



FDRA

FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA

**2016 GLOBAL FOOTWEAR
SOURCING ASSESSMENT**

Vietnam continues to produce more and more for the U.S. market. Sourcing in China has morphed and changed over the past few years; remaining factories are hungry for orders and working harder to lower prices and automate. Ethiopia is again on the rise, developing into a second tier option for smaller production orders to relieve capacity issues in Asia. India's new initiatives have helped boost production, and Cambodia is seeing spillover effect from Vietnam. Sourcing in the Americas continues current trends, while some companies are setting up small automated factories to make more custom ordered shoes in America. Meanwhile, input prices remain low even as wages rise and consumer demand for new products continues to increase. These issues and more are covered in depth in this definitive sourcing report.

About FDRA

Since 1944, the Footwear Distributors Retailers of America (FDRA) has been the footwear industry's voice in Washington, DC. Today, FDRA's voice is stronger and more respected than ever. FDRA has also enhanced its member services and support and is now the industry's intelligence hub. FDRA provides its members valuable business intelligence and expertise on a variety of trends and topics including product safety, customs, sourcing strategies, intellectual property and social compliance. It is also the only association able to provide in-depth sales data and analysis for footwear retailers. In short, FDRA boosts its members business. Visit www.fdra.org to learn why over 80% of the U.S. footwear industry belongs to FDRA.

FDRA forecasting seeks to provide the footwear industry with information and critical thought to better prepare it for global challenges and threats that may impact footwear businesses. All forecasts herein should not be considered legal advice in any way.

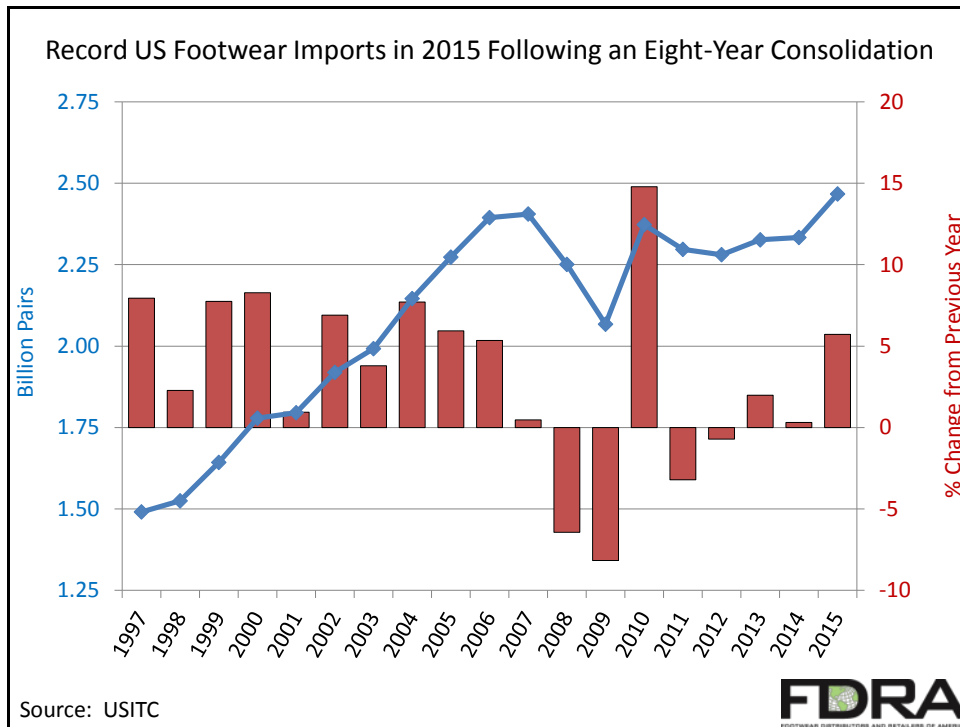
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2015 Footwear Sourcing Overview

Responding to record consumer demand, US imports of footwear continued to grow in 2015, climbing to unprecedented highs in volume, value, and average unit cost. At nearly 2.5 billion pairs, shipments last year rose 5.7%, the third straight year of expansion and the second-fastest advance in a decade. Gains were widespread across all key suppliers and most categories. In fact, of the 145 countries that shipped footwear to the US last year, 94 expanded their volumes. The value of footwear imports fared even better, rising 6.3% - higher sixteen of the last seventeen years - to a record \$27.7 billion. Again in 2015, the value of imports rose faster than the volume of imports, implying the average landed cost rose, higher ten of the last eleven years. The fact that imports continue to rise even as unit costs rise is a testament to shoppers' ongoing affinity for footwear.



Fast Footwear Facts 2015

America imported 2.4 billion pairs of shoes, or 7.7 pairs per person

The average duty rate was 11%

Total duties on footwear was \$2.9 billion

As sourcing challenges continued to morph in new ways in 2015, so have the ways in which footwear companies are working to address change and capitalize on opportunities.

Click on the video below to see an executive from Payless discuss global sourcing



Key Suppliers

China

As the world's largest footwear manufacturer, China remains - by far - the largest footwear supplier to American consumers, even as the country's dominant position continues to erode to smaller, more nimble, and often less expensive origins. To begin, this juggernaut's dominant position persisted in 2015 as the value of footwear shipped to US shores rose 1.2%, higher for the seventeenth time in the last nineteen years, surpassing an unprecedented \$17.2 billion. The volume of footwear destined for US shoppers also expanded in 2015, rebounding 2.8% to a four-year high of 1.9 billion pairs. Since the volume of shipments grew faster than the value, the average unit costs eased, off -1.5% from a 2014 record to \$9.07/pair. In short, America's largest footwear supplier grew even bigger in 2015, owing in part to modestly lower landed costs of those shoes reaching US shores.



Toll knows shoes

Just as you produce different shoes for your customers who engage in different activities and occasions, we offer you the perfect fit for your supply chain requirements.

With a proven track record of designing, implementing and executing complex end-to-end fashion and retail logistics solutions, Toll's range of products and network capability will add value to your supply chain - from factory floor to retail store.

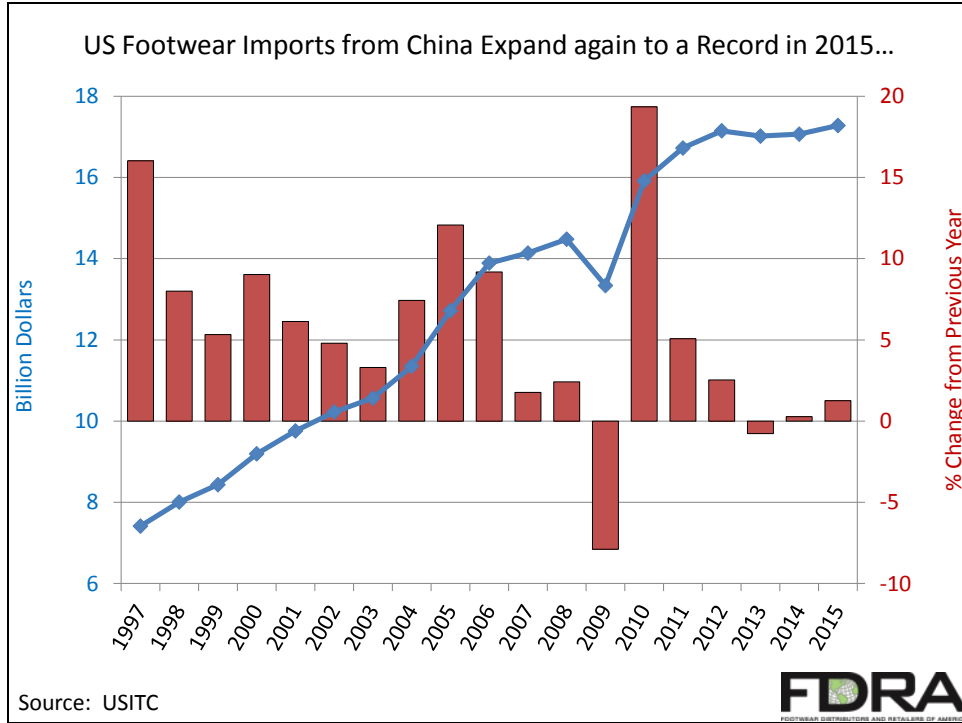
Headquartered in Hong Kong, Toll Global Forwarding operates globally throughout Asia, Europe, North America, Africa, Australia, New Zealand and the Middle East.

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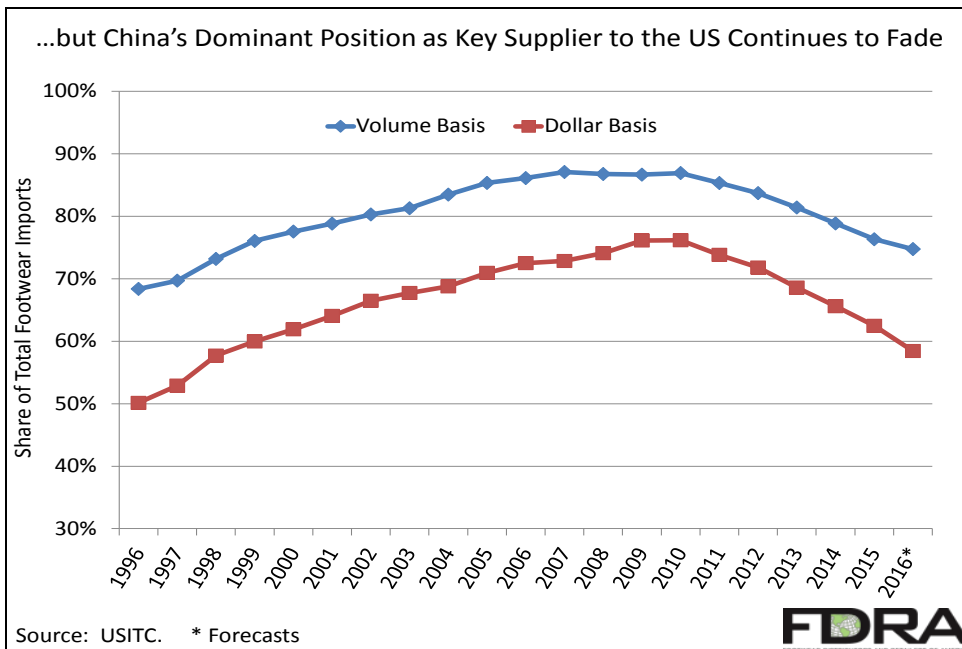
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TOLL



But even as China's shipments to the US grew again to a record last year, imports from other suppliers fared even better, implying China's dominance continues to slide. In other words, the country's share of total footwear imports continued to wane last year as footwear sourcing shifted elsewhere, echoing our long-held view.



By 2015, China's share of global footwear shipments to the US slid to just 62.5% in dollar terms and 76.3% in volume terms, both multi-year lows. And early evidence in 2016 suggests this trend will persist again this year. At just 57.8%, the country's year-to-date share of the dollar value of shipments to America is on track to fade to the lowest annual share in eighteen years.

Click below to see videos of executives from Fila and Caleres discuss sourcing in China



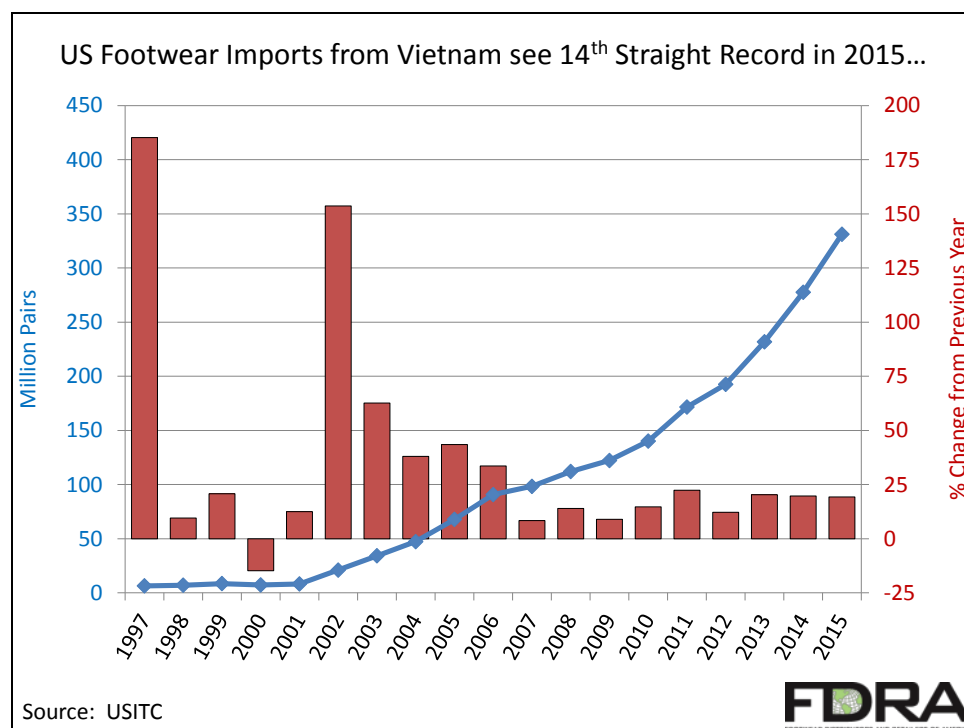
Sourcing Insight: The “New” China



Sourcing Insight: A Look at Wages, Labor, and Other Issues in China

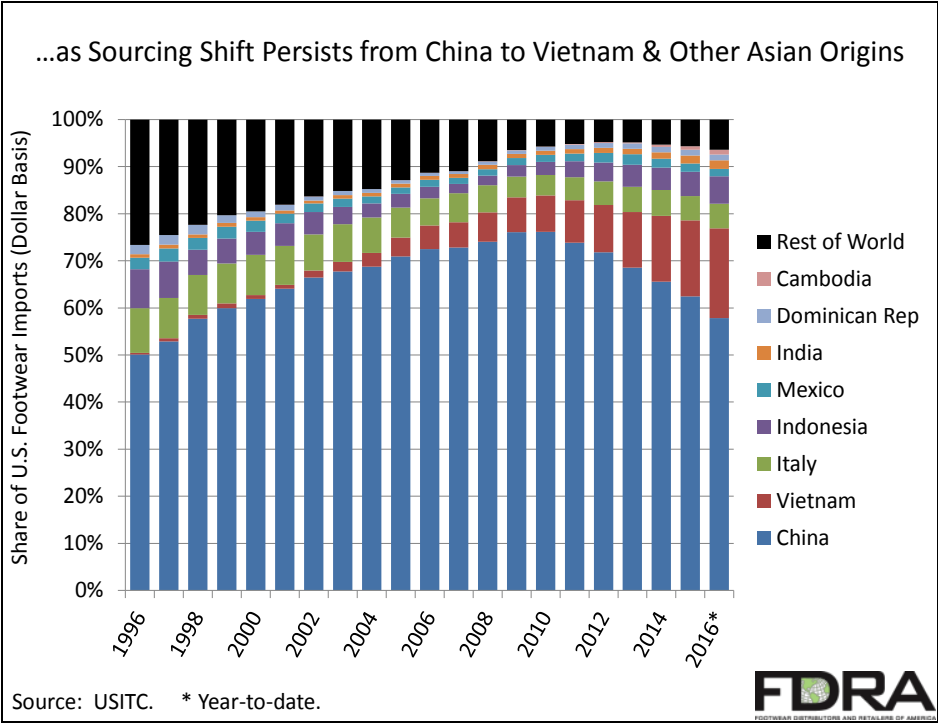
Vietnam

Once a sidelined manufacturer that was constrained by more than two decades of no economic relationship with the United States, Vietnam has become a major footwear supplier to the US in recent years, second only to China. In 2015 the volume of Vietnamese footwear destined for the US market sailed a year-over-year 19.3% to 331.2 million pairs, the fourteenth straight record year and sixth straight double-digit increase. The persistent growth in the dollar value of these shipments has been just as impressive, surging 23.5% in 2015 to an unprecedented \$4.5 billion, the twelfth double-digit increase in the last fourteen years. What's more, these shipments have grown as the average landed cost of Vietnamese footwear entering the US has risen each of the last six years. Rapidly growing shipments in spite of rising unit costs for those footwear suggest the country will remain a formidable competitor in coming years.



As Vietnam's shipments to the US in recent years have grown faster than US imports from the rest of the world, Vietnam naturally has taken share from the rest of the world, typically China. The two dominant themes on the following graph are the gradual erosion in China's share of total US footwear imports, mirrored by nearly-offsetting gains in Vietnam's share over this same period. At just 5.0% a decade ago, Vietnam's share more than tripled to 16.2% in 2015 and is poised to expand even further this year. Imports from the rest of the world also are expanding but are relatively small, growing from 16% at the turn of the decade to just 21.4% in

2015. On balance, while niche opportunities with second-tier suppliers remain, US footwear imports are a two-horse race dominated by China, but with Vietnam galloping faster to close the gap.



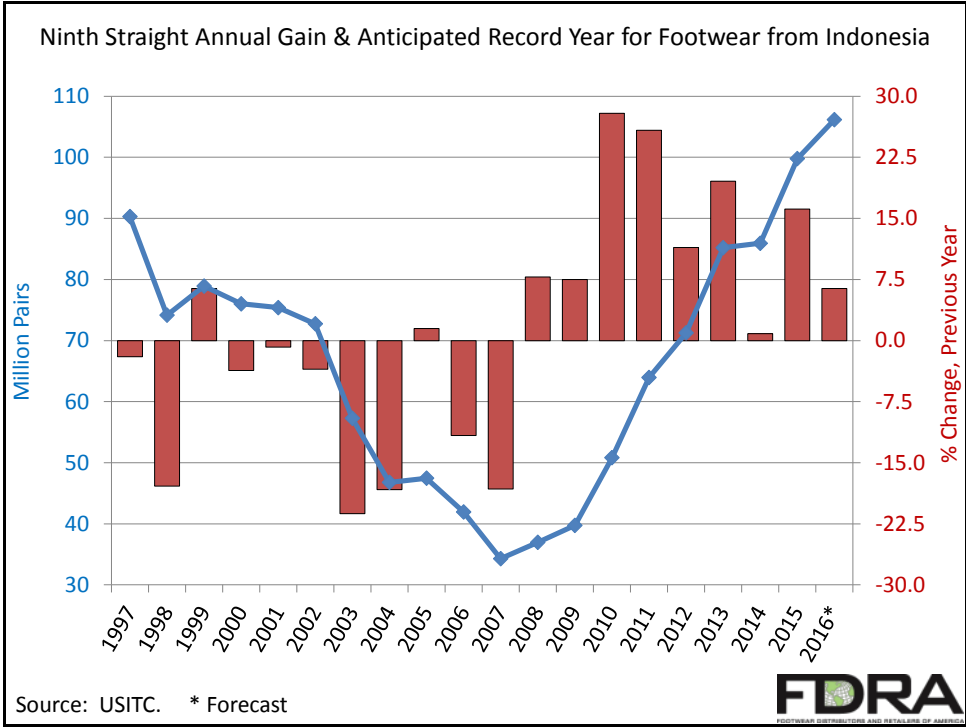
Click on the video below to here an assessment of production in Vietnam



Sourcing Insight: A Look at Footwear Production in Vietnam From the Ground

Indonesia

As America's third-largest foreign supplier of footwear, the Indonesian footwear sector has enjoyed a revival over most of the last decade. In the decade following the 1997 Asian Financial Crisis, Indonesian footwear exports to the US fell sharply, from 90 million pairs to hardly 30 million ten years later. But the country's shipments to our shores rebounded impressively, growing each of the last eight years to a record 99.8 million pairs in 2015. And early-2016 data suggest this volume will expand again this year to perhaps more than 106 million pairs.



The local footwear industry faces several positive and negative issues that may color its outlook in future years. First, the country has announced its desire to join the Trans-Pacific Partnership (TPP) when possible, a trade agreement that promises to lower trade barriers and tariffs and boost footwear trade across the region. Plus the country's currency, the rupiah, eroded since 2012 to a multi-year low - boosting export competitiveness - before stabilizing over the last year. But the country has seen sharp increases in minimum wages the last few years, a major headache for local footwear manufacturers. And the country remains constrained by the availability of foreign inputs for manufacturing, particularly leather and rubber. In spite of being one of the world's leading natural rubber producers, the commodity needs to be exported first for processing purposes as domestic processing facilities are still lacking. How these positive and negative issues evolve are likely to be key in determining if Indonesian footwear exports to America continue to march higher in the years to come.

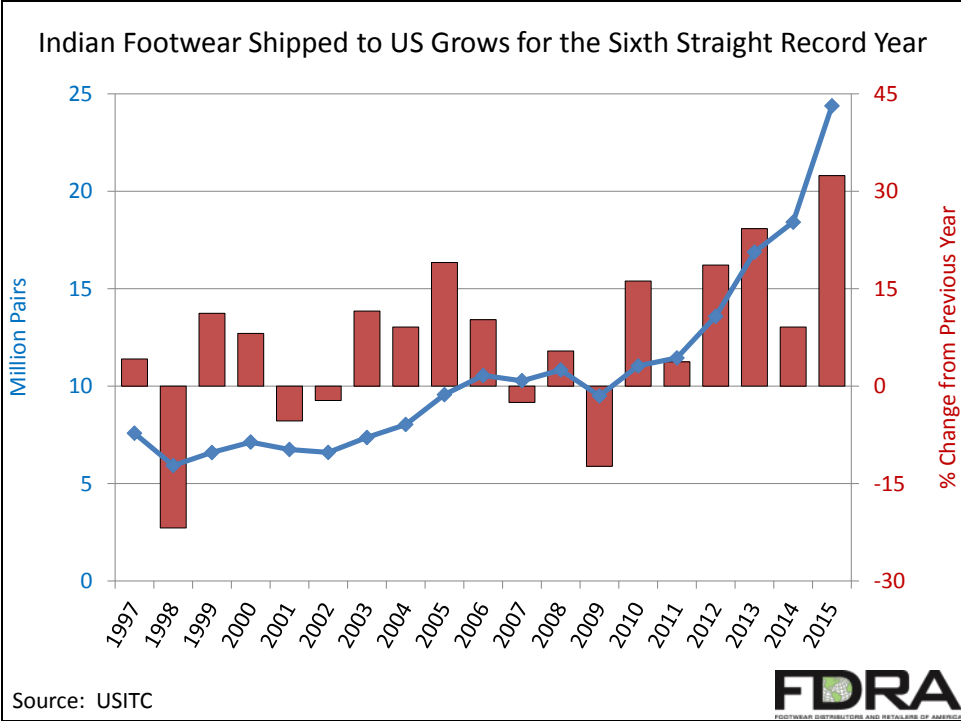


Download the footwear
infographic 'Benefits of
testing & certification'



India

Supported by the "Make in India" campaign, Indian footwear shipments to America surged to a record in 2015, paving the way for the domestic industry to expand these exports in coming years. At an unprecedented 24.4 million pairs worth \$468.0 million, the volume of Indian footwear shipped to the US in 2015 jumped 32.4% from the prior year, the biggest annual advance on record. The year marks the sixth straight increase and the sixth straight annual record. In fact, these shipments grew to account for 1.0% of all US footwear imports in 2015, India's highest share on record. We note these exports destined for US consumers grew while the average landed cost far exceeded average costs from China and the rest of the world, suggesting the domestic footwear sector is thriving by not competing just on a cost-only basis.

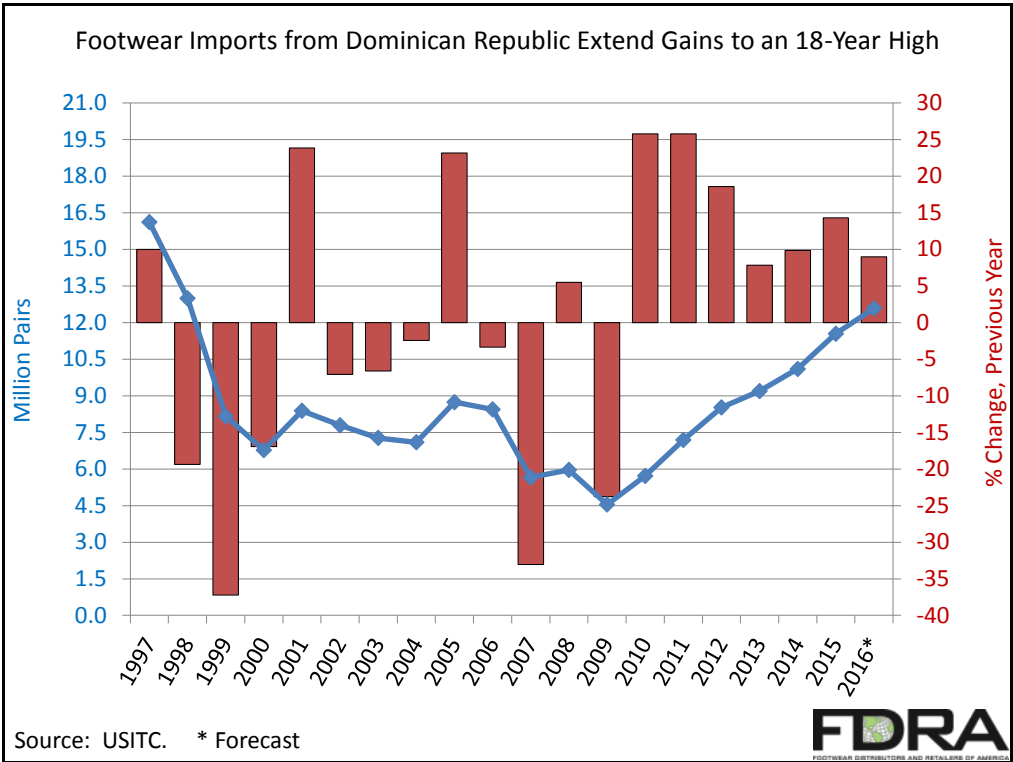


Launched in late 2015, "Make in India" is an initiative promoted by the Indian government to encourage domestic and multinational companies to manufacture their products in the country. The initiative focuses on the domestic leather sector along with 24 other manufacturing sectors critical to the health of the economy. Already, the country accounts for 21% of the world's cattle and buffalo and 11% of the world's goat and sheep population. India produces 2 billion square feet of leather, roughly 10% of the world leather requirements. Under the initiative there is no import duty on the import of raw hides and skins, semi-processed leathers like wet blue, crust leather or finished leather, giving Indian footwear manufacturers an advantage over other competitors. With a range of new policies supporting

the local footwear sector and promoting foreign investment, India is likely to become an even more formidable second-tier supplier in coming years.

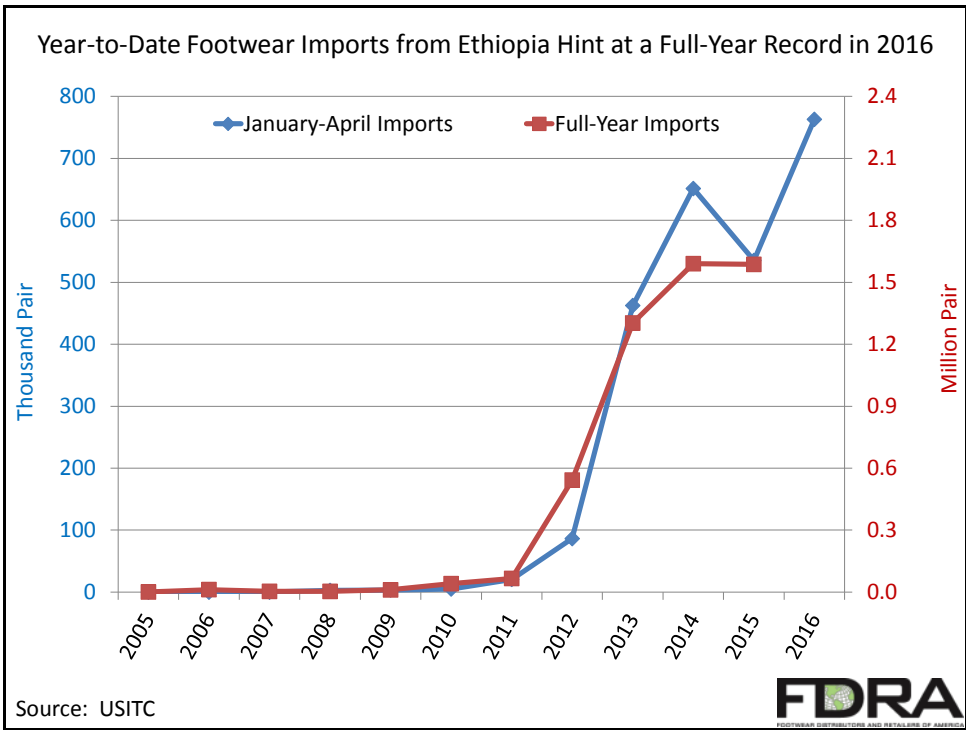
The Americas

Three countries dominate American footwear imports from the Western Hemisphere - Mexico, Brazil, and the Dominican Republic. While the first two traditionally have had larger exports to the US, their shipments have been relatively flat the last few years. Meanwhile the DR has enjoyed persistent growth for some time, with exports destined for US shores climbing each of the last six years. At a forecasted 12.6 million pairs, exports from the DR to America are pegged to advance again in 2016 to an eighteen-year high. Particularly interesting within this surge over recent years is that DR footwear shipments destined for US consumers grew while average landed costs far exceeded average costs from China and the rest of the world, suggesting the domestic footwear sector is thriving by not competing just on a cost-only basis.



Rising Star

Another small footwear supplier we commend as a 'rising star' for its rapid growth in recent years is Ethiopia. While its record shipments the last two years still accounted for less than 0.1% of total US footwear imports, the country has enjoyed robust growth in these shipments, as the graph below demonstrates. And year-to-date data strongly suggest the country will export a record volume of footwear to US shores in 2016, perhaps more than 2.2 million pairs. The Ethiopian industry continues to push for increased access to both foreign and domestic capital, the development of more proximate commodity inputs, and continued utilization of duty free access to the US market via the African Growth & Opportunity Act (AGOA). With such an organized approach to the development of the footwear industry in Ethiopia, we expect these important trends to continue into the near future and beyond.



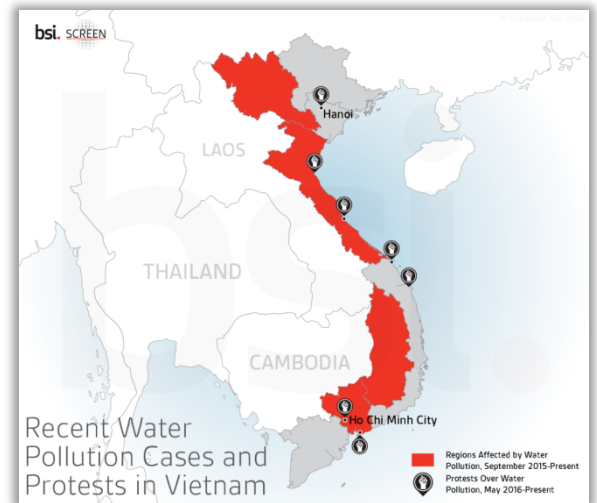
Companies currently sourcing in Ethiopia include U.S. based Harbor Footwear (GH Bass & Giorgio Brutini) and Caleres, U.K. based Overland Shoe (G-Star Raw Brand), and French company SAWA.

BSI Spotlight: Sourcing Risk Intelligence

Vietnam Spotlight

Increasing Risk of Water Pollution

- BSI is increasing the threat rating for water pollution in Vietnam to Severe
- Factories implicated in dumping untreated waste into waterways in four regions since September
- Officials ordered new inspections of facilities, suspended some factories, and ordered compensation payments
- Significant protests occurred over six weeks in four regions
- More than 500 arrested, protesters beaten

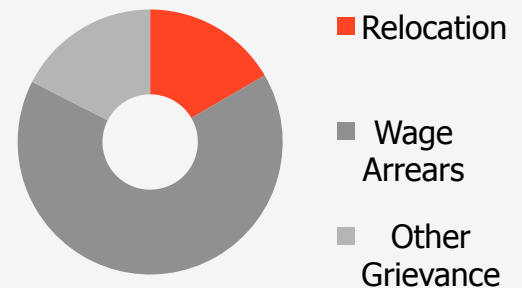


China Spotlight

Labor Unrest – Q2 Update

- Major protest in Dongguan in late May highlighted increasing concern of protests over factory closures and relocations
- Portion of relocation-related factory strikes in China has increased significantly over the past year
- Protest numbers likely to continue rising as operational costs in China escalate

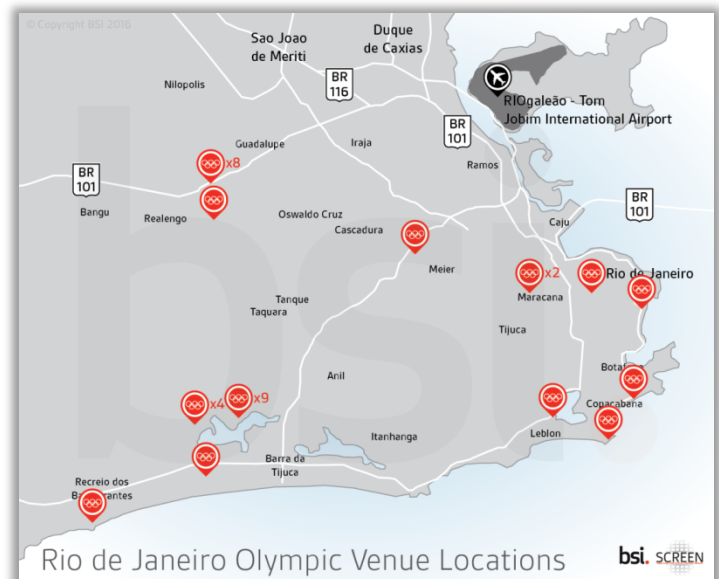
Factory Strikes in China by Grievance 2016 (YTD)



Brazil Spotlight

Cargo Transportation Restrictions during the Olympics

- Cargo transportation restrictions can be expected in Rio de Janeiro during the Olympics
- Restrictions will likely be similar to those imposed during the World Cup
- Cargo trucks only allowed to operate during certain times
- Cargo trucks may be banned from areas around stadiums and venues
- Possible delays from extra inspections



Supply Chain Risk Management Services and Solutions

BSI is the leading global provider of risk-based supply chain management services and solutions, including geographic risk intelligence, supplier risk assessment management, global auditing services, and supply chain advisory services. Our holistic risk management suite helps organizations take a proactive approach by providing the insight and resources needed to effectively identify, manage, and mitigate global supply chain risks and areas of non-compliance before they can severely impact the supply chain.

Advisory Services: Our experts help organizations understand their supply chain risks, map out their supply chain to identify and prioritize the highest risk areas, and implement best practices and mitigation strategies to build resiliency in the supply chain.

Supply Chain Risk Intelligence: Supply Chain Risk Exposure Evaluation Network (SCREEN), is a web-based, global intelligence system that provides data and analysis on Supply Chain Security, Corporate Social Responsibility, and Business Continuity threats and trends. SCREEN is used to measure country level risk factors through 20+ proprietary risk ratings in over 200 countries. SCREEN is used globally by importers, manufacturers, and governments to monitor global incidents and trends, and gain unparalleled visibility into geographic exposure to the supply chain.



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- **Automated Risk Assessment Management:** Supplier Compliance Manager (SCM) is a web-based, self-assessment and audit management tool that allows organizations to assess, analyze and track supplier compliance with standard or customizable risk assessments. SCM enables organizations to effectively communicate with suppliers, identify areas of non-compliance and issue corrective actions, and continuously improve supplier performance. SCM is a versatile solution that helps organizations manage their global supply chain and increase visibility and compliance.

Global Auditing Services: Our global auditing services provide organizations with the information needed to effectively manage supplier and enterprise risk. BSI Audits provide cost-effective assurance that your suppliers are not exposing your brand to potential security, corporate social responsibility or business continuity risks. Our experienced auditors are located worldwide and will go on-site to confirm that your suppliers' business information, policies, and procedures are in line with your organizations requirements and objectives.

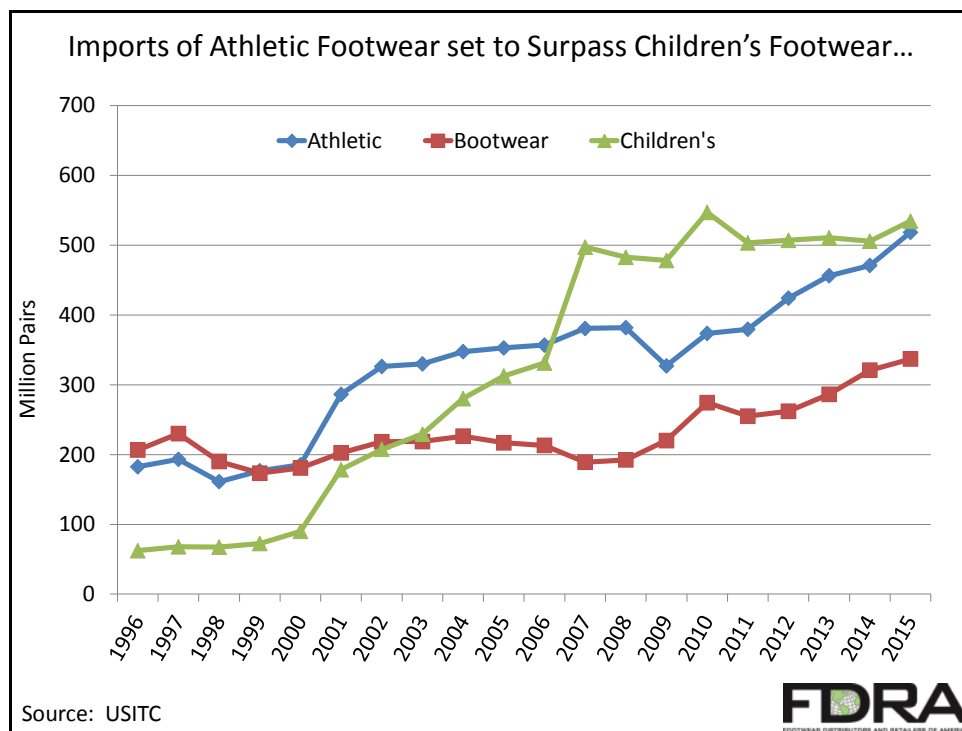


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Key Categories

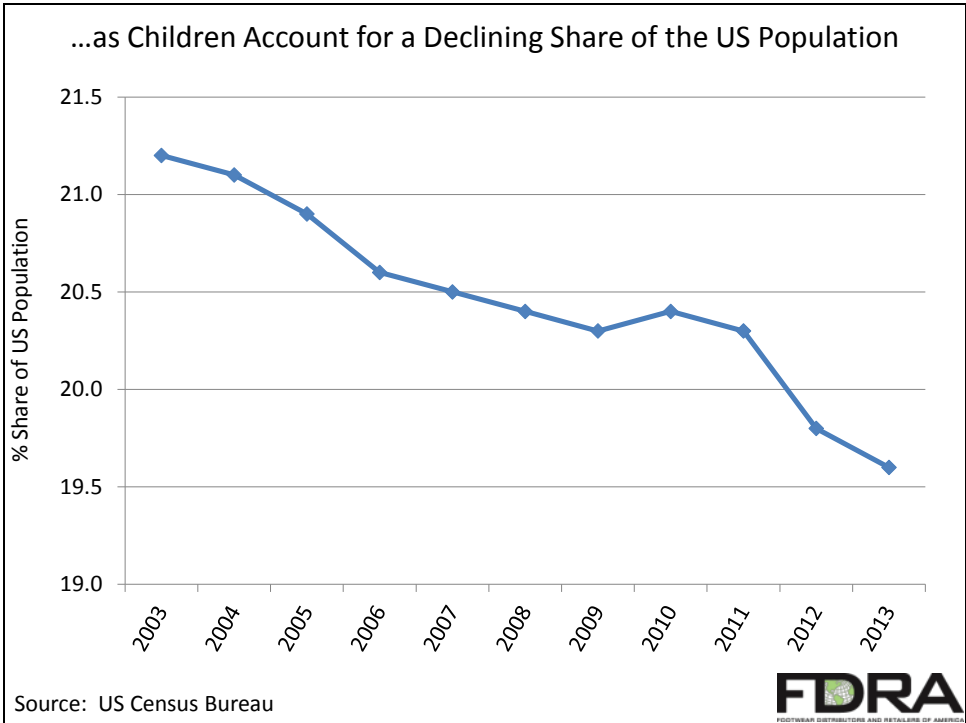
Athletic

In addition to footwear imports showing shifting shares among key suppliers, different categories of footwear imports show shifting shares as well. While the volumes of key import categories athletic (+10.0%), bootwear (+5.0%), and children's footwear (+5.7%) all posted gains in 2015, growth in imports of athletic footwear nearly doubled growth rates in other categories in 2015. In fact, athletic footwear imports climbed to a record 518 million pair in 2015, nearly matching the volume of children's footwear imports which have been relatively flat over the last eight years. And early 2016 data suggest athletic footwear imports will surpass children's footwear imports for the first time in over a decade, accounting for a record 20.7% of total footwear imports. A look into underlying demographic and attitudinal trends hints at prospects for this pattern to persist in coming years.



We see two key drivers behind this shift in share from children's to athletic footwear imports. First, the persistent trend of declining birth rates in the US results in children comprising a relatively smaller share of the US population than just a few years ago. The graph below shows that in 2003 the share of the US population aged 15 or less stood at 21.2%. This share sagged over the next decade to just 19.6% while older cohorts aged 45-64 and 65 and older gradually

expanded. In turn, relatively fewer children imply relatively less demand for children's footwear, a trend that birth rate forecasts suggest is unlikely to rebound any time soon.



A second key driver is more qualitative in nature, the trend to "athleisure" wear in which clothing designed for workouts and other athletic activities is worn in other settings, such as the workplace, casual or social occasions. Reports in *USA Today* and in the *Wall Street Journal* describe the athleisure market as growing rapidly, displacing typical workwear styles and cutting in to sales of jeans, with a market size in 2014 of \$35 billion, an 8% increase from the previous year. According to one estimate, the athleisure market - including footwear - will reach \$270 billion in 2016 and may grow another 30% by 2020. A consequence of this fashion trend is more athletic footwear is paired with new yoga pants, tights and leggings, cutting into demand for non-athletic footwear that traditionally may have been paired with jeans. If these upbeat forecasts for the athleisure market come to fruition, athletic footwear imports may continue to outperform shipments of other categories.

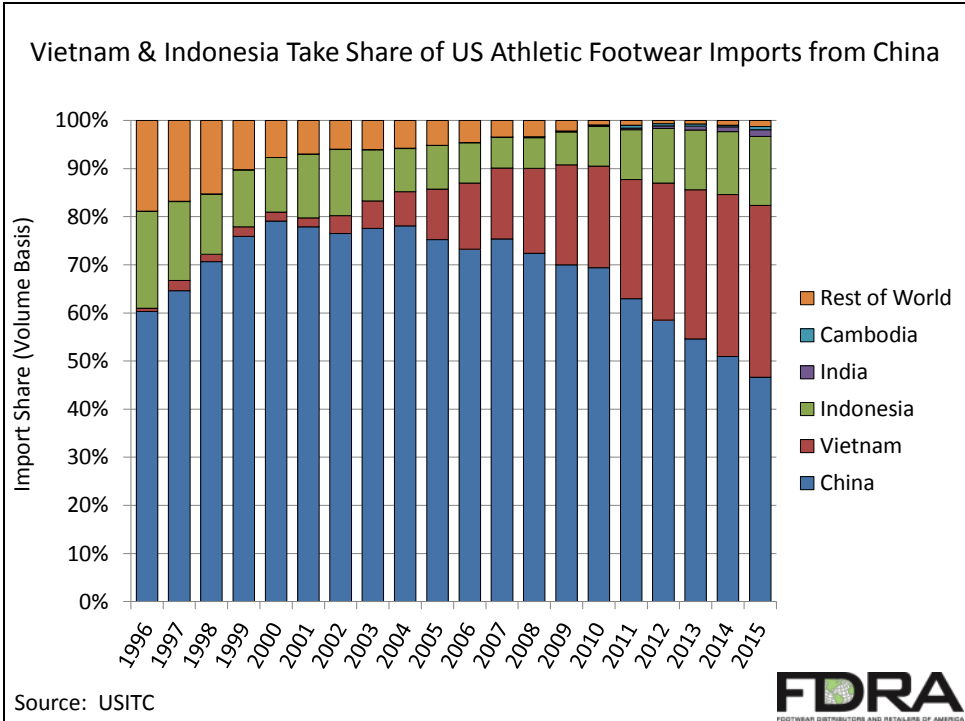
Athletic: By Origin

The key foreign suppliers of athletic footwear to US shoppers typically are the same key suppliers of total footwear, but these suppliers' shares are less concentrated. China remains the largest, with shipments rebounding to 241.5 million pairs in 2015. But while total athletic

footwear imports have grown, China's have been relatively flat for nearly a decade, implying China has lost share. Indeed, the country now accounts for just 46.6% of athletic footwear shipped to America in 2015, a share that has withered rapidly from nearly 80% a dozen years ago. Surging shipments from Vietnam and Indonesia took much of the share lost by China over this period.

Indeed, athletic footwear from Vietnam and Indonesia have soared each of the last few years, outpacing growth in the rest of the world and confirming what FDRA members have been telling us for quite some time. At 74.6 million pairs, imports from Indonesia rose 21.0% in 2015, higher each of the last six years. This latest advance pushed the country's share of total athletic footwear imports to an eighteen-year high of 14.4%, the most since the fallout from the Asian Financial Crisis.

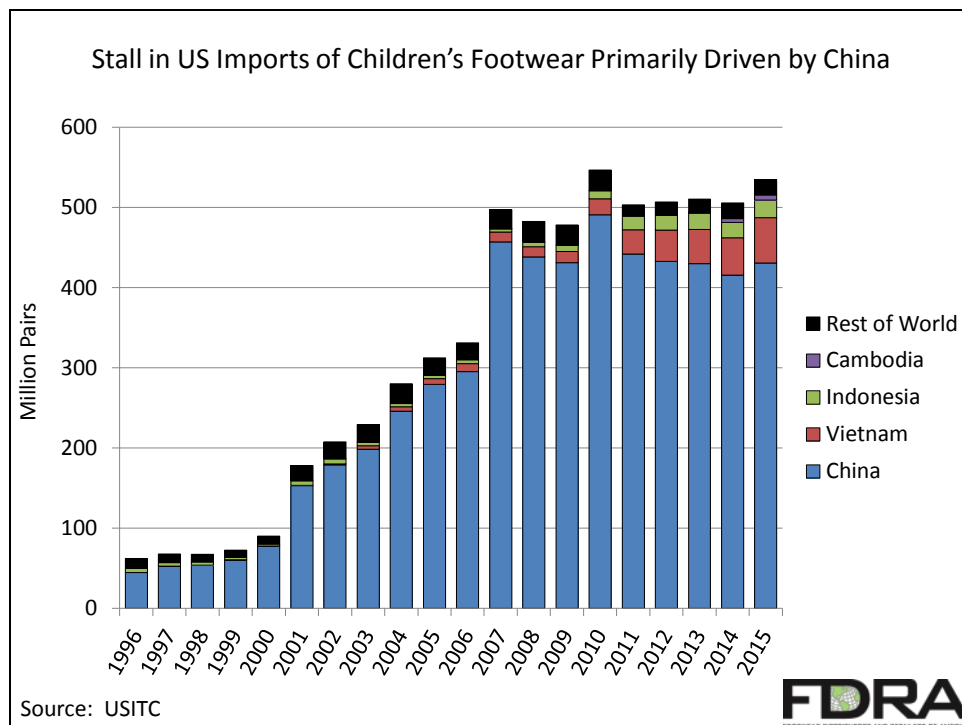
Vietnam is faring even better, with shipments climbing at a double- or triple-digit pace fourteen of the last fifteen years. The 185.1 million pairs the country sent to America last year accounted for 35.7% of all athletic footwear imports, rapidly encroaching on China's fading share. Lower average landed costs from Vietnam versus China in recent years are behind these shifting shares, an issue that we believe portends a similar reversal of fortunes between China and Vietnam for total footwear imports over the next few years.



Children's

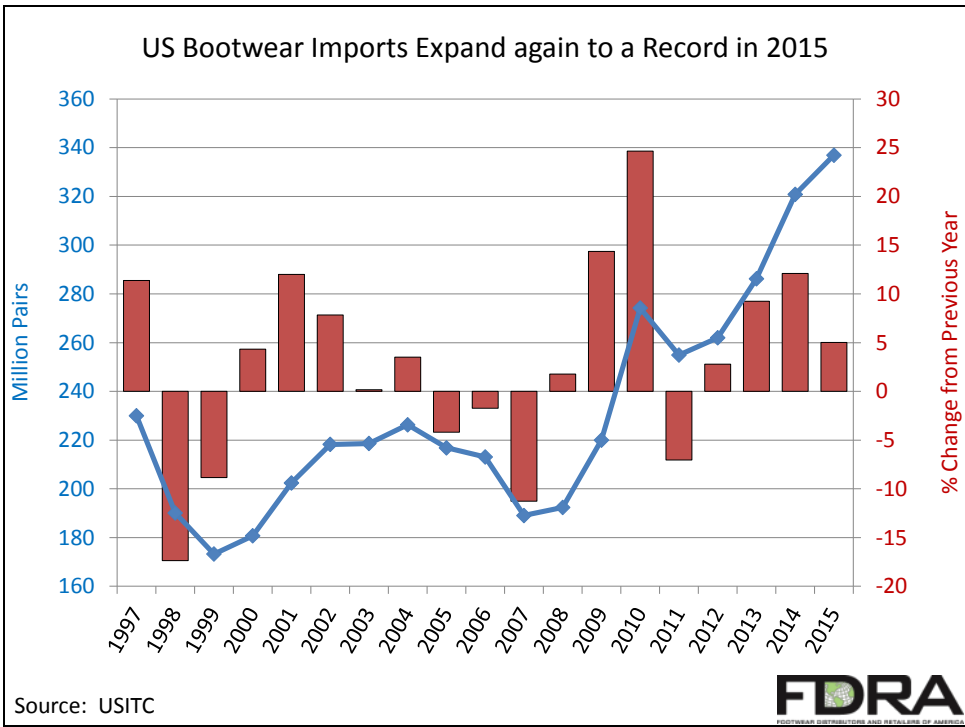
There are both demand-driven and supply-side factors impacting the amount of children's footwear the US is importing, with both issues suggesting shipments may remain dull in coming years. Earlier we discussed how a declining US birth rate is resulting in children accounting for a declining share of the national population. Relatively fewer young people imply less demand for children's footwear relative to other categories. In turn, with the vast majority of retail demand filled by imports, relatively dull demand implies relatively dull shipments from overseas.

From a supply-side perspective, children's footwear imports indeed have been mostly flat over the last eight years, owing to dull shipments from our largest supplier China. While the country still accounted for a dominant four in five pairs of children's footwear imported in 2015, this share is the lowest in seventeen years. Vietnam again has been the primary beneficiary with its shipments growing to records each of the last thirteen years, but even this expansion has not been enough to grow worldwide children's footwear shipments to America appreciably over recent years.

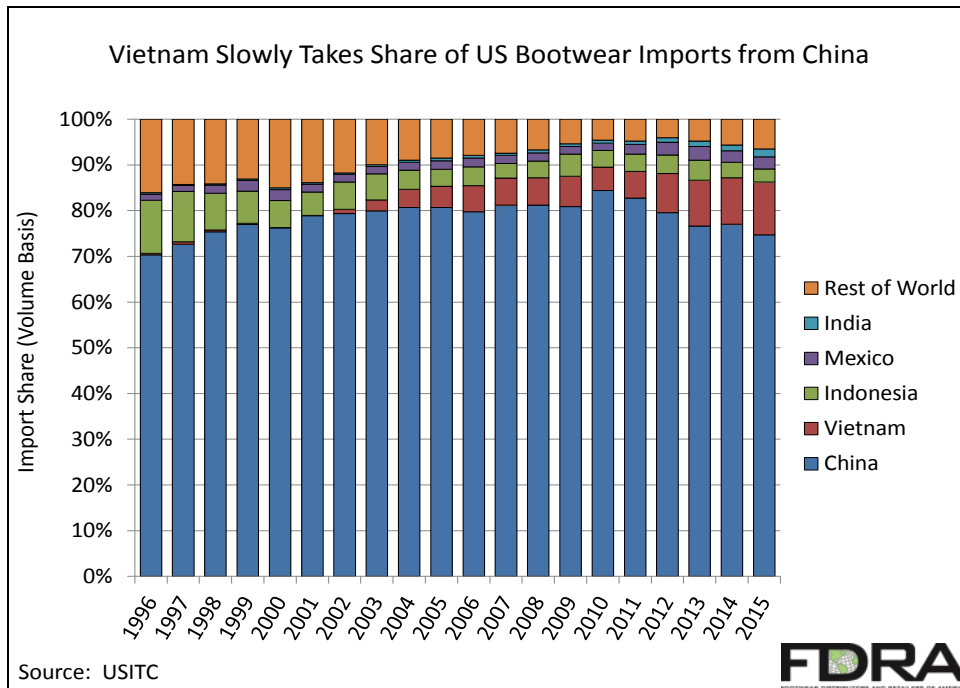


Bootwear

Whether for fashion, the rugged outdoors, or industrial uses, few wardrobe items conjure positive images of Americana quite like boots, and Americans' affinity for bootwear remains vibrant, judging by the latest import data. At an unprecedented 336.9 million pairs, shipments into the country in 2015 climbed for the seventh time in the last eight years. This growth continues even as the average landed cost of boots has remained near a record high of \$20/pair each of the last four years. Consistent growth in imports in spite of these lofty costs is a testament to Americans' ongoing love affair with this iconic symbol of Americana.



Bootwear sourcing from overseas also remains concentrated primarily in China, but Vietnam also is slowly whittling away at this dominant share. First, import growth last year was widespread across most origins, with suppliers expanding their shipments to the US exceeding suppliers reducing their shipments more than 2-1. Accounting for three in four pairs of boots the US imports, Chinese shipments grew again in 2015 to an unprecedented 251.7 million pairs. But bootwear from Vietnam again grew faster, up 19.9% to a record 39.0 million pairs, accounting for one in nine pairs of imports last year. All other origins account for less than 17% combined, suggesting America's import market for boots remains a two-horse race dominated by China, but with a distant Vietnam gaining rapidly.

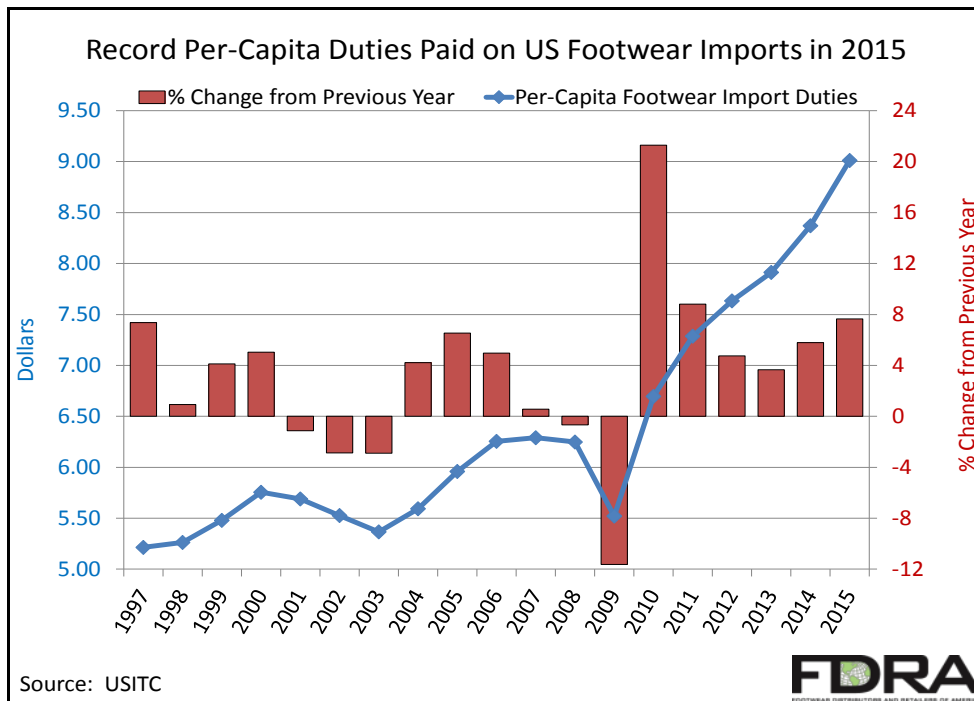


Unprecedented Costs and an Unprecedented Opportunity

Unlike few other industries, US importers of footwear are burdened with paying an inordinate amount of tax on footwear sourced overseas. In 2015 these duties jumped 8.5% to an unprecedented \$2.9 billion, the eleventh record in the last dozen years.

Viewed another way, indirectly every man, woman, and child across the country paid an average \$9.01 last year in duties. Without this burdensome tax in place, shoppers could spend more, manufacturers could supply more, and retailers and distributors could sell more product than ever before. Just such an opportunity recently has been presented to the industry.

A key opportunity for distributors and retailers of footwear is unprecedented cost savings available through the Trans-Pacific Partnership (TPP). For the US footwear industry, the TPP could be *the most commercially significant free trade agreement (FTA) ever*, providing half a billion dollars in savings for footwear consumers and companies during the first year of implementation and six billion dollars over the first decade. Duty savings from the TPP will help lower costs, boost profitability, as well as help strengthen footwear jobs across the US in manufacturing, trucking, retail, warehousing, design, marketing, administration, and at our nation's ports.



Following seven years of negotiations, all twelve nations agreed to the TPP in February 2016, an event welcomed by FDRA. But while President Obama notified Congress he intends to sign the agreement, both presumptive presidential candidates from the two leading parties have come out strongly against the agreement. Many expect that the only opportunity for Congress to vote on the TPP this year will during the lame-duck session after the November elections and before the newly elected Congress commences in January 2017. Any postponement beyond 2016 could jeopardize this monumental agreement.

Beyond the TPP, the US has FTAs with countries all over the world providing market access for goods between the US and its trading partners. FDRA supports expanding such agreements so that more footwear coming into the US from overseas can be tax free, lowering shoe costs, expanding demand, and strengthening the American footwear industry.

Forecasts

The industry is seeing paradigm shifts ranging from trends in initial commodity input prices to an evolving retail shopper that will color the footwear landscape for years to come. Seldom have the evolutions of different linkages across the supply chain been as rapid or as tectonic for the industry. Those able to anticipate these shifts and navigate through these contrasts will reap the bounty of selling to the largest footwear market in the world.

A look to the horizon poses a range of issues for footwear distributors and retailers. For example, in this new era of presumably rising interest rates from record lows, will the dollar firm even further and will the US economy avoid a slowdown that could jeopardize demand for footwear? What will the congressional calendar and the presidential election hold for the Trans-Pacific Partnership? Will Vietnam continue to take import share from largest-supplier China? And will retail footwear prices be able to muster steady gains, providing breathing room to distributors and retailers alike? We address each of these and more in our look to the future detailed over the next several pages.

The Dollar's Impact on Trade

Arguably the single biggest factor driving US footwear import costs is the relative strength of the dollar. And key issues that can drive the dollar are the vitality of the US economy and the level of interest rates, particularly relative to rates in other countries. A strong economy will attract investment from all over the world due to the perceived safety and the ability to achieve an acceptable rate of return on investment. Similarly, relatively higher interest rates imply higher rates on US bonds, thereby attracting foreign investment in these bonds, boosting demand for dollars to buy these bonds. And as the dollar rises or falls, costs of imports tend to fall or rise in mirror-opposite fashion, as it takes fewer dollars relative to another currency to pay for imported goods.

Naturally, prospects for a stronger or weaker dollar can color the outlook for footwear imports costs and ultimately sales. Footwear importers, retailers, and consumers have enjoyed the fruits of a relatively strong dollar over the last year and a half, with the greenback keeping hikes in the average landed cost of footwear imports relatively contained recently.

Looking ahead, we believe the dollar will remain strong over the next several years, owing primarily to relatively weak economic growth abroad and relatively more accommodative economic policies overseas versus at home. Late last year America's Federal Reserve raised its Federal Funds rate for the first time in nearly a decade, signaling an end of the 'easy money' period that saw this rate decline to a record low. And the potential fallout from the "BREXIT" - Britain's referendum to leave the European Union - over the next few years is likely to weigh on the euro, in turn adding support to the dollar. If the greenback remains firm, the currency is unlikely over the next few years to contribute substantially to a surge in footwear import costs.

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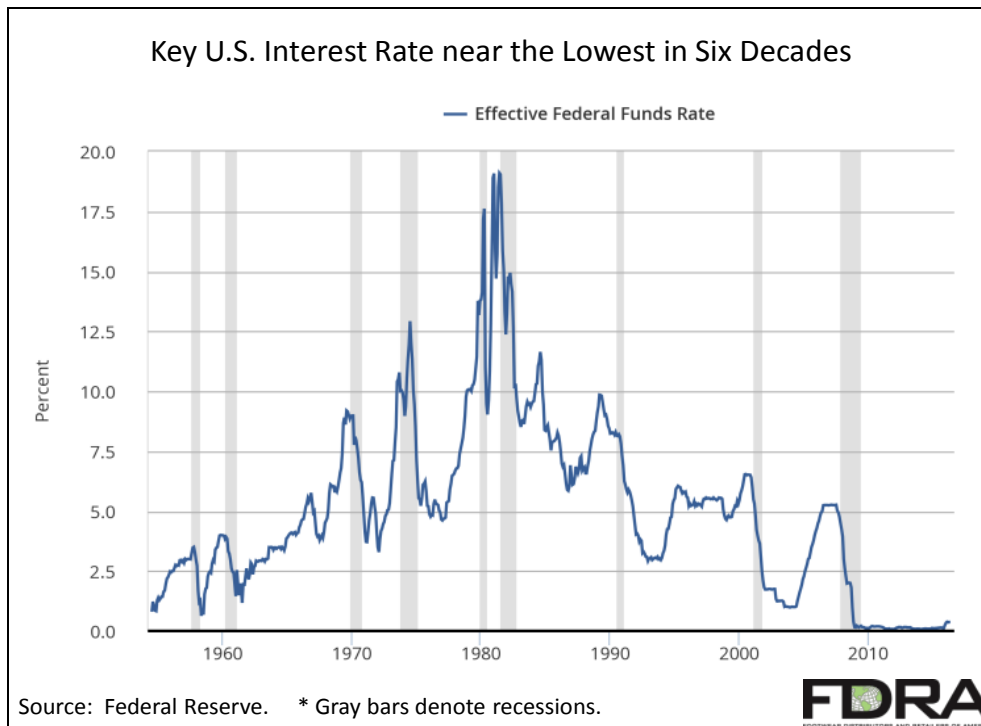
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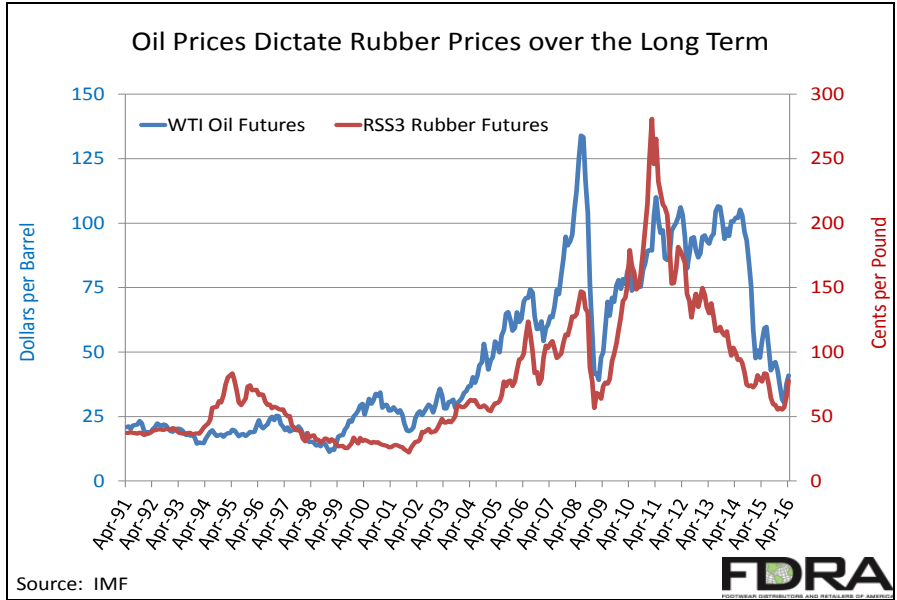
FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA



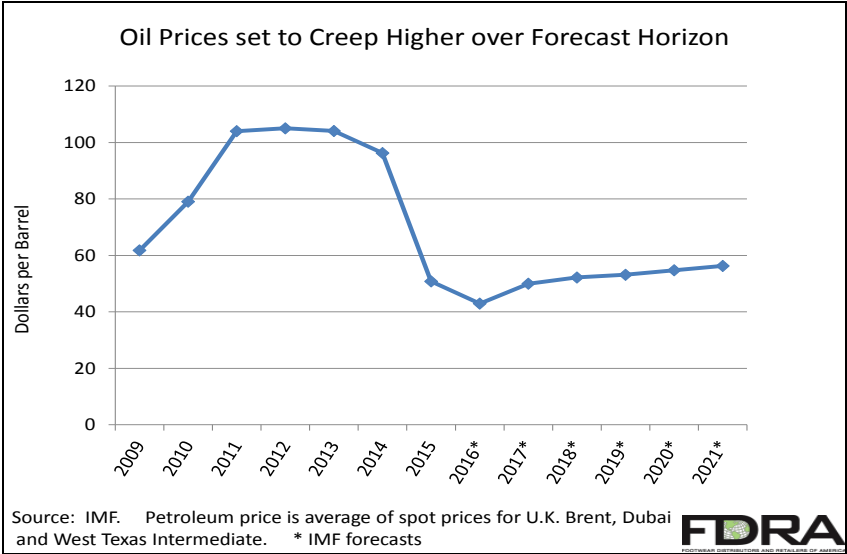
Footwear Input/Commodity Costs

Oil

Perhaps no commodity has as pervasive an impact on the global footwear market as petroleum, particularly crude oil. The impact comes in different forms, whether as a key input cost, component of supply, or determinant of consumer purchasing power. As an input cost, crude oil factors into the cost and supply of many primary commodities indirectly through the use of various energy-intensive inputs (e.g., fertilizer, textiles and fuel). Oil and its fuel derivatives of course also enable the transportation of commodities and goods produced and consumed across the footwear supply chain. And as the root feedstock in the production of a number of synthetic fibers used in footwear manufacturing, petroleum is a key factor in the industry. Other commodities used in footwear manufacturing compete with these synthetic products, particularly cotton vs. manmade fibers, natural vs. synthetic rubber, natural vs. synthetic leather, and so forth. We see an example of this relationship in the graph below, showing the close relationship between oil prices and a benchmark measure of rubber futures, a key cost component in footwear manufacturing.

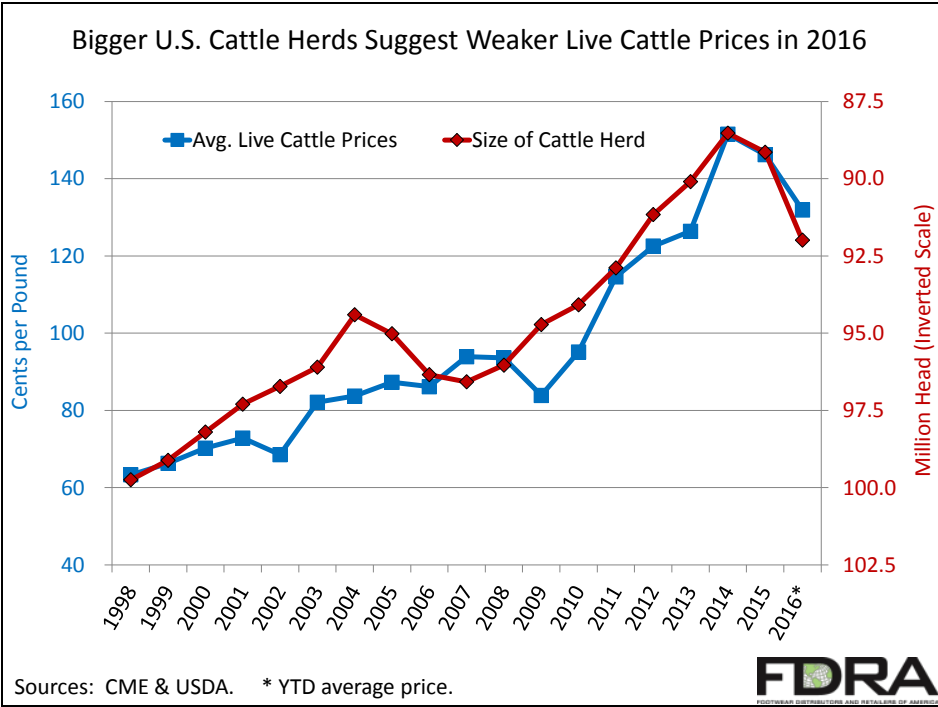


Given petroleum's pervasive impact across several commodity costs for footwear manufacturers, an oil price projection is warranted. America's Energy Information Administration pegs 2016 average Brent oil prices at a near-term low of \$37/barrel, increasing to \$77/barrel by 2020 as demand and supply come into balance. After 2020, the EIA sees prices continuing to rise, as growing demand results in the development of more costly resources. But until then, oil markets are expected to remain oversupplied in the short term, keeping EIA's forecast for annual average prices below \$50/barrel through at least 2017. Accordingly, the short-term outlook for oil prices little changed from prevailing levels suggests prices for derivative products--like synthetic fibers or artificial leather--or their competitor commodities--like cotton or natural leather--also may see little upside.

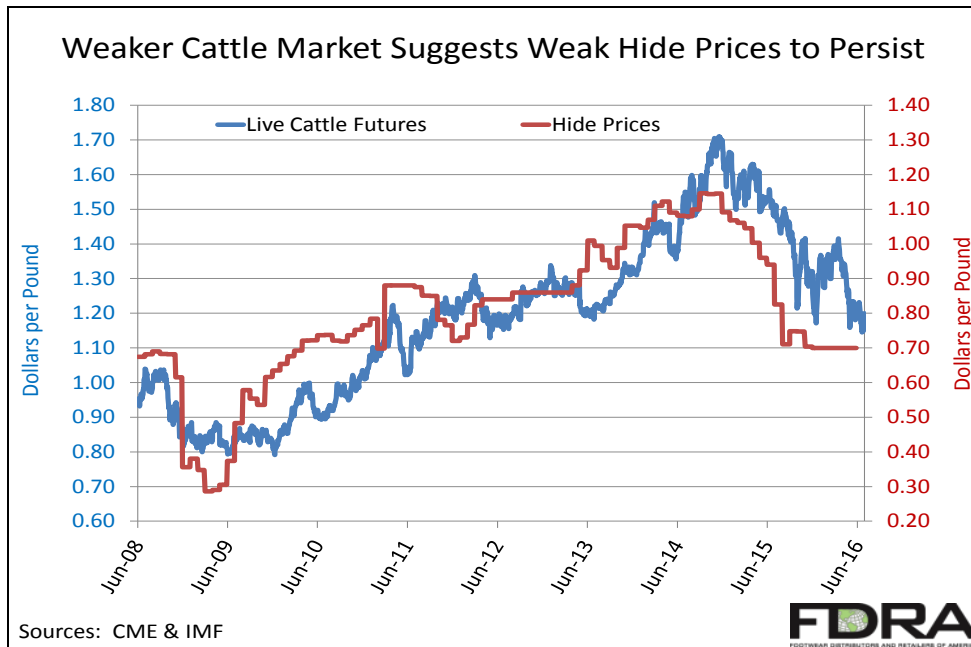


Leather

Along with rubber, one of the biggest material costs in footwear manufacturing is leather, a product that recently has been subject to unprecedented cost pressure. Fortunately, evidence suggests costs for cattle--and by extension, leather--will remain soft over the short term, owing in part to a rebuild in the US herd size. Key basic fundamental factors impacting the live cattle market include weather, disease, USDA reports, and broader economic trends and geopolitical factors, among others. Prices for feeds including soybean, hay, corn, and grains also can impact cattle prices, as can prices for substitutes like hogs. The graph below demonstrates how the rebounding herd size--shown on an inverted scale on the right axis--portend live cattle prices will weaken again in 2016. Indeed, we see limited upside for the market as global beef fundamentals are expected to loosen moderately in the 2016 marketing year.



In turn, we expect over the medium term that hide prices will remain little changed well into 2017 from relatively flat levels witnessed over the last six months, near their lowest in six years. The following graph demonstrates the co-movement between live cattle futures and hide prices over the last several years. If live cattle futures remain weak owing to a larger herd size, hide prices--and leather costs--similarly may remain relatively contained through the medium term, well below lofty levels witnessed the two previous years.



Presidential Election and Prospects for the TPP

There is no question that the current tenor of the 2016 US presidential election season has been dominated by anti-trade, protectionist rhetoric from both presumptive nominees. Secretary Clinton, in response to a surprise showing by Senator Bernie Sanders in the Democratic primary season, was forced to pivot towards a more negative approach to trade and the TPP than her previous positions as Secretary of State. On the Republican side, Donald Trump has led an all-out verbal assault on the benefits and virtues of trade liberalization, all in the name of restoring the economic vitality of the American middle class.

Anti free trade rhetoric is no stranger to US presidential campaigns. Many will recall the pronouncements of Ross Perot in the campaign of 1992 as he warned against the North America Free Trade Agreement (NAFTA) and the “giant sucking sound” the agreement would create as it siphoned jobs away from the United States to the benefit of Mexico (never mind the fact that 27 million new jobs were created after NAFTA was implemented and before President Bill Clinton left office in January 2001). Even in 2008, Senator Obama and Senator Clinton fiercely debated in Ohio who would renegotiate NAFTA more quickly upon entering office or withdrawal from the agreement all together – something that never happened.

The most unique aspect of the 2016 campaign is the fact that Donald Trump’s anti trade declarations are in direct opposition to the official platform of the Republican Party, closing off the historic source found in the Republican nominee that defends the importance of trade in an

election year. This is a perfect storm for trade and the clash of competing ideologies – considering a massive, once in a lifetime trade agreement at the same time a presidential campaign universally lambasting trade is underway. It is our hope that pending the results of the election, cooler heads will prevail, proven economic precedence will take hold and the TPP will be passed because passage only becomes more difficult in 2017. Of the 218 votes in the House that were cast in favor of Trade Promotion Authority (TPA) in July of 2015 (considered to be somewhat of a TPP proxy vote), 20 of those members are retiring at the end of this year. That means that a significant amount of new votes will have to be found in the next Congress in order to move the agreement next year.

All of this is to say stay tuned, stay active, and take part in the process. The leadership is in place now with President Obama, House Speaker Paul Ryan, and Senate Majority Leader Mitch McConnell to pass the TPP this year. After this year, all bets are off.

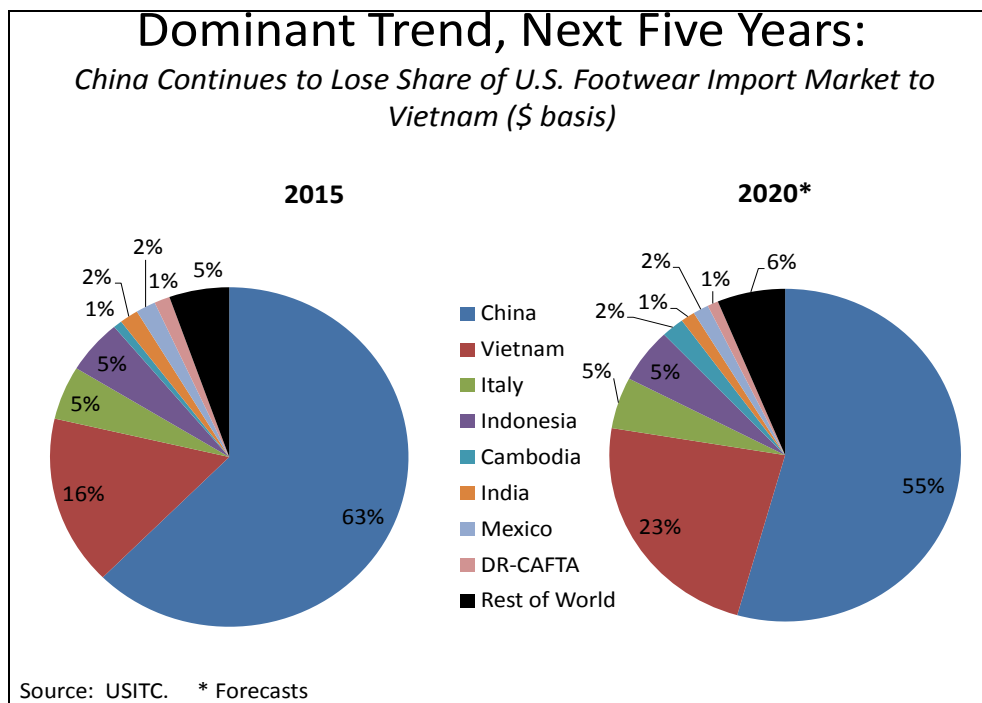
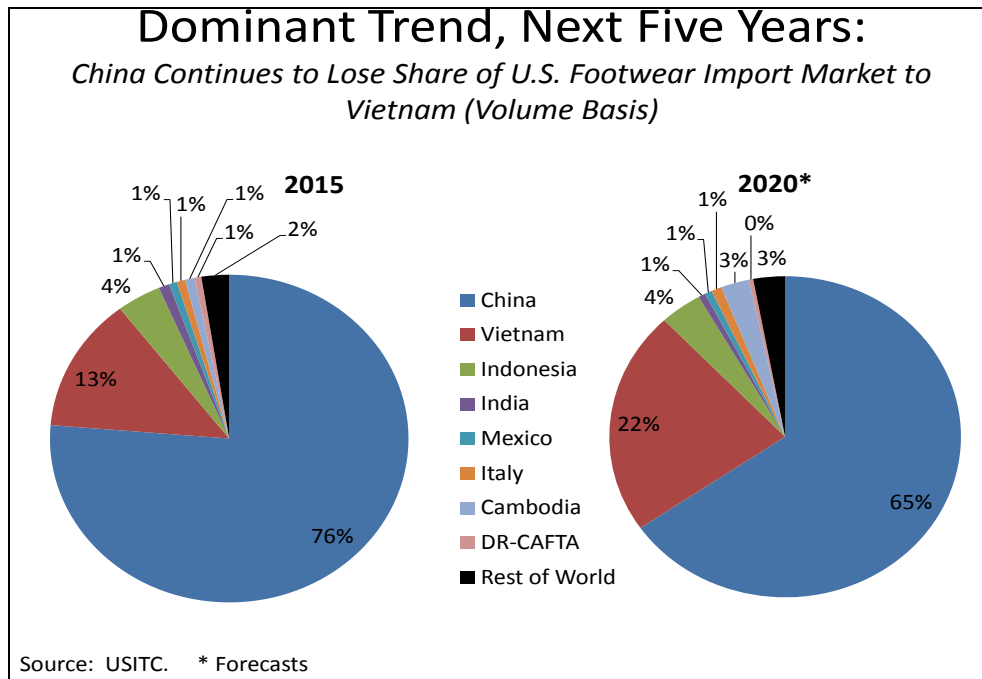
Import Trends

Our five-year view to the horizon for US footwear imports is one of growing shipments, moderately higher average landed costs, and Vietnam's continued encroachment of China's dominant share. Three years ago we said footwear imports would grow from \$23.4 billion in 2012 to a record \$29.6 billion in 2017. After reaching \$27.7 billion in 2015, indeed we remain on track to reach this unprecedented figure next year and imports may climb over the next five years to well north of \$31.7 billion by 2020. This projection is based on a number of factors, including growth in population and per capita disposable income, retail footwear sales, and changes in unit costs of footwear imports over the forecast horizon

Prospects for changing unit costs of footwear imports over the next several years will depend upon several factors, none easy to forecast. Chief among these is the dollar discussed earlier. By extension, strength or weakness in the dollar may drive in mirror-opposite fashion weakness or strength in a range of dollar-denominated commodity prices for footwear manufacturers, including rubber, leather, and synthetic fibers. And the outlook for a final implementation of TPP could bring substantial duty savings to retailers and consumers alike during the forecast horizon, helping reduce average landed costs for footwear imports.

Looking at shifts by origin, the overriding trend witnessed over the last few years of Vietnam gradually eroding China's dominant share of US footwear imports remains in flux, and we believe this will be the key issue coloring sourcing decisions over the next several years. Recall we projected several years ago Vietnam would slowly and steadily increase its share of US imports, largely at the expense of China. We see this pattern continuing over much of the forecast horizon, with Vietnam accounting for upwards of 22% of total footwear imports on a volume basis and 23% on a value basis. In a distant third place, Indonesia's share of total US

footwear imports also may expand, but modestly relative to Vietnam's advance. Both of these suppliers' shares could expand even faster if the TPP is signed into law and implemented in the near future. While China is likely to remain the dominant supplier of US footwear imports, Southeast Asia will continue to take share from this juggernaut.



An Innovative Industry

In the coming years the shift into Vietnam will hit even more capacity and new wage challenges due to its limited population. The shift of sourcing to inland China to alleviate high wage costs and labor shortages is not a long-term strategy. The greater the realization of these challenges in future years, the more automation in footwear factories will occur.

Factories who can survive and succeed over the next 10 years will focus on reducing the number of touches and quality defects on the production line each year – either through machines or a serious look at their setups. Successful factories will also set up systems that continue to use CADs software to ensure prototypes match end product. In fact, within 10 years FDRA believes half of all factories will no longer have sample rooms.

Even as factories overseas automate, some companies are moving forward with plans to set up small production facilities in the U.S. to meet the rising demand of the new “now” generation. These facilities could eventually be fully automated, using machines and 3D printers, but in the near term may look more like a hybrid; importing some components while machines produce and/or assemble the others. Over the next 5 years, this will become an increasing reality. Indeed, Elan-Polo produces millions of pairs of mold-injected shoes in its high-tech facility in Georgia.

“It's the Economy, Stupid” 2.0

2016 is 1992 again in political-economic terms. One key issue that could color the outlook for the dollar as well as footwear demand itself is the health of the US economy. Accounting for about two-thirds of economic activity, consumer spending naturally is a key factor in gauging the vitality of the economy. And as the graph below demonstrates, consumer spending downshifted during almost every one of the last eight recessions, denoted by the gray vertical bars. As a component of overall consumer spending, footwear consumption has trended with overall consumer spending over the years, albeit in a more volatile fashion. More particularly, footwear spending has contracted during each of the last several recessions as shoppers turning less optimistic and more hesitant shift their discretionary purchases away from footwear.

While the graph does not show a current recession, we caution that spending on footwear has slowed each of the last four years. What's more, over the last seventy years the US has endured a recession an average of every 6.4 years. The last recession ended in 2009. In the current environment of rising oil prices, gradually higher interest rates from America's Federal Reserve, and seven years since the last recession, the odds grow stronger of a recession on the



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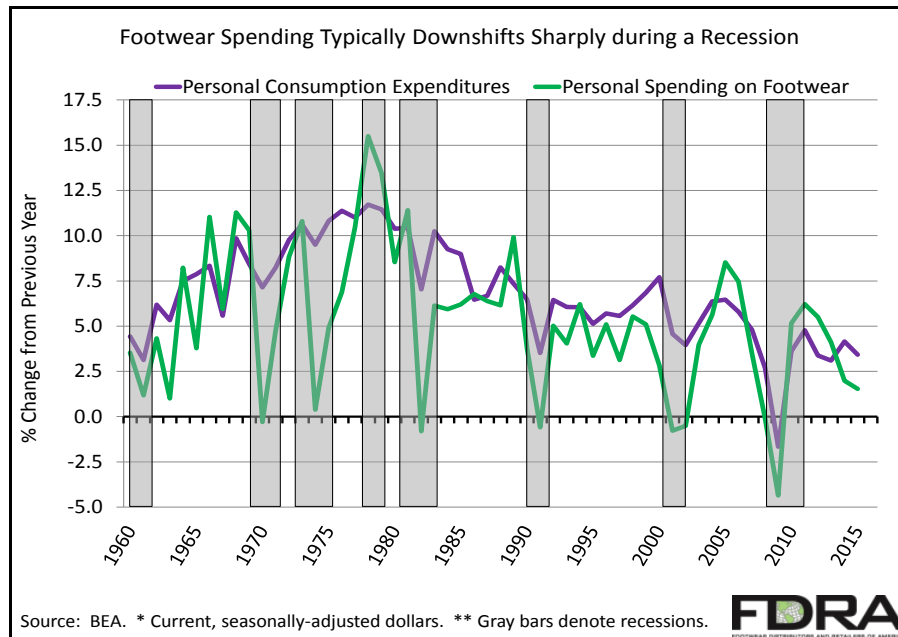
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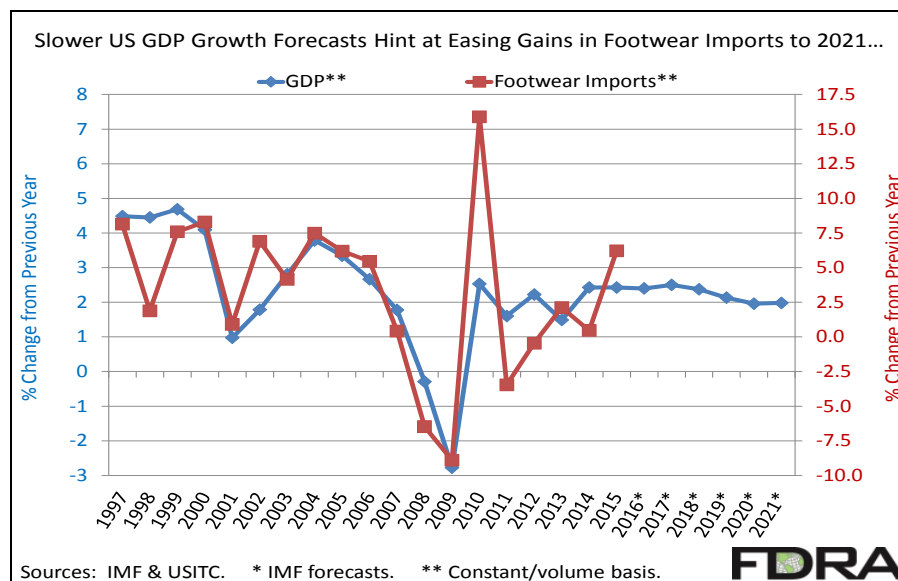
WHEN YOU NEED TO BE SURE

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horizon. If so, history strongly suggests footwear spending may decelerate further - or even contract again - should a recession develop.



Economic growth also is strongly correlated with footwear imports, as the graph below demonstrates. The latest projections from the IMF call for America's economy to expand at roughly 2.4% this year and in 2017, before decelerating modestly each year thereafter. Assuming this outlook comes to fruition, footwear import volumes similarly are likely to grow, albeit at a decelerating rate over the five-year forecast horizon. In short, America is likely to continue to source record volumes of footwear each of the next several years, but the annual growth is likely to taper to an anemic rate.



An Evolving Consumer

A final issue in this sourcing assessment that cannot be ignored is the impact of an evolving shopper. Just last year, Millennials - Americans born between 1982 and 2000 - numbered 75.4 million, surpassing the country's 74.9 million Baby Boomers to become the largest living generation in the history of the US. And as more Boomers retire and more Millennials grow their careers and families, soon this cohort's purchasing power will eclipse all other generations. And with this tectonic shift in who is buying footwear will come a shift in *what, when, and how* they are buying. The entire footwear supply chain from manufacturer to distributor to retailer could thrive by taking heed of this evolution in the customer base in the years ahead.

One major trend that we see continuing is the growth of mobile shopping. Purchases from smart phones will only increase and adapting websites to the mobile friendly platforms will not be enough. To capitalize, companies must create dynamic coding so that each time the customer visits they see a different product sold within the company's collection. Data collection will continue to be paramount so that products specific consumers are most likely to buy are prioritized on the website to encourage purchases. At the same time, we do not see the death of shoe stores – on the contrary, we believe shoe stores will continue to grow thanks to dynamic displays, automations and technology improving in-store experiences.

Another trend we see is that more and more companies will use some form of CADs program to allow shoppers on their websites to design their own shoes – creating an engaging experience

that merges with social media in ways that may create the next pair of must-have shoes before they are even put into production.

Lastly, we will continue to see pressure on designers and factories as consumer demand increases. Just as four seasons have turned into six or more, the future means an increased array of designs but a decrease in volume of individual shoes. It means that factory automation to increase productivity will not be a luxury but an absolute necessity in the coming decade.

Conclusion

All things old are new again as production in China now presents new types of opportunities for companies – a desire to fill orders so much so they are negotiating price more so than in years past. Meanwhile, Vietnam continues to grow but is nearing a tipping point where capacity is being reached so quickly prices may rise faster than anticipated. Global production will continue to increase, but are clearly only seen by many U.S. companies as a way to do one product line or small batch orders to relieve price and capacity constraints from their suppliers

in Asia. Meanwhile, thanks to a continued global economic rut, material costs will remain in check over the next few years...allowing companies to offset increases in wages. As consumers continue to morph into generation “now” companies will continue to struggle with inventory control, yet factory automation and the future of production through 3D printing and small automated factories may begin to meet these just-in-time production challenges in the coming years.

Among this sea of changes and these forecasts to the horizon, FDRA remains the steadfast beacon guiding the way on issues impacting footwear production and the U.S. market. From services ranging from support to advocacy to market intelligence, from product safety, customs, and factory compliance solutions to helping companies develop advanced sourcing strategies, FDRA is the only trade association dedicated solely to serving the footwear industry.

FDRA will continue to provide monthly import data by country and category (athletic, boots, children, and fashion), as well as a look at monthly changes to footwear input costs (rubber, textile, synthetic, etc.) in its monthly [sourcing newsletter for members \(sample\)](#). Be on the lookout each month to note trends and stay ahead of the game.



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