



Report to the Fair Labor Association

**Financial Rationale for Decision to Close Jerzees de
Honduras Factory by Russell Corporation – Headquarters Investigation**

**Conducted by Doug Cahn, Principal
The Cahn Group, LLC**

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INTRODUCTION

The Cahn Group, LLC was retained by the Fair Labor Association to conduct an investigation into the financial business rationale of the decision of Russell Corporation to close the Jerzees de Honduras factory in Honduras. The Cahn Group, LLC was asked to then render an expert opinion on whether the decision was supported by legitimate business considerations. The investigation was limited to the financial business rationale of the decision based on an examination of the records and interviews with personnel at the Corporation's headquarters offices.¹

Following the execution of a confidentiality agreement between The Cahn Group, LLC and the Russell Corporation's parent company, Fruit of the Loom, the Russell Corporation provided access to confidential business records and to personnel bearing on the decision to close the factory. The investigation took place at the headquarters of Fruit of the Loom in Bowling Green, Kentucky on October 27, 2008 in accordance with the Terms of Reference contained in Appendix A. The investigation was conducted by Doug Cahn, Principal of The Cahn Group, LLC.

METHODOLOGY

The investigation was organized to pursue the following avenues of inquiry:

- Establish the organizational and governance structure at the company that was used to make the decision to close the factory, including the process used and accountabilities;
- Obtain knowledge of the overarching manufacturing strategy of the company;
- Understand the internal and external factors that influenced the decision to close the factory;
- Understand the components of the decision itself; and finally
- Examine selected fleece product sewn by the company in Honduras.

To examine claims made by the company, relevant company employees were interviewed and a range of documents were reviewed. A list of documents reviewed is contained in Appendix B; a list of company officials interviewed is contained in Appendix C.

The company cooperated fully with all requests. Following the on-site investigation, the information was analyzed and this report was prepared.

BUSINESS CONTEXT

The manufacture of fleece product for Russell is largely integrated into the manufacturing operations of Fruit of the Loom and, therefore, the analysis of the decision to close Jerzees de Honduras takes into account the business needs of both companies, according to company

¹ The author understands that the FLA has authorized a parallel investigation in Honduras into allegations of inappropriate actions by the company related to its commitment to respect the right to freedom of association. In order for the reader to reach an informed conclusion regarding the company's action, the findings of this report should be viewed together with the report of the parallel investigation.

officials. References to demand, inventory, cost of goods and other key financial indicators noted in this report refer to the combined company.

Industry-wide, the fleece garment business has suffered a major downturn in 2008, with the most substantial downturn taking place in the last 60 - 90 days. According to an email received by a company executive from the Collegiate Licensing Company, the most recent quarterly fleece royalties (and therefore sales) for collegiate licensed fleece products industry-wide dropped 33% in the last 12 months.

Business indicators for fleece products at the company are also unfavorable. Demand is down. The 2009 operational forecast for fleece tops, fleece hoods, zipper fleece, basic fleece pants and pocketed fleece pants are off by double digits since the beginning of the year and significant single digits since August 2008. Available operating cash, while within acceptable limits, is down.

Inventories in general are up. Company wide inventory is higher than in 2006 and 2007 for each month of 2008. In July and August of 2008, inventory turns are lower than in the prior two years. SPI (Sales/Production/Inventory) reports by fleece product category project inventory levels by product category by month. A review of SPI reports show inventory for fleece zips will be normal for the next several months then rising in excess of need in the later half of 2009.² Inventory for fleece tops and fleece hoods is significantly in excess of need for the next 12 months. Inventory for basic pants, all of which are sewn at the Jerzees de Honduras factory, is significantly in excess of need for the next 12 months. In fact, there is no demand for any basic pant sewing for the next 10 months. Inventory of pocketed pants is normal now. Forecasts for pocketed pants project that inventory is expected to fall slightly short of anticipated capacity in Q3 2009.

August year-to-date costs are up. Projections for 2009 show increases in the “Standard,” or benchmark the company uses to establish the cost of goods.

The process used by the company to generate monthly forecasts that then influence production scheduling is robust and credible. Input from the sales force and production planning team are included in the formulation of the monthly forecasts.

Under such conditions, it is understandable – in fact it is imperative – that the company take steps to significantly reduce factory capacity.

MANUFACTURING STRATEGY

It is the strategy of the company to manufacture its products primarily using internal resources, i.e. factories that the company operates using its own labor force. In only approximately 10 percent of the company’s business are orders placed in independently owned and operated factories. The company favors the use of internal manufacturing because it believes that the policy results in better quality, better on-time delivery and a shorter pipeline resulting in the need

² A company executive reports that inventory requirements vary some by product. The average target is 12 weeks; the fleece target is 8 to 10 weeks because it is not considered “a basic where we can gamble more on carrying more inventory.” The author notes that these inventory ranges are customary in the industry.

to carry less inventory. The company believes in the ability of its people to consistently outperform manufacturing from external sources.

FLEECE PRODUCTS BY FACTORY

The following factories sew fleece for the company:

HONDURAS

- El Progreso. Primarily sewing briefs, a product with high level of difficulty. This factory is leased.
- Buena Vista. Makes crews and not pants. This plant is owned by the company and not leased.
- Jerzees de Honduras. Sews 100% of basic pants although largest volume is in tops. This is a leased factory.
- Tela. Makes zipper hoods, pocketed pants with high degree of difficulty and shorts. This factory is leased.

MEXICO

A fleece factory is located in Mexico for the Mexican market.

ASIA

An independently owned and operated fleece factory located in Asia makes garments for a large retailer. This is considered to be a small run with complex stitching.

CRITERIA/DECISION FOR PLANT CLOSING

The factories considered for closing are sewing plants; none is vertically integrated. The company owns the equipment in each of the factories, regardless of whether the company owns or leases the facilities. All factories considered for closing are located in Honduras (note that the Mexico factory produces for the domestic Mexican market and the Asia-based factory produces for a large box retailer and are not reasonable substitutes for fleece production for general market needs).

The company identified several factors that support the closure of Jerzees de Honduras:

- Low demand for product sewn at Jerzees de Honduras. The need for the products sewn at the Jerzees de Honduras factory is lower than at any of the other factories in Honduras. Inventory to meet forecasted demand for basic fleece pants (sewn only at Jerzees de Honduras) will not require any additional sewing for the next 10 months. This basic fleece pant currently

accounts for 20 percent of the factory's capacity. In addition, there is significant excess inventory coupled with low demand (and therefore excess capacity) of fleece tops that are sewn at Jerzees de Honduras.

- Product mix. The more complex processes at the Tela factory (pocketed pants) and the El Progreso factory (briefs) do not lend themselves to the sewing capabilities at the Jerzees de Honduras factory.
- Factory ownership status. The poor economic environment ruled out any serious consideration of selling a factory that the company owns (i.e. Buena Vista). This is a justifiable position for the company to take inasmuch as the market for selling a factory is likely to be poor at this time.
- Cost to close factory. The focus of the decision then turned to the relative costs of closing Jerzees de Honduras versus Tela. The company produced documentation detailing lease/ownership obligations for each of the factories it uses in Honduras. The company has a month-to-month lease with Jerzees de Honduras, while the company has lease obligations until March 2012 at Tela. Closing Tela (as opposed to Jerzees de Honduras) would result in an expenditure of more than \$2 million.
- Factory efficiency. One common method of measuring factory efficiency is the cost per SAM unit. The cost per SAM (Standard Allowed Minute) unit is used to determine a cost based on the minutes required to assemble a garment based on industrial engineered rates. In practical terms, the cost per SAM unit is used as a tool to assess profitability, determine load levels for factories and establish piece rates for workers.

Comparing Jerzees de Honduras to Tela, the cost per SAM unit was higher at Tela than at Jerzees de Honduras, reflecting the fact that Tela is a smaller factory with considerably less volume than Jerzees de Honduras. A company executive explained that Tela is a factory that has been reconstituted in recent years and that the company has made a commitment to invest in increasing the productivity of workers at Tela over time as driven by demand.

When company representatives were asked to add the incremental costs of direct labor, indirect labor and variable overhead necessary for the larger volume at Jerzees de Honduras to the cost per SAM units there, the difference in cost effectiveness of the two plants (i.e. Jerzees de Honduras and Tela) was negligible.

The records show that in September 2008 the size of the labor force at Tela was within 10 percent of the size of the labor force at Jerzees de Honduras. For the same month, the number of minutes/month as recorded in company data sheets was dramatically higher at Jerzees de Honduras, reflecting greater volume at Jerzees de Honduras, and, the company argues, lack of product demand available to put into Tela.

While these indicators reasonably support the company's decision, the author notes that other factors can influence the suitability of any single factory to receive orders, posing questions as to the adequacy of information available at headquarters to fully assess relative productivity and profitability at the two factories.

For instance, the fact that the workers at Jerzees de Honduras lack the skills and experience to sew pocketed plants could be the result of historical decisions made by the company to invest

in training at Tela where pocketed pants are sewn. Other factors that can affect the suitability of a factory to accept certain orders can include the reliability and sophistication of equipment, limitations (or benefits) of the physical plant, and distance to shipping routes, for instance. A determination of these factors was not possible within the scope of this investigation.

- Variances against Standard. The ability of each factory to meet, exceed or fall short of the projected cost of goods is the variance against Standard. The company sets the Standard before the beginning of each year. Variance against Standard at Jerzees de Honduras was less favorable than at the other fleece facilities in Honduras. However, the difference in the variances between Jerzees de Honduras and the other Honduran fleece sewing factories is not significant and, therefore, not a strong argument for closing or not closing Jerzees de Honduras.

Taking into account all of the above criteria and recognizing the need for the company to align the decreasing demand and high inventory with factory capacity, the company argued that two primary considerations went into the decision to close Jerzees de Honduras:

- Low demand for the product sewn at Jerzees de Honduras. All of the company's basic pants are sewn at Jerzees de Honduras. There is no need for any sewing of this product for 10 months. In addition, there is a reduced need for fleece tops that are sewn at the plant.

Analysis: Due to reduced market demand and excess inventory, particularly of basic pants, the company needed to reduce fleece capacity dramatically, including an estimated 30% of current capacity at Jerzees de Honduras. A retrenchment of that magnitude reasonably warrants the closing of a factory since the expense of continuing to operate an underutilized factory is cost prohibitive. Whether it was more prudent to close Jerzees de Honduras over Tela is less clear and is complicated by a myriad of factors that can be reasonably considered, some of which are not within the scope of this investigation. Therefore, on the relative merits of demand, product mix, factory efficiencies and workforce skills, the decision of the company appears rational but the evidence examined was not conclusive.

- Cost to close factory. The Jerzees de Honduras plant would be the least expensive factory to vacate. The fact that the company has a month-to-month lease with Jerzees de Honduras, whereas it was locked into a lease until 2012 at Tela, results in more than \$2-million in savings.

Analysis: A review of information provided by the company clearly substantiates the claim that it would be significantly less expensive to close Jerzees de Honduras than Tela.

CONCLUSION

The company took a prudent step to significantly reduce manufacturing capacity for fleece products. The downturn in demand together with above normal inventory levels made this step a business imperative.

Due to the size of the forecasted overcapacity, the company was justified in making the decision to close one of its factories, as opposed to incrementally reducing its workforce at one or more of its fleece sewing facilities.

There were two primary factors cited by the company in selecting to close Jerzees de Honduras:

- Rationalization of product mix, demand and inventory; and
- Cost of exiting the factory.

The first factor is reasonable but due to the scope of the investigation it was not possible to determine if there were other countervailing considerations that could have resulted in a different company decision.

The second factor is compelling. The company demonstrated that it stands to avoid more than \$2 million in expenditures by closing Jerzees de Honduras as opposed to exiting the most probable alternative, Tela, a factory with a long-term lease. On this point, the company makes a sound business case.

Taking these two factors together, the company is justified on the basis of the financial business case to close the Jerzees de Honduras facility based on significant, short-term cost savings. However, additional investigation in Honduras will be required to provide more complete conclusions concerning allegations made against the company.

APPENDIX A: TERMS OF REFERENCE

10/24/08

Terms of Reference for Investigation of Rationale for Closure of Jerzees de Honduras Factory by Russell Corporation

Independent expert will conduct an investigation of the business rationale for the decision by Russell Corporation to close the Jerzees de Honduras factory in Honduras.

The independent expert will examine the information and decision-making process that Russell used to make its decision, and render an opinion on whether the decision was supported by legitimate business considerations.

Subject to a confidentiality agreement executed between the independent expert and the corporation, Russell has agreed to provide the expert access to confidential business records and to personnel bearing on the closure.

Review of the records and interviews will take place at Fruit of the Loom's headquarters in Bowling Green, Kentucky.

The expert will conduct the independent investigation the week of October 27 at Bowling Green.

The expert will produce a report setting forth the methodology of the investigation and documenting in as much detail as possible the basis for the opinion rendered.

The expert will produce a draft report for review by the FLA. The FLA will have the opportunity to make suggestions on the form and content of the report and seek clarification, but not on the conclusions.

The final report will be completed as early as possible during the week of November 3. The FLA will make public the expert's report and distribute it, as appropriate, to interested universities and other parties.

APPENDIX B: DOCUMENTS EXAMINED

1. Organization chart for direct reports to Rick Medlin, Executive Vice President
2. Organization chart for apparel organization and direct reports to Tommy Hardcastle, Senior Vice President, Apparel Manufacturing
3. Organization chart for Operations Planning, Tonda Spencer, Senior Vice President, Planning
4. Organization chart for Danny Munford, Senior Vice President, Manufacturing Services
5. Spread sheet comparing cost of lease for Jerzees de Honduras and the Tela factory
6. Fruit of the Loom consolidated expenditures August YTD, Actual
7. Total Inventory Finished Goods, Total Company (w/o Europe) Month-end August 2008
8. Plant Inventories – Total Company (w/o Europe)
9. Russell “revolver availability” YTD 2008 describing cash available to wholly owned subsidiary
10. 2009 Cost Increases, Standard to Standard
11. 2008 Operational Forecast, by make
12. 2009 Operational Forecast, by make
13. SPI (sales production inventory) spreadsheet, Aug 08 – Dec 09 for fleece products: tops, hoods, zips, basic pants and pocketed pants.
14. Manning by plant 2008 – Mar 09.
15. Email dated October 27, 2008 to company executive citing Collegiate Licensing Company statistics noting 33% drop in fleece sales year over year in most recent reporting period.

APPENDIX C: ON-SITE INTERVIEWS

1. Clair Hammond, Vice President, Operational Finance
2. Mike Holland, Senior Vice President, Distribution and Sales Operations
3. Rick Medlin, Executive Vice President
4. Tony Pelaski, Senior Vice President, Human Resources
5. Patrick Petty, Controller, Apparel
6. Tonda Spencer, Senior Vice President, Operations Planning
7. Shane Vandiver, Senior Director, Capacity Planning/Master Scheduling