Tropical Sportswear International (A)

Mr. William Compton, a long time veteran of the garment industry, sat in his office contemplating the first steps to take in bringing growth and profitability back to the company he had just purchased. Driven by his desire to own his own company, Mr. Compton had just closed a deal resulting in the purchase of Tropical Garment Manufacturing Corporation (TGMC).

The events of the last several months flashed through Mr. Compton's mind very quickly. He had spent two decades in the garment industry working for garment manufacturers such as Hager, Farrah, and Munsingwear.[1] During his employ with these companies he had watched the garment industry change quickly in response to new fashions, new technologies, new materials and new processes. But none of this proved to be as exciting as this moment in time.

Tropical Sportswear International (TSI), the new name given to TGMC, will be the second time that Mr. Compton has sought to manage a turn-around. In the years prior to purchasing TGMC he had made a deal to buy the failing Munsingwear once it was turned around and profitable. After managing the company through the difficulties of re-engineering Mr. Compton sought to exercise his option to buy. But now that Munsingwear had been pulled from bankruptcy into profitability and generous cash flows, the owners reneged on the deal, raising the original purchase price commensurate to the newfound profitability. Mr. Compton soon left Munsingwear to pursue the rights of ownership elsewhere.

After seeking out and analyzing several potential opportunities to purchase different companies, Mr. Compton came upon TGMC. Less than twelve months after leaving Munsingwear, Mr. Compton made an offer on TSI, including a purchase price set in stone.

TSI: A brief history

TGMC, originally founded in 1927, is a men's pant manufacturer and was family owned and operated until 1985. The founder's son and son-in-law, both age seventy years plus and both seeking retirement, turned TGMC over to senior management in early 1985 with plans to eventually sell TGMC to management. Rapid changes in the industry and lack of management's shift away from long-term relationships with small retailers lead TGMC into deep financial and operational difficulties by early in the first quarter of 1988 (for financial data see exhibits 1 and 2).

The downturn in profitability after TGMC's operations had been turned over to the management team left little hope that TGMC could be sold. So, in early 1988, the owners resumed management responsibility hoping to bring TGMC back to financial stability. Soon a new plan focusing on the higher margin special order customers was in place with a turn-around projected by mid-1989.

Unfortunately, the owners, being out of the business for three years, found that their old relationships within the industry were worth little. In the three years they

[1] These are integrated garment manufacturers and wholesalers. Hager and Farrah produce men's dress and casual slacks, while Munsingwear produces men's, women's and children's shirts, pants and underwear.

were in retirement, senior management had not shifted the customer base to include the new large retail accounts that were transforming the industry distribution networks. This left TGMC with shrinking order quantities as the price-competitive, high-volume accounts drove the smaller stores and chains, TGMC's core customers except for Levi Strauss' Dockers®, out of business. Adding to this, the owners were not fully aware of the impact of changes in the industry at the retail and product level, as well as changes in technology.

By mid-1989, TGMC was faced with implementing one of three options: close down operations, sell the company, or put $3 to $4 million into the company to buy time to continue turn-around efforts. Investing more money was too risky and closing would result in greater losses than putting it up for sale. So, in September 1989, less than one month after signing a new loan package totaling $3.5 million using personal assets and inventory as collateral, the owners put TGMC up for sale.

The Deals

Levi Strauss & Company (Levi) was anxious to get control of TGMC. Levi had initiated contracts with TGMC that allowed TGMC to acquire the piece-goods and accessories for Levi's orders from TGMC's suppliers, who in turn would bill Levi directly. Because TGMC acquired no out-of-pocket expenses for raw materials, these contracts reduced TGMC's need for cash and helped to keep TGMC afloat for several months prior to being placed on the sale block. Being involved with TGMC, Levi was aware of its financial conditions and expected TGMC to fold and fall into bankruptcy, at which time Levi could just take over TGMC for pennies on the dollar.

Baxter, a conglomerate from New York, tendered an offer which folded under the pressure of inordinate accountability placed on the owners after the sale was to be complete. Baxter was unwilling to renegotiate TGMC's current loan agreements that held the current owner's personal assets as collateral. In effect Baxter wanted the owners to remain responsible if TGMC continued into bankruptcy.

A third offer came from a group of investors lead by Mr. William Compton. After a brief visit to the plant and facilities, Mr. Compton made an offer that included a $3.8 million cash in-flow, contingencies for purchase price reductions if actual conditions were found to be inaccurately stated in TGMC's records and reports, and for Mr. Compton to manage the company until the closing date set for 16 November 1989. The offer was made 1 November. Financing was approved in New York and closing was finalized 15 days after the offer was made.

TSI: The Industry

There are many players in the supply chain of the garment industry and TGMC is right in the middle of it. The industry, in general terms, consists of cloth mills and accessories manufacturers (who cut and sew the raw materials), wholesale garment buyers (who purchase from the manufacturers) and garment retailers (who buy wholesale and sell to the end customer).

There is vertical integration within the industry, especially among large companies like Levi. No one is integrated from cloth milling to retail selling. Levi moved close to full vertical integration when it added Colonel Days retail casual wear outlets to its list of operations.

Levi, like Farrah, Hager, and other big companies, sew some of their own garments as well as contracting for those

services. This provides the flexibility to easily fluctuate production with demand. Garment wholesalers rely on various retailers as customers for their goods and networks to the end consumer.

In most cases the smaller retail chains and stores buy name brand items from the wholesalers. However, contracts with independent garment manufacturers like TGMC exist. These contracts are usually of low volume and often involve unique patterns, accessories, or materials.

Unless a garment manufacturer is a brand name label, there is little opportunity to focus sales efforts directly to retail outlets. Instead, throughout the industry, wholesalers act as sourcing arms for most retailers buying from independent manufacturers. Independent manufacturers generally do not have the resources to maintain research and development in new fabrics, finishes and processes, as well as being able to keep up with technology.

Typically, advertising in the industry is provided by the wholesalers with branded names like Levis or Hager. Some of the larger retailers carry store branded garments, but consumers often perceive them to be of lower quality. This perception allows high margins on name brand items.

Historically, the majority of the retailers in the garment industry have been small chains or mom-and-pop stores. Therefore, large retail chains are now able to take full advantage of the generous margins on brand names through high-margin pricing structures on store brand items as well.

In order to carry a variety of colors, sizes and styles retailers limit the number of product lines that are carried. This makes it difficult to gain entrance to display space once a retailer has chosen its product offerings.

Products and Materials

There are three main categories in men's pants: work pants (e.g., Dickies® and jeans), casual wear pants (e.g., jeans and Dockers®) and dress slacks. Within each category are many different styles, colors, materials, and sizes. The number of styles carried by a retailer within a category is limited to allow for greater diversity in color and material. It has been industry practice to carry every style in a variety of colors and materials and all available sizes.

Sizes

Pant size has two dimensions: inseam length and waist length. For men's pants, inseams range in length from 28" to 40". Waist measurements vary from 28" to 44". Larger waist and inseam measurements are producable, but generally carried in specialty shops. About eighty percent of all sales come from even waist sizes 30" through 38".

Materials

Material represents one of the largest cost factors. Cloth weight is determined by two factors: warp and fill. Warp is the number and weight of threads per inch running lengthwise that provide the base for weaving in the fill, the crosswise threads, which also vary by weight and number per inch. Typically, warp threads are heavier and fill threads are lighter. Variations on either of these dimensions results in a less or more expensive cloth.

Other materials, the accessories, also vary in cost. Brass zippers are the most expensive, wearing longest and withstanding the most stress. But zippers also come in aluminum and nylon. Both of which are lighter, less expensive, endure less stress and wear out sooner. Brads, copper or brass rivets found in most denim jeans, can be used at stress points or can be substituted with double stitching. Buttons and snaps

can often be interchanged and are made from a variety of materials. Thread-weight and color used in sewing the garment is also an accessory. All choices of accessories affect the manufacturing costs of the garment.

Industry Changes

From 1985 through 1989 four major changes evolved within the garment industry that proved significant to remaining competitive. These changes occurred in product, distribution channels, consumer preferences, and technology.

First, there was a product revolution as permanent press technology for cotton and cotton/poly blends emerged. "Pants that have a memory" became an effective marketing tool. "Wrinkle free" cotton was also an effective advertising slogan. These product changes were a result of R&D efforts by the integrated garment manufacturers/wholesalers to gain product differentiation.

The consumer spoke quickly and in a short period of time pants, and garments in general, carried the "wrinkle-free" label or they would not sell. Players in the industry scrambled to get the new technology before being "pressed" out of the game.

This technology opened the casual wear category to broader product lines as consumers were able to have the comfort of 100% cotton without ironing and without wearing jeans. An explosion of offerings came forth igniting growth in segment sales.

The second major change came in distribution logistics. Mass merchandisers like Sam's Club, Wal-Mart, K-Mart, Target, and department stores like Nordstrom's, J.C. Penney, and Sears increasingly sought growth through expansion into new locations—often in locations previously thought not to have the market size needed for sustaining operations. The effect of this growth in mass merchandisers and department stores was felt most directly by the "mom & pop" retail outlets that had been the key to survival in the garment industry since the turn of the century.

A third change taking place in the late 1980's was the heightening of consumer awareness that began to shift preferences away from the expensive brand name labels to the more affordable store brand labels. Customers began seeking value, a balance between cost and quality.

Technology was the fourth area undergoing changes in the late 1980's. Speed, flexibility and the general axiom "to do more with less" pervaded very industry, including the garment industry. Applying technological solutions to these issues increasingly became a necessity to stay competitive. Information systems and programmable industrial machines began to replace the paper shuffle and inaccuracy of human processes. Advancements in technology could bring speed, flexibility and delivery of high quality products at a value point never before possible.

The combination of retail growth through expansion and shifting consumer preferences set the stage, in the late 1980's, for a potentially dynamic shift in the industry distribution networks. Many industry experts thought that if store branded sales volumes grew as projected over the next few years, large regional and national retailers would become attractive targets for direct sales efforts from independent garment manufacturers.

TSI: Current Operations

On 1 November 1989, Mr. Compton assumed management of TGMC and on 16 November 1989 assumed ownership renaming TGMC to Tropical Sportswear International. As a part of the purchase Mr. Compton received a cutting facility, a

corporate office / warehouse / distribution center (leased from the current owners), all of the equipment, two offshore plants in Costa Rica (CR), 6 contracted plants in the Dominican Republic (DR), and a trained work-force.

The Facilities

The cutting facility receives accessories (snaps, zippers, buttons, etc.) and material from mills and suppliers. The accessories are repackaged according to orders. The accessories come in cardboard boxes with packing slips enclosed. These cases are opened and the contents sorted to various TGMC orders. Often a case contains accessories for only one of TGMC's orders, but for quality reasons it must still be opened and checked.

The cloth is received in bulky rolls which are laid out, patterned, cut, packaged as cuttings according to orders, matched with the accessories and together shipped to Miami through customs and onto either the DR or CR to be sewn.

The warehouse/distribution center receives finished goods from offshore, sorts them by SKU and fills orders for shipment to customers. This results in warehousing 10,000 to 12,000 SKU's depending on the season. Special orders[2] are received from the customer before raw materials are ordered. This allows TGMC to keep fewer SKU's in finished goods inventory (see exhibit 3 for layouts).

The Equipment

The cutting facility houses twelve cutting tables onto which bolts of cloth are laid out several layers thick. Patterns are then laid out on top and stapled in place, then the material is cut. The knives used to cut the layers have a long blade that reciprocates perpendicular to the material. Outside of pallet jacks, this is the extent of automated equipment.

The equipment in the distribution center consists mainly of sewing machines used for labeling pockets and waistbands. All other equipment is made up of common warehouse items such as shelving, pallet jacks, rolling carts, etc.

All of the automated equipment (cutting tables, knives, sewing machines), though in good working condition, is approximately five to ten years behind current technology. Computer technology exists in the office but no local or wide area networks connect any of the CPU's.

The Offshore Plants

TSI operates two company owned plants in Costa Rica and supplies six contracted plants in the DR with piece goods and accessories. Each plant requires 250 to 300 employees. Plants in CR average $.96 higher cost of production per pant.

Once these plants receive the materials they are sewn into pants, heat-treated, pressed or washed[3], repackaged and returned through customs to TGMC's warehouse/distribution center.

The plants in the DR are contracted on a piece-rate system. This means that any down time, due to lack of supply or change-over to a new chassis[4] of pant, is costly to the plant owner/operator and may mean forfeiture of contracts in cases where either is excessive (see exhibit 4 for layouts).

[2] Special orders result from a request for garments that require raw materials not kept on-hand in the normal sixteen week raw materials inventory or from a request for a new chassis pattern.

[3] Most pants receive a finishing process. These processes determine the finish of the material, the life of the crease, and the durability of the cloth.

[4] A chassis is a basic pattern. The style and accessories can vary on each pair (i.e., number and placement of pockets, pleat placement, number of belt loops, etc.).

The Work-Force

The general workers in the cutting facility require little training though there is a learning curve associated with sorting piece-goods by order and by plant location. The material handlers that lay out, pattern, and cut cloth require some training and experience. All of this training is done on-the-job.

The skills required in the warehouse/ distribution center are of the same nature. Most jobs are of low skill and can be learned very quickly. Most of the training revolves around sewing on labels, reading pick and order tickets, and packaging goods for shipment.

These low skill requirements coupled with low wages has allowed TGMC to attract a diverse work-force. Most of the employees come from the ethnic parts of town, speaking and reading little or no English. This communication barrier often leads to problems in quality control, inventory accuracy and shipping.

Cycle-Times and Inventories

TGMC receives orders for merchandise six months or more before delivery of the finished goods is to take place. This is fairly standard across the industry. As a result of these long lead-times, inventory in all segments of the industry are excessive. TGMC is no exception. TGMC, on average, keeps sixteen weeks of raw materials inventory in the cutting facility. This inventory level serves the purpose of buffering production in both the cutting facility and the off-shore plants against long lead-times from the mills and suppliers.

Once materials are cut and ready to ship through customs to the off-shore plants, there is a seven to ten week cycle-time. During this time period, work-in-process inventory goes through customs to the off-shore plants to be sewn, processed, and shipped back through customs to the warehouse/distribution center.

From this point, shipment to the actual customer could take twenty-one days or more, leaving three or more weeks of inventory in the distribution center. The finished goods inventory is attributable to the time involved for quality inspection, sorting, final labeling, packaging, preparation for shipment, and in some cases, holding merchandise till its specified ship date.

TSI: The Challenge

On 1 November 1989, Mr. Compton sat at his desk reviewing TGMC's records and reports, not liking most of what he found.

There was no cash to purchase raw materials and suppliers cut TGMC off weeks before as their days payable were extended as far as possible. The normal sixteen week inventory has dwindled to just four days. By the 6t^{h} of November, the cutting facility will have to be shut down until more raw materials can be purchased.

Under the new debt service, the cash flow has become so tight that purchasing maintenance and janitorial supplies is not allowed. There is still a seven week supply of finished goods scheduled to come in from off-shore, but any margin would go directly to continuing distribution operations—leaving no money for purchasing raw materials.

On 16th November, TGMC, as TSI, will receive a $3.8 million cash inflow, but that won't pay the $5+ million in overdue trade payables. Even with bank loans renegotiated and payable periods relaxed a little more, time and cash would be limited.

Cost-cutting measures can be taken to reduce cash outflow and increase cash for continuing operations, but what changes in

operations will be needed to build profitability in the long-term?

Issues

If Mr. Compton repositions TSI to take advantage of changes in the industry, by selling garments directly to large retail accounts, will a six month cycle-time be adequate? How will warehousing and distribution have to change to gain the speed and flexibility being demanded by these new accounts? Can technology appropriately applied give TSI a competitive edge over the "big" guys?

Can TSI remain focused on the special orders or will adopting a core product line with high volume be the vehicle to carry TSI to profitability? Because TGMC's research and development always followed on the heels of the industry, can in-house R&D be cost effective? Will it be a necessity?

What about vendors, both the raw goods supplier and the off-shore manufacturing plants? What can be done with the suppliers to forge a working relationship to allow the purchase of new raw materials? Since off-shore plants have witnessed a slow erosion of business, what can be done to hold on to the existing plants and pick up new ones as TSI grows?

Exhibit 1

Tropical Sportswear International

(all values in 000)

Income Statement

YEAR	1984	1985	1986	1987*	1988	1989
Net Sales	$ 50,740	$ 56,230	$ 55,226	$ 55,630	$ 48,445	$ 52,107
Cost of Goods Sold	$39,772	$43,539	$42,843	$42,843	$38,903	$42,256
Gross Profit	$10,968	$12,691	$11,507	$12,787	$9,542	$9,851
Expenses:						
Selling Expenses	$2,696	$3,111	$3,475	$3,075	$2,241	$2,191
Shipping Expenses	$2,458	$2,702	$3,042	$2,705	$2,743	$2,607
Gen. & Adm. Expenses	$4,384	$4,820	$4,828	$5,114	$4,451	$4,613
Factoring Expense					$260	$284
Other Deductions (Net)	($39)	($93)	($76)	($18)	($133)	($159)
Net Expenses	$9,499	$10,540	$11,269	$10,876	$9,562	$9,252
E.B.I.T.	$1,469	$2,151	$238	$1,911	($20)	($20)
Interest Expense	$813	$1,022	$1,057	$994	$1,175	$1,175
E.B.T.	$656	$1,129	($819)	$917	($1,195)	($1,350)
Income Taxes	$282	$618	($400)	($388)	($514)	($369)
E.B. Cum. Effect of Acctg. Chg.	$374	$511	($419)	$529	($681)	($981)
Cum. Eff. On Prior Yrs. Of Chg. In Acctg. Of Inv. Costs						
Net Income	$374	$511	($419)	$529	($544)	($981)
Preferred Stock Dividends	$2,000	$0	$0	$0	$0	$0
Cash Dividends	$52	$52	$52	$52	$52	$52
Additions to Retained Earnings	($1,678)	$459	($471)	($596)	($596)	($1,033)
Retained Earnings (year end)	$4,805	$5,264	$4,793	$4,674	$4,674	$3,641

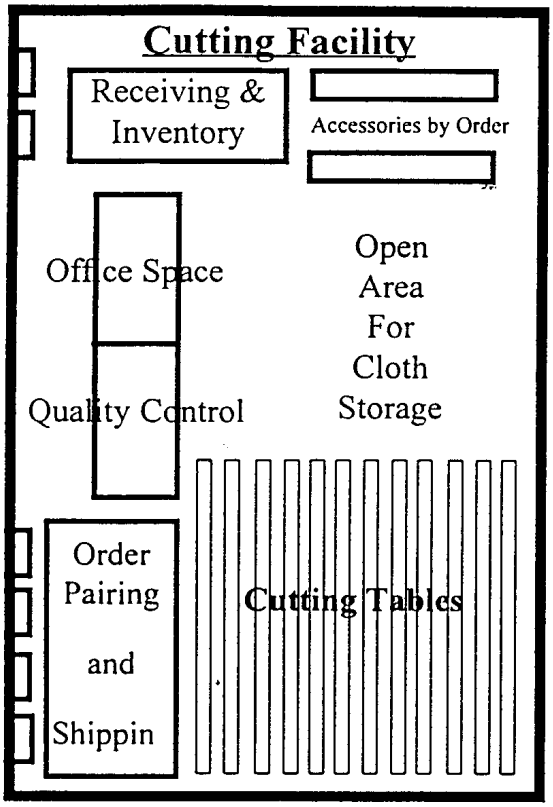
* Year ended 3 October 1987 – 53 weeks

EXHIBIT 2
Balance Sheets 1988 – 1989
Tropical Sportswear International

(all values in 000)

Assets			Liabilities and Equity		
Year	**1988**	**1989**	**Year**	**1988**	**1989**
Current Assets			Liabilities		
Cash	$ 224	$ 59	Current Liabilities	$ 6,477	$ 11,143
Receivables			Notes Payable	700	400
Trade Accounts	378	60	Current Portion LTD	37	42
Factors	7,052	10,563	Current Lease Obligations	5,015	5,652
Doubtful Accounts	(199)	(149)	Accounts Payable, Trade	2,769	1,540
Total Receivables	7,231	10,474	Accrued Expenses	14,998	18,777
Inventories			Total Current Liabilities		
Finished Goods	6,711	6,590			
Work-in-Process	3,720	3,446	Long-Term Debt	2,275	1,567
Raw Materials	3,030	2,597	Capital Lease Requirements	46	13
Total Inventories	13,461	12,633	Deferred Compensation	470	462
Refundable Income Taxes	614	418	Deferred Gain	85	75
Other A/R & Prepaid Exp.	257	239	Total Liabilties	17,874	20,894
Total Current Assets	21,787	23,823	Equity		
Property, Plant & Equip.			Stockholders' Equity		
Land & Improvements	59	60	20,000 shares 5%		
Machinery & Equipment	2,676	2,849	noncum., nonparticipating		
Leasehold Improvements	988	1,070	preferred stock, $100 par	2,000	2,000
Gross Prop., Plant & Equip.	3,723	3,979	Common Stock		
Accum. Dep. & Amort.	2,532	2,758	10,000 shares $10 par	100	100
Net Property, Plant & Equip.	1,191	1,221	Retained Earnings	4,725	3,744
Long-Term Note Receivable	202	186	Treasury Stock		
Deferred Income Taxes	112	148	5000 common shares	(125)	(125)
Other Assets	1,121	1,078			
Non-Compete Covenant Less Accumulated Amortization	-	-	Total Stockholders' Equity	6,700	5,719
Excess of Cost Over Net Assets Of Acqd. Sub. Less Acc. Amort.	161	157			
TOTAL ASSETS	24,574	26,613	TOTAL LIABILITES & EQUITY	24,574	26,613

EXHIBIT 3



- Receives raw materials from various vendors and millers
- Sorts all of the piece goods by order and repackages
- Bolts of cloth are stored on rolling racks for ease in handling
- Q.C. checks incoming raw materials for desired specifications
- Twelve cutting tables where cloth is spread, patterned and cut by order
- Shipping dock where sorted piecegoods are paired with the cuttings and put into containers for shipment

These three facilities are separated from each other by 2 to 3 miles.

Office

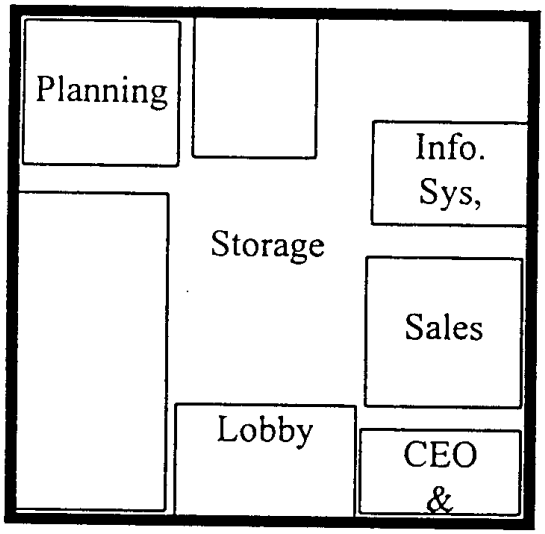


Exhibit 4