

# **Dyeing breed**

By <u>Sasha Planting</u> 24 Apr 2009

Rex Trueform, Seardel and indirectly, Brimstone are the only remaining listed clothing manufacturers on the JSE, and they are hanging by a thread. In six years the clothing industry has shed 39,000 jobs as the companies have failed to grow their market to grow their market caps significantly.

The value of Rex Trueform, for example, has hardly moved in real terms from its R15,5 million 10 years ago to around R26,15m now.

#### Closures and delisting

Within the year, it is likely that Seardel (R241m market cap) will be the only listed company involved in clothing and textile manufacture — and even that cannot be guaranteed. This week's announcement that Seardel is to close its spinning, weaving, finishing and denim divisions within Frame Textiles — adding another 1400 people to the jobless queue — reflects the state of crisis the clothing manufacturers are in.

This follows the closure last month of AECI-owned SANS Fibres, a supplier of technically sophisticated nylon products, including automotive air bags, textured yarn for military fabrics and other speciality fabrics. "The clothing manufacturing industry is burning holes in our pockets and I don't know for how long we can sustain it," says Brimstone CEO Fred Robertson.

The demise of this sector on the JSE has been a long time coming. As far back as 1997, the sector was a blip on the radar, accounting for only 0.12% of the all share index's total market capitalisation of R1,133 trillion. The sector's overall p:e ratio of 10.6% was the fourth-lowest on the bourse. At the time (1997), the Industrial Development Corp warned that SA's footwear, textile and clothing manufacturers would have to sharpen their game if companies were to compete with Asian imports. At the same time, insurance company Credit Guarantee was warning that illegal imports had the potential to destroy the industry.

### By a thread

While companies like AM Moolla and Durban-based textile maker Coastal Group have disappeared from the scene, Seardel, Rex Trueform and Brimstone's House of Monatic have survived — by hook or crook.

Rex Trueform is the smallest of these companies and makes garments for retail chain Queenspark. Though its history is deeply embedded in manufacturing, this division is now an albatross. In the six months to December Rex Trueform grew

operating profit by 12% to R14,8m, but the manufacturing division made a R766,000 loss, almost double the previous period's R458,000.

This loss scenario is unlikely to improve as further reductions in orders are expected, according to the company. In addition, Rex Trueform has faced "unacceptable levels of absenteeism and an unstable workforce" at its Atlantis factory. Efforts to change this have been unsuccessful.

Company secretary Alan Hodgkinson did not want to comment, but Nedcor retail analyst Syd Vianello says: "Rex has only one small factory remaining in Atlantis. Losses are ongoing, it's no longer core to the business and it is likely that it could be closed down." Clothing manufacturers cannot compete with imported goods, he adds. "Government has been promising the industry relief for years and all it got was the two-year quota, which has had no effect."

#### Keeping the fire burning

As a late industry entrant, investment company Brimstone (with a market cap of about R223m) has found that supporting the clothing industry may be noble, but building a fashionwear empire is not for the fainthearted. The company will conduct a strategic review of its clothing portfolio. This follows the recent liquidation of Fifth Element, its clothing design and wholesale business which owns fashion and sportswear supplier Canterbury International SA and surfwear and fashion brand O'Neill SA.

Its Atlantis denim manufacturer, Novell — which was controversially funded by the Western Cape provincial government using taxpayers' money — has yet to turn a profit. Its House of Monatic factory in Salt River continues to supply SA retailers, but is operating on short time and management is allowing "natural attrition" to take place.

"We can't continue in this way," says Brimstone's Robertson. "The cost of capital is high, labour costs are high, other input costs are high."

## Impacts of dishonesty

He adds that dishonest agents who import clothing on behalf of SA retailers, but underinvoice, further skew the playing field. "Retailers turn a blind eye to these practices because they drive down the cost of imported goods. I cannot expect Brimstone shareholders to continue to carry this burden."

That said, Brimstone is not turning its back on the industry. There will be job losses and it will be smaller, but the task of turning the 100-year-old clothing manufacturer House of Monatic into a sexier brand-house contender is ongoing.

Seardel, though not as old as Rex Trueform and House of Monatic, is by far the biggest. In 1957, when Aaron Searll acquired it for R500, the company made nurses' caps and bras, employed 15 people and turned over R31,000. Five decades later Seardel employs 14,000 people and turned over R3,9bn in 2008. By December last year, half-year results showed an attributable loss of R183m compared with R4m profit in the corresponding period.

After adjusting for the nonrecurring items, Seardel recorded a core loss of about R91m despite a marginal increase in turnover. This loss was almost entirely due to the deterioration of gross margins and increased finance costs. Mounting losses meant the company faced almost inevitable liquidation last year.

#### **Union bail-out**

But a saviour came in the form of the Southern African Clothing & Textile Workers Union (Sactwu), which pressured HCl to acquire a 71% stake in the company through a rights issue. HCl is 40%-owned by Sactwu, so Sactwu, instead of looking only at the industry's problems from a labour perspective, now finds itself in the position of employer.

Under the chairmanship of HCI's Johnny Copelyn, the new management — which includes CEO designate Stuart Queen,

COO Anthony Dixon-Seager and executive director Amon Ntuli — have wasted no time in making changes in their bid to turn the business around.

"We need to act if we are to create a sustainable business," says Queen. "The decision [to close the Frame businesses] is not about asset-stripping. We modelled every possibility and did not see a way to improve our margins. Those business units have been making a loss for years — by December we were losing more than R10m a month. We are a small group and could not hold on to businesses that make those losses."

But there are rumours in the industry that Seardel is losing R30m a month and that Sactwu (about the second wealthiest trade union in SA) is underwriting HCl's losses.

#### Centralising management

The new management also wants to cash in on the economies of scale implicit in a R4bn company. It has begun moving from a decentralised to a centralised management structure — in the process removing many of the MDs of Seardel's smaller operations. "We don't envisage closing, moving or consolidating plants, which are located mainly in KwaZulu Natal and the Cape, but management has to be restructured to reflect a large group," says Queen.

Change is not always welcomed and the market is awash with talk about HCI's "arrogant young blood" that has no interest in preserving the "institutional knowledge" within the group.

Queen counters this. "There's room for improvement. We are bringing in engineering and management skills. The factories were not designed to be flexible."

#### Changing tack

The new vision is for the company to compete with low-cost producers by having quicker turnaround times and shorter production runs. "That's what global retailers want. To survive, we will have to deliver it," says Queen.

He is modelling much of the company's new vision on Spanish retailer Zara, one of the world's most profitable clothing retailers. "They procure from low-cost producers, but they also source from manufacturers in Europe, where costs are higher than they are in SA."

So, what does this mean for local retailers? Foschini and Truworths, in particular, have been supportive of efforts by the likes of Seardel and Brimstone to improve their manufacturing operations. "We procure about 70% of our product locally," says Foschini CFO Ronnie Steyn. "It suits us, it's easier to get what we want."

Importing can have price advantages, he says, but lead times are long. Foschini has its own manufacturing arm, TFG Apparel, which it is transforming into a competitive advantage.

Though unlisted, Pepkor is also dependent on the local industry. About 35% of its clothing, footwear and textile products are sourced in SA. This equates to 125m products with a cost value of R1bn. Of this 80m units are clothing and textiles and just 15m are made by Pep Manufacturing.

# The bigger picture

The closure of the Frame divisions will have a "huge impact", says chairman Christo Wiese. "Frame is the core supplier of school uniform fabrics, including grey poly viscose serge used for trousers and shorts, and white and coloured poplin fabrics for school shirts, as well as cotton twills used in drawstring shorts. There is one smaller manufacturer of grey serge fabric, but it does not have enough capacity for the total market."

These fabrics would now have to be mostly imported, he says.

It's increasingly unlikely that textile and clothing manufacturers will ever be a force on the JSE, and government's rescue package (coming about 10 years too late) will fail to save this sector. Investors would do well to steer clear of it.

Source: Financial Mail

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