

From Deadwood to Hollywood

Worn by 19th Century gold miners and 21st Century gold diggers, the market appeal of denim jeans shows no signs of fading — yet.

Rough and tough gold prospectors plying their trade in the frontier territories of California were the first customers of Levi Strauss back in the days of Wild Bill Hickok.

The Bavarian immigrant, who developed the first indigo-dyed woven pants in 1850, would have been shocked that his simple sturdy jeans would in future be designed by fashion icons and craved by superstars on the fashion cat-walks of today.

In fact, even 10 years ago, denim was seen mainly as an informal apparel item, to be worn at home when the work suit was safely tucked away in the wardrobe. But in recent years it's denim that has come out of the closet with the advent of casual dressing at work. It is now regularly worn at 'dress-up' occasions, and shows up alongside business suits, at celebrity award shows, business meetings and conferences.

This new demand for denim has created a new 'premium' market, which has exploded and dragged up the average prices for denim apparel. This is in stark contrast to the downward pressure on retail apparel prices. The main reasons for this market trend are the increased purchases of denim by upper-income consumers, the availability in higher-end channels of denim in a variety of styles and fit, and an increased willingness of consumers to pay full price for denim jeans.

According to Cotton Inc., premium jeans sell for anything above \$70 but certain female consumers in the US think nothing of shelling out upwards of \$200 - 300 for a pair of coveted premium jeans. "Premium denim represents 3% of the total denim market. However,

the explosive 138% growth in this niche sector over the past year indicates a tremendous opportunity for premium denim brands and retailers alike," said Cotton Inc.

At point of sale, the world jeans market was estimated to be worth US\$49 billion in 2004 and it is forecast to grow to US\$53.2 billion by 2012 with a volume growth of 11%.

These estimates could be driven even higher by sales of premium denim. US import figures show that the dollar value of Italian and Japanese denim imports, priced well above world average, climbed 38.9% and 8.1% in the first half of 2005. This is consistent with market growth for premium denim, and US import data shows that per square metre equivalents (SME) of Italian denim cost \$4.23 while Japanese denim SME was \$4.88. Average world cost was \$2.49.

However, latest figures (as we go to press) show that Japanese denim exports started to decline in the second half of 2005. Shipments in November were poor overall despite slightly lower prices. Supplies to major markets such as Hong Kong and the US have fallen and sales to Vietnam and Italy were also weaker although China's orders rose 50%.

Overall US importers bought 30% less denim from Japan in the eight months to August 2005 compared to 2004. The overall sales shrinkage is despite slight reductions in unit values and could be the first sign of a slowdown of the premium denim market. Prices for Japanese denim exports averaged at US\$3.58 per square metre compared to \$3.62 for the prior year whilst also being a fractional 0.18% lower than November 2004.

US denim imports 1st half 2005

	Share	Million SME	% Change
Fabric	100	39.3	- 25.1
Apparel	100	450.6	+ 31.7

Japanese exports to Vietnam started to decline in November 2005 although importers there paid one of the lowest prices at just \$2.95 per square metre whilst US and Italian buyers paid, on average, over \$5 each for Japanese denim.

The latest figures also show that overall, US imports of blue denim fabrics from China have rocketed in the first month of 2006. The category, which is not covered by limits in the US, has been rising month-on-month throughout 2005 and January shipments are already around one-quarter the total for 2005. World denim shipments to the USA overall are down and consequently give China a 50% market share, but this is likely to be for apparel outside the premium denim sector.

In the first half of 2005 US denim sales were strongest in jeans purchased for over \$60.00, sales of which were up 141.7% in units and 233.7% in dollars. Consumers aged 13 to 24 bought the largest share of premium denim jeans (51%), but the strongest growth in premium denim was among 25- to 34-year-olds, according to figures from US consultant NPD. It was noted that 75% of premium jeans sales in the US are women's.

Another report by NPD in February revealed that sales of women's jeans in the US were worth \$7.6 billion, up nearly 10% on 2004 and women's premium jeans (jeans priced over \$100) accounted for 18% of denim sales in U.S. department stores, up from 12% in 2004.

The market for premium denim presents retailers the opportunity to raise jeans prices based on what consumers are willing to pay. When Cotton Incorporated asked US consumers how much they paid for jeans, the average price reported by "elite" premium denim consumers (those who paid over \$130) was \$159.57, and the average price paid by "typical" premium denim consumers (those who paid \$70 to \$129) was \$89.39.

However, when asked by Cotton Inc what was the most they were willing to pay for jeans, these consumers quoted a figure 27% higher than the actual price.

A pair of jeans that would entice these buyers to pay "the most," instead of the average price for premium denim, could potentially have brought in an additional \$178.5 million to US cash registers in the first six months of 2005.

Top five US denim apparel suppliers by region (1st half 2005)

	Import share	Million SME*	% change
Mexico	35.2	128.4	+6.2
China	15.4	56.2	+1729.2
Cambodia	4.0	14.8	+17.0
Hong Kong	3.4	12.5	- 12.4
Costa Rica	2.9	10.7	- 2.6

Source: Cotton Inc. SME*: Square metre equivalent

The fit, is it

The main reason consumers pay over \$70 for denim jeans is fit— this was the reason given to Cotton Inc. by 59% of those who bought premium jeans. In addition, more than half of ‘elite’ consumers said that when buying premium-priced denim jeans, they found it “somewhat” or “very” easy to find jeans that fit, compared with just 4 of 10 typical ‘premium’ jeans buyers — reflecting the efforts of manufacturers to engineer fits for which consumers will pay a premium.

But comfort and well-being are also a big sales story. American Fibers and Yarns Company recently teamed up with Avondale Mills to develop a new high-performance denim for active lifestyles. The fabric features a 24% blend of Innova yarn to give light-weight, durable and moisture-wicking denim.

Meanwhile, St John Knits is looking at a new way of knitting denim that has emerged in Korea. The special knitting technique mimics woven denim products in terms of durability and look, but there is not the regular draping associated with knits. The new fabric is said to be breathable and soft, but also very stable.

In Europe, soft stretch is almost a given in the women’s denim apparel market. Around 95% of all denim products for women at UK high street retailer Next have a component of stretch. Marks & Spencer has also introduced some stretch into their denim men’s wear range, but this tends to be for the older end of the male market — who like denim!

Apparel companies in Europe are now also looking beyond Turkey for their ‘locally’ sourced denim fabric. Pakistan is building eight new denim mills and local companies such as Artistic are working closely with Dupont and its T-400 chlorine resistant stretch fibre to make innovative denim products.

Europe’s biggest retailer, Hennes & Mauritz is said to be looking at switching production from Turkey to Pakistan as the mills become more advanced. But it is India and China which look likely to remain the suppliers of choice for European brands and retailers. Only last month, Raymond Ltd., India, and UCO NV, Belgium, said they would merge their respective denim businesses to create a global denim giant with an annual capacity of 80 million metres. The deal with UCO is the fourth that Raymond has concluded with a European company which

Denim fabrics from Europe (H1 2005)

	Total share	Million SME	% change
Italy	14.6	5.7	+32.0
Turkey	6.5	2.5	+101.5

also includes a joint venture with Gruppo Zambaito in Italy. Although many Italian weavers now have JV’s in China, unlike the States, Italy still remains a major supplier to its own premium denim sector.

Consolidation

There looks set to be further consolidation in the premium denim market as major apparel companies tussle for new, highly profitable niche sectors.

High-end denim firm Citizens of Humanity agreed an investment partnership with private equity firm Berkshire Partners, reportedly worth \$250 million. Berkshire now holds around 63% of the California-based denim company. Market reports suggest Citizens of Humanity had around \$100 million in sales last year and sells its jeans for \$150 or more to high-end department stores across the U.S and appears in stores such as Neiman Marcus and Barney’s.

In a separate move earlier this year, the Jeantex Group, Inc. secured \$10 million in equity financing with Cornell Capital Partners to expand its operating platform over the next two years. The deal allows the denim specialist to raise up to \$450,000 at a time by selling shares of common stock to Cornell. Jeantex CEO Henry Faham noted that the investment will fund “growth in private label manufacturing, branded sales, auxiliary denim services, and strategic acquisitions.”

One such recent acquisition was Jeantex’s deal to buy Yves Castaldi Corp. in January. The California-based firm designs high end apparel under the ‘Just Yves,’ ‘I Generation’ and ‘Instinct Yves’ brands. Jeantex acquired 51 % of Yves Castaldi Corp. for 10 million of its shares and \$650,000 in cash.

Jones Apparel Group is another company which still sees a huge amount of growth in the premium denim business even though it handed back its Polo Jeans licenses to Polo Ralph Lauren Corp in January.

This deal, which was part of a long-running lawsuit between Jones and Polo will suit both parties. But especially Jones, which can now offer premium branded denim products to compete with Polo Jeans, which the license deal did not allow.

It also gets rid of Polo Ralph Lauren’s contractual right to take back the Polo license in 2010 at 80 % of fair market value.

Jeff Lubell, president and CEO of True Religion Apparel says his company sees a 38% to 40 % growth rate in 2006 on the back of its premium jeans business. Its strategy is to increase its penetration globally by going into Latin America, Central America, Eastern Europe and going deeper into Asia. He also wants to add 10 to 12 new distributors this year and increase distribution in Russia.

Will the market crash?

Overpriced denim could be described as an essentially fickle market. And market research by Cotton Inc. agrees with this statement. It found that in the US, although 85% of premium buyers said they would purchase their current brand of jeans again, 84% expressed willingness to try a new brand, indicating that brand loyalty is shallow, and that these buyers will gravitate to, and pay handsomely for, any jeans that fit.

Earlier this year, there were also claims of market fragility and speculation that the market for premium denim had already peaked and then plateaued. The first sign is usually price cuts and some US chains have started to go down this route. But a better global indication may be that the exporters of premium denim fabric, such as Japan, have noted a slowdown in sales at the end of 2005.

But consumers who pay a premium for their jeans, tend to buy as a wardrobe addition rather than as a replacement item. This type of consumer will buy more regularly and help to sustain the market for longer.

There are also opportunities with sizing. In most markets premium-denim sizing maxes out at around the 28 inch waist mark, but surely there is also some potential for growth in the plus-size womens’ market — if the comfort and fit are spot on.

But at some point fashion will decide that a pair of jeans is, well, just a pair of jeans. When this happens, it will then be harder to sell denim embellished with Swarovski crystals to Gwyneth Paltrow, than it would be for Levi Strauss to sell the same pair to a grizzled 19th Century prospector.

But for 2006 at least, the premium denim market will continue to mine its own particular brand of gold.

DENIM FACTS

- Teens in Asia own eight pairs of jeans (compared with 11 pairs by U.S. kids, and seven pairs by those in Europe and South America).
- Older consumers in Asia (over 45) own as many pairs of jeans as their age peers in the U.S. (6.6 pairs), and more than European (5.8 pairs) or South American adults (4.0 pairs).
- Overall, ownership of denim apparel items remains highest in the U.S., Germany and Colombia, and lowest in India and China. However, most industry experts expect denim consumption in Asia (most notably China) to explode over the next several years as incomes rise and wardrobes change.
- The love of denim is universal: everywhere in the world most consumers say they love or enjoy wearing denim. The highest reading is with 15-24 year-olds in South America (80%), and the lowest reading (note that it is still quite high!) is with 45-54 year-olds in Asia with 45%.

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