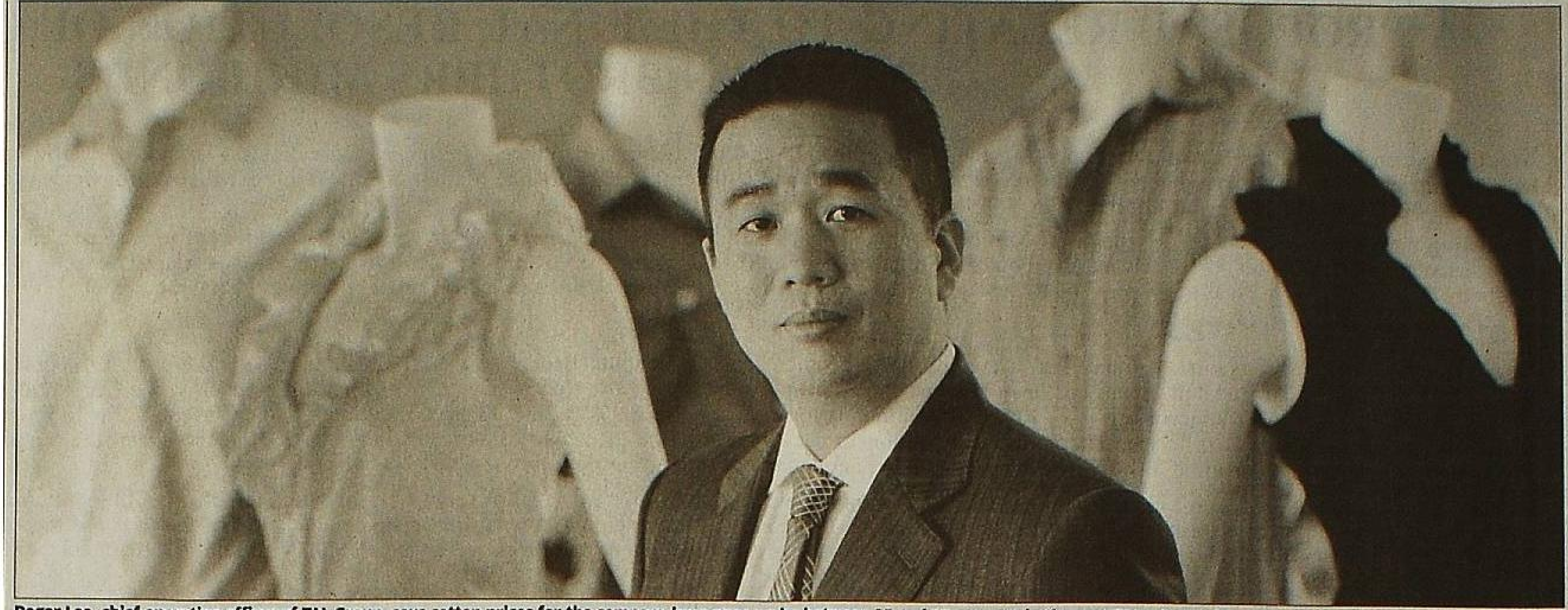


Roger Lee, chief operating officer of TAL Group, says cotton prices for the company have gone up by between 25 and 50 per cent in the past 12 to 18 months. Photo: Dickson Lee

Rising cotton prices may bring an end to the era of the US$2 T-shirt

Amanda Lee

The days of buying a T-shirt for just US$2 might be over as cotton prices surge to record highs and forecasts are that they will stay there.

For a decade the cotton price has been relatively stable, at between 50 to 80 US cents for a pound (See graph).

But benchmark "front month" cotton futures contracts are now trading at just below US$2.10 for a pound, up 50 per cent compared to the end of last year. The term refers to the contract month with an expiration date closest to the current date, which is often in the same month.

The impact of those soaring prices is already evident in profit statements from retailers.

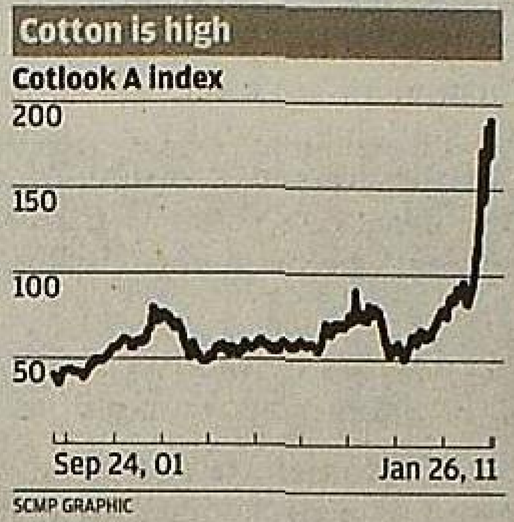
Hennes & Mauritz, which sells fashionable garments at low prices, reported a 10 per cent fall in its gross profit margin last year largely due to rising costs of raw materials. The Stockholm-based retailer, which has been growing its business rapidly in many parts of the world, said that it would not raise prices because it wanted to preserve market share.

The recent surge in cotton prices resulted from declining production, as many former cotton farmers switched to growing higher margin crops such as soya bean and corn as the financial crisis hit the global economy.

That led to a decline in global inventories of the commodity and levels were expected to remain low at the end of the 2010/11 season. At the same time demand, in particular from China, which is the world's number one producer, user, and importer of cotton, would be strong, noted food and agribusiness specialist bank, Rabobank.

China has increased its share of global demand for cotton from 25 per cent in 2000/01 to a forecast 42 per cent in 2011/12, according to the Dutch bank's report. Worse still, the volatility of cotton prices was exacerbated by mainland farmers holding stocks of cotton and speculative funds moving large amounts of cash into the futures markets, it noted.

"Even if we get a record year for production of the crop, which we are forecasting, it's still not enough to replenish the inventory that is demanded at the current level," said Keith Flury, Rabobank senior commodity analyst. "So volatility of cotton is likely to stay elevated."



Satish Lele, a vice-president of consulting firm Frost & Sullivan, believes there's rising pressure for garment retailers to lift their prices to protect margins as the costs of cotton are to remain high. While the larger and more established brands have been able to absorb the costs of raw materials and keep a lid on prices, budget clothing retailers could be at risk of losing out, he said.

"The textile industry was used to producing cheap garments for a long period of time," said Lele. "This might change."

Sitting on the top of the textile industry supply chain, yarn makers and garment manufacturers have singled out rising cotton prices as a major challenge, along with other costs, such as labour, and have raised prices, passing costs on to customers.

Hong Kong-listed Texhong Textile Group, the largest core-spun yarn maker on the mainland, said cost of sales last year rose 19.4 per cent to 4.16 billion yuan (HK$4.9 billion), driven mainly by the increase in the cost of raw materials.

The average unit selling price of yarn increased by 31.8 per cent to 24,539 yuan per tonne last year from 18,614 yuan per tonne in 2009 as a result of the rising cotton price, according to Texhong.

Privately-owned TAL Group, which makes one out of six shirts sold in the United States, said while its revenues have been in the stable range of US$700 million to US$800 million over the past few years, profit for 2011 has been forecast to be one of the poorest in history largely because of increase in fabric costs.

The group's Hong Kong-based chief operating officer Roger Lee said that fabric prices for TAL, which counts Britain's luxury brand Burberry and US-based retailer L.L. Bean among its customers, have gone up on average by 25 to 50 per cent in the past 12 to 18 months.

Margins in the textile industry are slim, typically just above 10 per cent, and surviving on producing cheap clothing could be a thing of the past.

Peter Lau Kwok-kuen, chairman and chief executive of Hong Kong-listed Giordano International, said prices on new garment styles would be marked-up. The Hong Kong-listed casual clothing retailer has been expanding its market share in the mainland's second and third-tier cities through franchising, which Lau said would help to keep its stores more localised and appealing to mainland consumers.

Giordano has said it wanted the brand to be different from the usual mass-market retailers that offer budget clothing.

"You don't want to be cornered into battling with a particular competitor," said Lau, referring to competition with global fashion chains that offer a wider range of fashion garments while keeping prices low.

"You select your opponent. It's just like in sports. If you are in the second division you won't want to pick a fight with someone in the premier league."