PAKISTAN COTTON CONSUMPTION SET TO FALL SHARPLY

US TEXTILE MILLS BEGIN PRODUCTION OF FACE MASK

EXPORT TRADE SLOWS TO A CRAWL

WILL A NEW SUPPLY CHAIN EMERGE FROM THE CRISIS?

JERNIGAN GLOBAL
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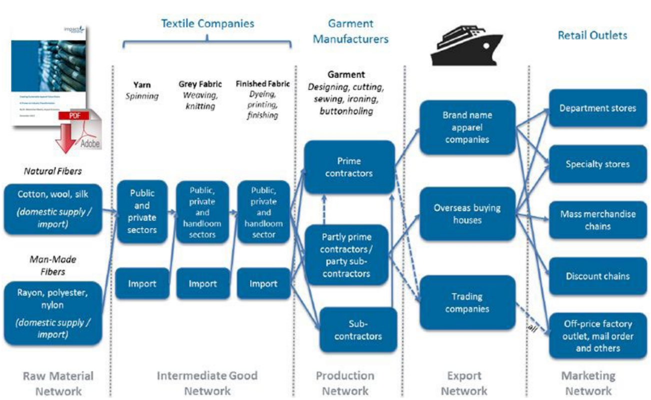
COTTON SUPPLY CHAIN NEEDS CREDIT, STABILITY, AND BRAND/RETAIL SUPPORT

The global cotton textile and apparel supply chain is in crisis today as brands and retailers across Europe, Canada, and America halt or cancel shipments. Across the cotton-consuming markets, the textile-manufacturing sector has received instructions to either cancel orders, delay shipments, or has seen brands and retailers halt all new orders. Others have indicated they will adjust orders depending on demand. At the same time, many of the major cotton consuming markets are in complete lockdown. Pakistan, India, and Turkey are all in lockdown and pretty much under a 24-hour curfew. All commercial businesses are closed except for essential industries or businesses, and spinning mills do not fall into that category. These three countries had been expected to consume 42.8 million bales and import 11.5 million bales. A few days after those three closed, Bangladesh announced a nationwide shut down from March 26th to April 4th, which is another 7.4-7.6 million bales of cotton use at risk. Bangladesh will also import that total volume. We understand mills can still operate. While the production side of the equations is closed, there is nearly a total closure, except for E Commerce, of the US, European, and Canadian retail trade block, plus additional markets such as Brazil, the largest consuming market in Latin America.

Concurrently, governments around the world are announcing significant stimulus packages that will ease the pain on the consumer. However, the CCP Wuhan Virus epidemic continues to expand in the US, Europe, and Canada. Europe is the hardest hit, and the issue is there doesn't appear to be a date on the calendar for a return to work.

For the past 100 years or more, the global textile and apparel supply chain has been one of the most segmented in the world, with the supply chain spread to all corners of the world. With only a few exceptions does the brand or retailer own the cut/sew operation or any other part of the supply chain. This has allowed the brands and retailers to manage risk and in most cases remain asset light. It has also allowed for companies to move quickly from country to country seeking the cheapest labor cost. The greatest concentration of the supply chain occurred in China, where, prior to 2017, the China Price first beat most other locations on price and then on quality. The China Price had several strategic advantages, with lax labor regulations and no environmental standards. In addition, the Chinese government provided a host of subsidies for export. Despite the risk that the supply chain has had to face and the slim margins, the practice has continued. We have always had admiration for the spinner, the first link in the supply chain. They must be able to buy the cotton at the right price, sell the yarn at an acceptable margin, and then manage the sales during times of falling prices as defaults during declining prices is always a problem due to weak legal enforcement. Then, the weavers and knitters, along with dyeing and finishing, navigated the tricky world of changing prices, which could destroy the profitability of a sale. The cut-and-sew operations must work a small margin and deliver the correct quality at a very competitive price, oftentimes on a tight timeline.



The extent to which the current crisis has impacted the supply chain makes it difficult for a comprehensive analysis of the virus' impact. The center of the retail collapse in demand is Europe. The United Kingdom has one of the highest per capita spending in the world on apparel. The latest survey indicated UK consumers spent 5% of their income on apparel and 5% on home furnishing. One estimate places the lost apparel and household goods sales at 1.5 billion British pounds or 1.77 billion USD per week. UK retailers have been very quick to halt orders. Primark has stopped placing orders, and H&M has canceled and halted orders and has begun to lay off employees. Marks and Spencer reported it canceled 100 million British pounds in orders. Another shock is that the shutdown in Europe is rapidly being extended. Regarding the UK, indications have been given that the lockdown could continue through April, which means six weeks of lost sales, including Easter sales. This is being repeated across much of Europe. In Spain and Italy, police are being used to enforce a stay-at-home curfew. The European Purchasing Manager Index plunged to 31.4, which was before the nearly total shutdown. Overall, Europe is now the epicenter of the virus, and economic activity has collapsed. The EU has lacked any kind of uniform approach, with each country going its own way. Moreover, most borders are closed, which has added to the collapse in economic activity. However, reports suggest the shutdown as it relates to travelers has not been so complete, with lots of movement still occurring. The entire event now appears to have serious long-term consequences for the EU and its ability to act as a cohesive unit. China has launched a major campaign to gain influence in Europe and increase its soft power. This will have ramifications for textile and apparel trade.

In the US, the epidemic is continuing to expand, with New York City the epicenter with more than 30,000 cases as of Wednesday. New York City is a very important part of the US economy and a global financial center with a GDP of 1.5 trillion USD.

TURKEY

Turkey has been one of the hottest cotton consuming markets in 2019/2020, and it is amazing how quickly that has ended. In our March 9th issue, we discussed the fear that the spread of the virus in Italy and Europe would impact the Turkish market in a very negative way. That dread is now reality. Turkey is one of the major centers of what has been robust non-Chinese cotton consumption. Turkish textile and apparel exports were expected to reach 29 billion USD in 2020. Turkey was expected to consume 7.3 million bales in 2019/2020, which makes it the fourth largest consumption market in the world, outside China. This robust consumption had increased cotton imports. August-January imports reached 468,218 tons or 2,151,227 bales. This is more than double the previous season when usage was depressed by the domestic financial crisis. Turkey was projected to import 4.3 million bales in 2019/2020. Turkey's top textile and apparel export markets are Europe and Central Asia, and in 2018 this region accounted for 70% of all exports.

Germany was the largest individual market, with exports of 3.684 billion USD. Germany is the largest market in the EU, and retail sales in 2019 increased by 1.8%. The latest data suggests the outbreak of the Coronavirus has already had a negative impact on the economy, with a sharp slowdown in car sales. Several major conventions and trade shows have been canceled since the outbreak and its increasing expansion in Italy. Germany imports over 55 billion USD of textiles and apparel with China and Bangladesh the top suppliers followed by Turkey.

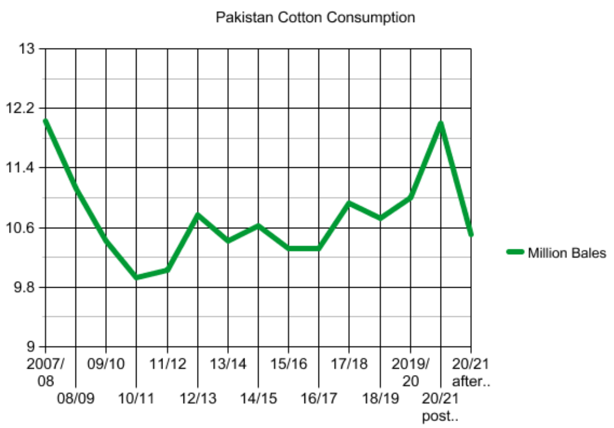
Spain is the second largest market in the EU, with 2018 exports of 2.7 billion USD followed by the UK at 2.47 billion USD. Italy is the fifth largest export market with shipments of 1.367 billion USD in 2018. Iran, another epicenter of the virus, is an important customer of Turkey. The domestic economy has been hard hit by the US sanctions, but in 2018 it officially imported 467 million USD of Turkish textiles and apparel.

Turkey has an estimated 7.5 to 8.0 million spindles and more than 700,000 rotors, which suggests cotton consumption still has room to grow. However, that growth will certainly stall due to the slowdown in European retail if the current virus outbreak continues for an extended period. Turkish exporters have an advantage over their Chinese competition due to the ability to provide just-in-time delivery with a very short supply chain. The Wuhan Virus epidemic has caused some problems with Chinese shipments, which had made EU brands and retailers switch sourcing. The quality of Turkish products is very good and of excellent quality.

Today, Turkey is in lockdown and mills are closed, which has brought most cotton trade to a halt. This has slowed cotton yarn trade to a trickle, with inventories building rapidly. Spinners are already seeking to delay shipments. As of March 12th, the US had 645,100 running bales of upland sales unshipped. A large volume of Brazilian cotton has been sold and is unshipped for the April through December shipment period. Turkish banks have already announced a package to aid business by suspending loan payments.

PAKISTAN

Pakistan announced a three-week shutdown of shops and factories and all non-essential services, which has brought spinning activity to a halt in one of the largest cotton consuming markets that was on track to use over 11 million bales before the pandemic. Pakistan is a very important cotton consuming market because it is a viable alternative to China. Before the crisis, the industry was operating at near capacity with hopes of new growth ahead. The textile and apparel industry is the largest industry in the country and the leading export industry. It also has fully integrated supply chains, which is allowing the country to provide customers with a complete turnkey solution for brands and retailers looking to move orders out of China. In addition, Chinese companies have not invested an appreciable amount of capital in the textile sector, which has left the industry self-reliant. The industry is over 90% owned by Pakistan companies. In December 2019, US apparel imports were weak overall. However, Pakistan imports surged 18% in volume terms. They were the second fastest growing major supplier. Pakistan has clearly taken a large block of orders from Chinese companies, and that percentage will grow. In 2019, Pakistan exported 3.046 billion USD worth of textile and apparel to the USA. The dollar values were small, but a sharp increase in yarn and fabric imports was also noted. The country's apparel exports have been rapidly expanding since 2010, and total apparel-only exports had previously been expected to exceed 8.5 billion in 2020, more than double the 2010 level. The EU and US are the top export markets. Two of the world's largest apparel retailers have set up substantial sourcing operations in Pakistan.



Million 480 lb. bales 2007/08-20/21

Jernigan Global Research 2020

Being a major supplier to the US and the world's largest Fast Fashion retailer has left Pakistan in crisis. Many of the major brands and retailers have suspended shipments, canceled orders, and put new orders on hold. Pakistani mills report that H&M, Nike, and Zara have all halted new orders, and said they will adjust existing orders according to demand. The ramifications throughout the supply chain have been devastating, and that was before countrywide business closures to halt the spread of the virus, which closed those operations that had continued to operate. Prior to the national shutdown, some companies had partially shut down operations and reduced capacity, while others had shut operations to control inventories. Small companies had already started to let workers go. The thin margins mean that small suppliers will not be able to pay workers or utility bills. The man-made fiber sector, even though small, has been very hard hit, with production cut sharply and prices reduced in an attempt to dump inventories. The exceptions to all of this are the suppliers to Walmart and Target, which report no change in orders. These two large US retailers are doing well, with stores remaining open due to groceries and other products considered essential supplies. Even suppliers to the Pakistan domestic market have been hurt, as all retail shops have closed due to the lockdown. A government aid package is under discussion that would help companies pay workers and utility bills.

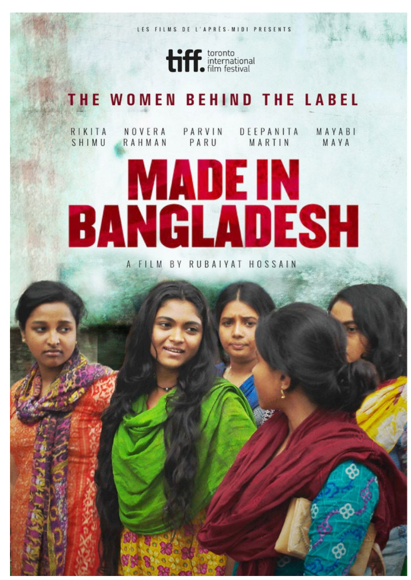
BANGLADESH

It was anticipated that Bangladesh would export approximately 33 billion USD in apparel exports in 2020, but this now appears highly unlikely with the CCP Wuhan Virus pandemic causing havoc around the

world. Bangladesh now estimates that 2.58 billion USD worth of export orders as of March 25th have been canceled, with over half of it coming from Europe, which has been hit very hard. Exporters report that "force majeure" has been invoked in many of the contracts, which means the supply chain will absorb the losses. While 2.58 billion in canceled orders is a large volume, it represents only 7% of the country's total expected export volume. We would expect the volume of canceled and adjusted contracts to increase over the near term.

Bangladesh is an extremely important cotton consumption market and is also an important alternative to China and was projected to consume 7.4-7.6 million bales, most of which is imported. It is the largest consumer of African Franc Zone cotton and of Indian cotton, excluding India. Even though few cases of the virus have been found in Bangladesh, the country announced a complete shutdown from March 26th to April 4th. However, apparel factories are exempt, and operations are employing new hygiene measures. The government announced an aid package that will help export companies keep people employed at a reduced rate for 45 days.

Bangladesh has been ground zero for the problem with order defaults. In recent years the country has been at the center of the apparel industry's campaign to improve the lives of workers. At the same time, the industry is under pressure to implement sustainable



production practices. However, Bangladesh textile groups are shocked at how quickly many of same apparel companies have canceled orders, leaving Bangladesh workers with the prospect of little to no pay. This has serious consequences when workers only live on 150-200 USD or so a month, and this only covers food and rent. This means these workers will go hungry, and their health care at risk. The head of BGEMA launched a video appeal on YouTube asking brands and retailers to honor contracts.

INDIA

India's 1.3 billion people are in complete lockdown and under 24 hour curfew, except to shop for food and basic supplies. On March 25th, the country essentially closed for 21 days, which halted 24.5 million bales or more of annual cotton consumption. It also will have a significant impact on the domestic economy their huge labor force is out of work and farmer's work in fields is delayed. The shutdown will reduce domestic consumption of cotton by 1.5 million bales and exporters are also facing canceled and delayed orders. Farmers are holding seed cotton and deliveries of seed cotton to gins have stopped. One additional concern is the fact that the seed processing plants are closed, which means there will be planting delays for cotton and other crops, depending on what happens after the 21 days.

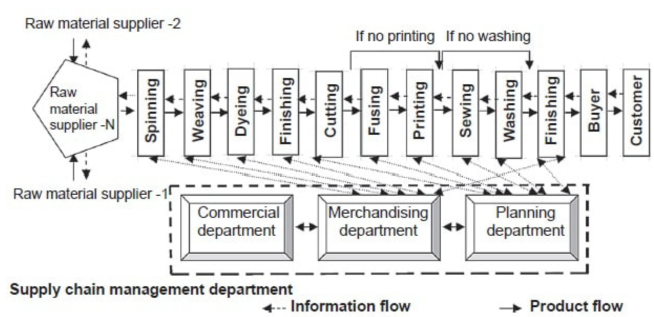
The crisis will have a serious impact on India. First, domestic consumption will drop by at least 2.5 million 480-lb. bales. Second is the question regarding the financial health of the smaller exporters and if they will be able to stay in business. Third, what is the extent of the damage to the domestic economy that will impact domestic offtake of apparel at retail? Fourth, the new crop planting will be delayed because of delays in seed processing, as well as distribution hurdles in getting the seeds to the farmers. Finally, the exportable surplus of cotton will increase, which will result in this cotton facing much weaker demand that will require an aggressive price.

US TEXTILE OPERATIONS SWITCH TO PRODUCTION OF MEDICAL SUPPLIES

A coalition of US textile and apparel companies has risen to the call of a country in need and began immediate production of some needed masks and other medical apparel and protective gear. The US supply chain for medical supplies has proven to be quite inadequate, and it is abundantly clear that hospitals and medical companies were not immune from the risk of the past 20 years associated with switching all sourcing to China. China is now the dominant source of the key medical supplies. US companies that do produce these supplies have limited US production and multiple plants in China. It was pointed out last week that the Chinese Communist Party nationalized US companies' production in China and is now selling these supplies to Europe at massive profits. One sale of 4.32 billion Euros was noted of supplies manufactured from US-owned companies to Spain. The sales included 950 ventilators, 11 million gloves, 550 million masks, and 5.5 million test kits. These types of situations are resulting in proposed legislation to require these vital medical supply chains to return to the US. In Australia, it was revealed that China had earlier instructed Chinese-owned companies in Australia to buy up all crucial medical supplies such as masks, hand sanitizer, etc., and ship them back to China. It was reported that this also occurred in other countries. The companies that purchased the supplies and shipped them back to China were viewed as private companies. This should end the myth of private Chinese companies.

The coalition in the US included Parkdale Mills, the largest US cotton spinner, Hanes Brands, Fruit of the Loom, Beverly Knits, American Giant, American Knits, LA Apparel, My Pillow USA, Glen Raven, AST Sportswear, San Mar, and Riegel Linen. 5-10 million masks are expected to be produced weekly. One of the masks is a three-ply cotton mask. It is unclear how much cotton use has been impacted by the switch. US suppliers also face the same issues with a closed domestic retail market. American Giant is making a major effort, with its operations expected to produce 35,000 masks the first week. Its CEO, Bayard Winthrop, is a major leader in the effort, just as he has been in bringing the textile and apparel production back to the US.

WILL A NEW SUPPLY CHAIN EMERGE FROM THIS CRISIS?

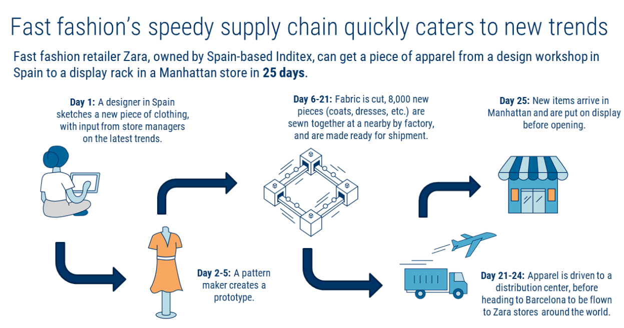


The global textile and apparel chain now faces its greatest challenge since World War II. Since that time it's all been about cost and the drive to find the cheapest locations in which to operate. The arrival of the China Price after the country joined the WTO destroyed the major supply chains in Europe, the US, and Latin America, while triggering a race to the bottom. At the same time, each segment of the supply chain has been assuming a higher degree of risk as they operate on a razor-thin margin. The current sudden collapse in retail demand and the ripple effect through the supply chain is proving to be the ultimate Black Swan event. Each segment faces huge losses that fall like a line of dominos all the way back through the cotton trade. Merchants are facing large books of much higher priced forward sales that are unshipped, and it is extremely likely that a large portion of those sales will be canceled, renegotiated, or rolled forward to next season, and that a few cases will default. The "Force Majeure", or act of God clause, is being invoked, which raises more than a few questions. The US alone has 7.153 million running bales of 2019/2020 sales on the books that was unshipped when the crisis hit. Brazil would likely have at least 1.5-2.0 million bales of 2019 crop sales for shipment before July that are at risk as well. In addition, you have an unknown volume of Greek and African Franc Zone, which is sold but also unshipped and is facing the same degree of risk.

Once any default or delay occurs, it affects the risk of the firm, which creates issues with bank lines of credit. The bulk of the supply chain was already in the Emerging Markets where credit was limited and expensive, and the likelihood of any meaningful government aid was small. This means many of the small-to-medium-sized operations might be forced to go out of business. This has serious implications for cotton use and for the industry's attempt to develop a diverse supply chain outside of China. The concern is spread from the cotton merchant through to the brands and retailers. The crisis will mean more consolidation, and that fear is growing, especially in the US market. The retail shutdown has not been equal. If the retailer's store included a grocery or pharmacy, such as Walmart, Target, Costco, and Amazon, then they continue to remain open and business is surging. In the case of the first three, apparel and other products are not segmented, which means the consumer can still shop for apparel and all other products just as they did prior to the virus. There is one big difference though. Most of their competition is presently closed. Target announced that March sales are up 20% and groceries are up 50%, while apparel is down 20%. This is very telling considering down 20% is far from zero percent, which is the case for almost all other retailers such as the Gap, Macys, Kohl's, and others facing zero sales in the second half of March. This is already evident in who is canceling the orders, and it is not Target or Walmart. The shares of the other retailers have collapsed. For example, during Thursday's US equity rally, Macy's shares fell nearly 8%. US malls are facing a near collapse without some significant help. The malls are closed and will not open until local governments give their OK, regardless of the tenant's wishes. Many tenants have already said they will not be paying rent during the closed period or in the near-term. What does this mean? There is the fear that it could be months before all this is sorted out, and then there's the question of how fast the consumer will return to areas such as malls. China is back open, but mall traffic is slow. One new study in the US indicated that more than 80% of the consumers wanted to avoid crowds and public places.

This has triggered the theory of "Revenge Spending," the practice of the shopping-starved consumer coming out of quarantine and overcompensating by spending extra-large amounts on merchandise such as apparel. Researchers are closely watching China to see if this will happen at some point.

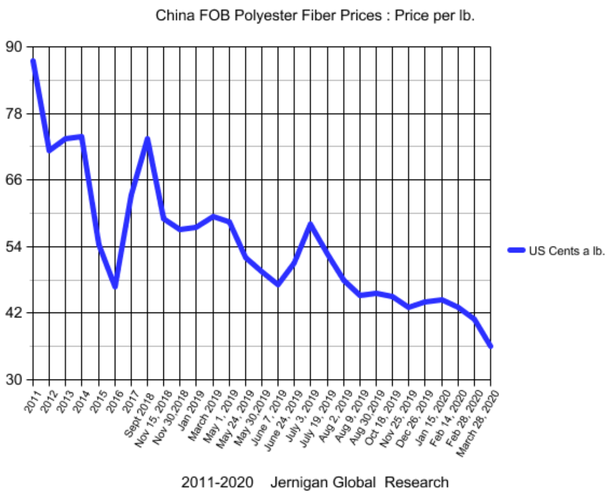
The industry is worried that when the US recovers only four major retailers will dominate the market – Walmart, Target, Costco, and Amazon. This would have significant consequences for the entire supply chain. At that point, throughout the supply chain, will the various segments continue to shoulder the risk as was the case pre-crisis? Few of the brands or retailers have invested in the supply chain and have very limited assets. There are exceptions, but in the pre-crisis world such investment were seldom rewarded, as the asset- light players undercut the units on price. The China Price was a major disruption, so the question is if, with the China economy in recession and exporters of textile apparel facing sharply lower domestic sales and exports, will the old standbys of government subsidies come back and allow the exporters to again simply undercut everyone else. This is a real fear for the spinners, weavers, and cut-and sew- operations that are facing large losses in continuing to operate.



Prior to the CCP Wuhan Virus epidemic, there was a major trend to diversifying away from China even with a higher price and increased sustainability practices. Now, with most all brands and retailers facing a significant financial crisis and attempting to hoard cash, will this matter? One segment that has been the first to react to the crisis is the Fast Fashion industry, with both Zara and H&M moving quickly to cancel orders. This group may suffer the most from the current crisis, since their business model calls for just-in-time delivery, low inventories, and a very low profit margin that requires shifting much of the risk to the textile apparel chain. The damage done by the record cancelations means many of the normal companies may not be able to continue operations, and those that do will have a different risk profile. This business model faces a possible change in consumer behavior away from throwaway apparel.

EXPORT TRADE WAS NEAR RECORD LEVELS IN EARLY MARCH BEFORE THE RED SWAN HIT

Never in modern times has cotton trade gone from booming record demand to a collapse in demand in just a few days. The USDA weekly export sales report for the week ending March 19th showed a net 277,100 running bales of upland and 18,400 of Pima sold for 2019/2020, along with 120,100 running bales for 2020/2021 shipment. Vietnam, Turkey, Pakistan, China, Indonesia, India, and Taiwan were all noted buyers. Export shipments were also brisk at 386,800 running bales of upland and 17,400 of Pima. Export trade over the last week was light, with a few of the largest mills bottom picking, while a few extended coverage through the summer.



The concern remains over the ability to get letters of credit open on pending shipments. For merchants, any new sales carry a major focus on counter party risk. Pressure on man-made fiber prices continues, with the average polyester price now below 36 cents for larger orders in China. Viscose fiber has fallen below 60 cents.

ICE AND ZCE COTTON FUTURES POST ADDITIONAL LOSSES AMID LIGHT DEMAND

Spinners worldwide are seeking some indication as to when demand will return, but the problem is that retailers in many markets extended the expected reopening date, which means it is impossible to get a handle on what is the core demand. The shock the market is encountering is simply unbelievable. In Pakistan, exports of apparel in February increased by 20% to a record, but March exports will fall 60% or more. Just how much damage the supply chain will suffer depends on the brands and retailers and if they are willing to provide some sharing of the losses. The entire business model of the textile/apparel supply chain is at risk. This means global cotton trade will face disruptions in the season ahead.

ICE and ZCE futures remained under pressure last week, as the market attempted to find a clearance price. The May ZCE contract closed Friday at 10,735 RMB a ton or 68.68 cents per lb. The contract lost 1.79 cents a lb. for the week. The May ICE contract lost 2.35 cents for the week. The largest sellers in the week ending Tuesday were Swap dealers and the Index funds. Daily volume remained heavy on ICE, as the Exchange allowed the Algo's and HFT systems to move prices at will as they created volume.

Cotton export shipments from Brazil may be impacted by the efforts to contain the virus. In Canara in Mato Grosso, the shipment of grain out of the city was banned as it declared a lockdown. We understand that Cotton was not mentioned, and that the large exporters were given a grace period to comply. Sao Paulo has entered a 15-day lockdown. The Ports appear to not be affected. So far, in March, the ports report very brisk loading of all ag exports, with soybeans shipments up 102% over a year ago.

The US will release its first USDA planting intentions report this week. Many of the surveys may have been returned before the full impact of the Retail shutdown was known. This may make the planting intentions number higher than what will be the case. The changes in the Cotton/Corn ratio have moved from 6.6 to 13.5, and the Cotton/Soybean ratio has moved from 7.2 to 14.0, which suggest that US growers will switch from cotton. The entire futures curve is far below the cost of production for all growers.

The US Adjusted World Price, which can be used to redeem cotton from the CCC loan, fell 4.16 cents last week, far exceeding the futures decline. This should keep US export prices competitive. The CFR Basis has not yet shown much reaction to the collapse in demand. Overall prices are seeking a price level at which demand can stabilize. We did find a small glimmer of hope in a brief statement from the World Health Organization. When questioned whether the virus be carried on your clothes, they said the following:

"The coronavirus would likely survive better on artificial fibers such as polyester than on cotton"
– *World Health Organization*

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