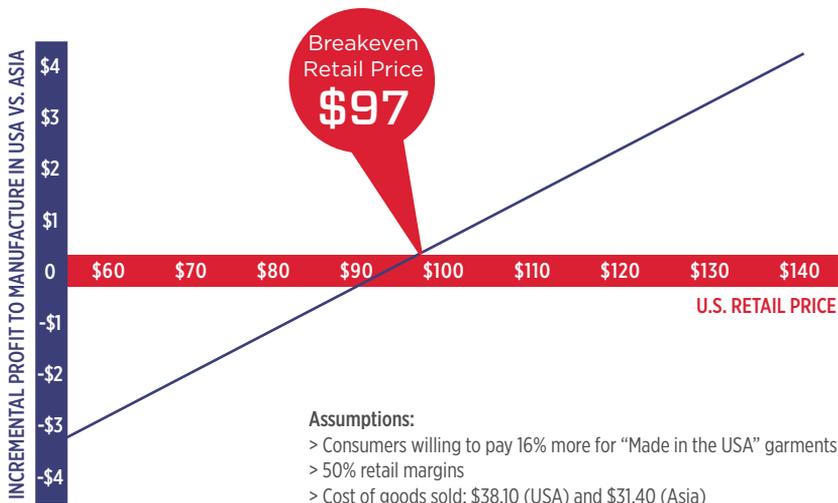
Source: *The New York Times*

In fact, American production can actually deliver increased profits, especially for higher-priced items. Assuming that consumers are willing to pay on average 16% more for American-made goods (see Exhibit 4) with the cost of goods sold as shown in Exhibit 5, along with a standard 50% retail margin,

American-made products can actually be more profitable, especially if they are sold at higher price points. (See Exhibit 6.) This lends further credence to the idea that high-end and contemporary fashion brands may find particular benefits to re-shoring production.

EXHIBIT 6: American-Based Production Can Deliver Higher Profits

Illustrative "Made in the USA" Breakeven Retail Price for Premium Cotton Garment



Given all this, it's no surprise Brooks Brothers re-shored 70% of its suit production due to increasing costs. And PVH is motivated by the same reasons. "For the first time in 50 years, PVH is now manufacturing shirts back in the U.S., in North Carolina today," said chief supply chain officer Bill McRaith at an American Apparel & Footwear Association conference. "We are scaling up quickly because it's financially viable, not because it's a good thing to do, not because we can make a statement, but because it financially makes sense to go make those products in that location. We can respond to the consumer so fast. It is completely irrelevant how much extra I have to pay for the product. I always make more when I sell. I may have to pay \$5 extra [to produce it in the United States], but I will make \$20 at retail."

Looking Ahead

Because of these two key factors, we expect to see continued growth in American-made apparel, especially in key categories like contemporary and high-end fashion, denim and suits, accessories, and localized or specialized products.

In fact, we are already seeing additional signs of life on the horizon. This year, men's shoe brand Allen Edmonds announced its intentions to expand into apparel with all

American-manufactured products. And the SEAMS Association is working with a major retailer of mid-priced apparel and lingerie to begin manufacturing significant volumes in America. The association is also in discussions with three "household name" apparel brands to begin U.S. production within three to five years.

For investors and brands, the lesson may be surprising, but don't assume American manufacturing is a thing of the past. For certain categories and brands, the combination of brand cachet and operational efficiencies American production can deliver makes it well worth taking a deeper look. ❖

AUTHOR

Dan Goldman, Senior Manager
daniel.goldman@kurtsalmon.com

- i American Apparel & Footwear Association
- ii Harris Poll
- iii Made in USA Foundation
- iv U.S. Bureau of Labor Statistics