

COTTON INCORPORATED ACTIVITY REPORT 2001

J. Berrye Worsham, III

Cotton Incorporated

The past year has been one of the most difficult years in history for our industry. I'm sure that most of you are sufficiently aware of many of the macro statistics related to the cotton industry so I won't cover too many of them today. However, I would like to frame my remarks today within the overall cotton landscape. The economic conditions of today and tomorrow will certainly affect the way our company operates.

The economic recession has adversely affected the total U.S. consumer demand for fibers. However, it has not been as severe as you might think. We will use close to 20 million bales of cotton in the U.S. economy in 2001, down 5 to 6 percent from the peak in 2000. This drop is consistent with the movement during other slowdowns in the economy.

What is more troubling is the sharp loss in cotton usage by U.S. textile mills. And the reason for that steep decline is the unprecedented rise in market share by imported textiles and apparel. Net imports account for nearly 60 percent of our markets compared with about 35 percent in 1997.

In Friday's economic meeting, Gary Raines, a Cotton Incorporated economist will be delivering a paper on the impact of the rapid rise in the U.S. dollar on the cotton textile business. Without going into too much detail, we believe that the dollar's rise since 1997 has cost our domestic textile industry over 3 million bales of annual cotton consumption.

This has contributed to some big shifts in global cotton spinning in the past four years. Although total world demand has not grown rapidly, there have been some sizable increases in many countries that supply the U.S. market—notably Asian countries. Unfortunately, there is yet no sign that these recent trends have changed.

What does it mean for our industry? If we are to produce 17 to 20 million bales per year and we use domestically what we are today at about 8 million, it suggests that our raw cotton exports must increase. Over the past ten years, exports have averaged about 40 percent of our demand but going forward, exports will probably have to account for 60 of demand.

So my first point to you today is that the distribution of our customer base is changing and probably will continue to change. We will have to be more export oriented.

If you are a cotton grower, your main barometer of the weakness in the cotton market is probably price. In the global economy, the price for our fiber depends on the global cotton market, not just the U.S. market. As evidence of this, look at the relationship between monthly prices received by producers and the world's stock-to-use ratio forecast each month by USDA. They are almost perfect opposites. The conclusion here is that anything that improves the world supply/demand balance will benefit growers in the U.S. or in any other key cotton-producing region.

Cotton Incorporated's simple mission statement is to improve the demand for and profitability of cotton through research and promotion activities. I believe that we have six major objectives that are certainly relevant in this new economic environment. They are:

1. Build and/or maintain consumer awareness and loyalty to cotton
2. Improve the yield, quality and value of U.S. cotton production
3. Develop stronger foreign markets for cotton exports
4. Improve cotton's competitive position by improving efficiencies in the processing and handling of cotton
5. Develop new and interesting fabrics for cotton
6. Expand the uses of cotton beyond traditional apparel and home furnishings

In other words, we have to create a stronger demand while improving the profitability for those growing it to those selling it.

I will address a few of these points in terms of what Cotton Incorporated has accomplished in the past year.

Build and/or Maintain Consumer Awareness and Loyalty to Cotton

The United States is the single largest consumer market for cotton in the world. In fact, over 20% of the world's usage of cotton occurs in our market. Even more impressive is that the U.S. market has accounted for virtually all of the growth in the past five or even 10 years. Protecting this market is vital to our industry and its participants.

In order for consumers to differentiate among the many fibers in the marketplace, they have to have some sense of fiber awareness. Delivering a positive and memorable message about cotton to the 270 million U.S. consumers is one of our most important assignments. In 2001, Cotton Incorporated reached 95% of U.S. households more than 20 times with a Fabric of Our Lives commercial. In 2001, our target continued to shift to a younger female audience—those who are key purchasers of textile products. In an effort to increase the vitality and spirit of our campaign, we introduced two more commercials in our pool that featured dance and updated music. Our early research indicates that these new commercials have high consumer acceptance.

This is important because the competition is getting better. Consumers today do not perceive polyester as negatively as they did five years ago. Our research indicates that those consumers who are aware of fibers tend to prefer cotton and other natural fibers to manmade fibers to a greater extent than those with a lower awareness of fiber.

We also make sure that the cotton trade is aware of the attributes of cotton. In 2001, we launched an innovative trade campaign featuring silicone dolls dressed in cotton clothes. In these attention-getting ads, we focused on cotton's core attributes, such as comfort. It's important to remind the designers and manufacturers about cotton's key attributes as well as remind them about the preference for cotton by the U.S. consumer.

The retailer is a vital part of the cotton industry, as they are the link to the consumer. And the Seal of Cotton is an important communicator of information to the consumer. The Seal is one of the most widely recognized national trademarks with a recognition level over 70 percent. In 2001, Cotton Incorporated continued to form partnerships with major retailers like Target, Wal-Mart, Kmart and Federated Department Stores to feature the Seal of Cotton on merchandise. In addition, we with key malls around the country with promotional efforts aimed at expanding cotton retail sales.

Improve Yield, Quality and Value of U.S. Production

In an environment where prices are low, improving profitability must come from increasing yields or reducing the percentage of our crop that is of quality that the market discounts. Unfortunately, despite the rise in 2001, yields have stagnated and quality measures, like strength, length and micronaire have negative trends. In addition, the likelihood that U.S. cotton will have to compete even more in the export market suggests that our quality will have to improve. I know that for growers and breeders, the market may not pay much for improved characteristics. But I believe that we must push for improvement. This is the nature of the market throughout the chain.

As an example, 10 years ago, wrinkle-resistant 100% cotton slacks were rapidly gaining market share in the men's retail market. During the first few years, retailers commanded a \$5 to \$6 premium compared with conventional finishes. Within 5 years, the premium was essentially zero. It was simply expected in the market.

Another example is bed sheets. What was considered to be a high-quality sheet with a 200-thread count ten years ago is more of a standard today. The bar continues to rise in terms of quality, whether you are selling to Wal-Mart or Bloomingdale's.

In the past year, Cotton Incorporated developed a plan to help the industry improve the varieties offered to growers. Heading up this effort is our new VP of Agricultural Research, Dr. Roy Cantrell. Roy replaced Dr. Bill Lalor who retired last September. Dr. Cantrell delivered a presentation on this topic earlier in the week so I won't repeat his presentation. Some of the highlights to this plan include:

1. Accelerating germplasm development and enhancement
2. Expand non-commercial public germplasm availability to the commercial breeders
3. Emphasize genetic enhancement for "output" traits
4. Expand genomic "tool kit" for public and commercial sectors
5. Establish "Cotton Incorporated Fellowships"

This program gets underway in 2002.

Of course we are continuing with our other agricultural research programs including our efforts to increase seed value through research and marketing programs. In particular, our marketing efforts to the dairy trade have helped increase the use of cottonseed as a feed blend, which provides value to growers.

In our efforts to improve quality, we recognize the importance of our Fiber Quality Research division. In our research center in Cary, North Carolina, we have a world-class fiber, fabric and garment-testing laboratory in which thousands of samples

are tested, catalogued and analyzed. This has proven to be valuable in the identification of key concerns among producers, ginners, mills and other industry participants.

Develop Export Markets

The need to expand export markets is a given. Building world demand helps our exports as does working with the major users of cotton and U.S. cotton around the world. Cotton Incorporated provides services internationally through our four international offices: Shanghai, Osaka, Singapore and Mexico City. What kind of services? Those range from economic and market information, fiber quality analysis, fashion presentations as well as technical services such as spinning, fabric development and dyeing and finishing. In the U.S. market, we have brought more of our services to the apparel manufacturers and retailers who are the ultimate decision makers. In addition to the services provided by our overseas technical specialists, we support international efforts through more than 80 weeks of overseas travel by specialists in Cary and New York.

Cotton Incorporated supports and works closely with Cotton Council International in our efforts to promote U.S. cotton worldwide. A key accomplishment in 2001 was the partnership between Cotton Incorporated, CCI and the Importer Support Program, from which we featured a Sourcing Caribbean Basin Initiative Summit in Florida. This was done to facilitate the use of upland cotton in the expanding Caribbean Basin market by helping to create meaningful business relationships. This was recognized as the first event of its type for the region and the attendance included representatives from 120 CBI manufacturers, 102 U.S. mills and 70 importers.

Improve Efficiencies in the Processing and Handling of Cotton

U.S. cotton competes with foreign cottons as well as with other fibers. In a world in which price increases at retail and at the manufacturing stage is virtually non-existent, profits will be made by lowering costs, reducing inventories and eliminating product defects. For cotton that will mean faster spinning speeds and looking for ways to more efficiently handle, dye and finish products. Our fiber processing staff continues to look to expand the range of cotton yarn counts on new spinning systems and our technical staff has worked to develop processes that are more cost effective and more environmentally friendly. This work does not end in the lab. Our people are servicing customers in the United States and across the world in the implementation of technology.

One of our most important contributions to the cotton industry is the EFS® Systems Software. In 2001, we developed MilNet 32, which is a completely new Windows-based cotton management system for textile mills. This system will enable a mill to preview, purchase and issue cotton contracts, schedule arrivals, warehouse and ultimately, select cotton mixes for multiple plants using HVI data. A general release is expected in mid-year 2002.

Develop New Fabrics

A perennial challenge for our industry is how to develop new fabrics using the same fibers and the same machinery. Consumers and retailers are constantly looking for something new. Our fabric development department in 2001 developed over 100 new apparel and home furnishings woven fabrics and another 50 new knitted fabric constructions. This is in addition to our in-house library of over 4500 fabrics. In the past year, we received an estimated 22,000 worldwide samples of fabrics. In particular, we worked at improving our offering of women swear fabrics, including a number of interesting cotton blends as well as 100% cotton stretch fabrics.

The reason that we focus on women's apparel is the fact that cotton's market share in this end use is significantly lower than in men's apparel. Furthermore, the size of the retail market for women swear is nearly twice that of men swear.

Expand Beyond Apparel and Home Furnishings

Apparel and home products account for about 95 percent of the cotton used at the end market. We need better diversification. Nonwovens is a major market for fiber but a relatively small market for cotton. We have developed cotton and cotton rich products for some major key categories such as:

1. Diapers
2. Wipes
3. Beauty Care
4. Feminine Hygiene

In addition, we continue to develop cotton products in area and bath rugs. Although the amount of cotton used is relatively small, there are opportunities for expansion.

In summary, our industry is changing and I believe that our company is structured to meet these changes. Unfortunately, there are no single answers to the multitude of challenges our industry faces, but I am confident that the company is organized in such a way as to maximize the benefit to producers and importers from their investment. Every five years, all commodity check-off programs are required by the USDA to have their respective programs independently evaluated. The review on our program was very favorable with significant returns to both producers and to importers. I would like to read to you an excerpt from the summary report prepared by the Research Triangle Institute.

“The Cotton Program has a strong and positive effect on the demand for U.S. upland cotton”

“The returns to producers substantially outweigh the costs”

“Evidence suggests that Cotton Incorporated may be successfully leveraging its research programs with outside parties to the benefit of cotton producers and importers”

“...even though cotton prices have declined, especially in recent years, prices would have been significantly lower without the Program.”

That concludes my remarks and I can assure you that going forward, Cotton Incorporated will continue to work to maximize the value of our services to U.S. cotton producers and importers.