OUR HISTORY OF MOVEMENT

Ready....

It all began with a chicken’s foot in 1906...
Today, at $2.5B+, New Balance is one of the largest privately-owned companies in the United States.

Approximately ¼ of NB shoes sold in the United States are assembled or manufactured in the United States at one of NB’s five owned factories.
THREE AREAS OF NB RESPONSIBLE LEADERSHIP
NB CSR & FOOTWEAR SUPPLIERS

- In 2012-13, the NB Compliance team and its representatives conducted more than 250 audits to approximately 200 factories in more than 30 countries around the world.
  - 2012 pre-sourcing non-approval rate = 22% (all product categories)
  - 3.6% of supplier base terminated in 2012 for compliance reasons
- Footwear suppliers represent approx. 20% of the NB supplier base, but deliver 80%+ of volume and total revenue

HIGHLIGHTS OF FOOTWEAR COMPLIANCE PROGRAM

- ~100% of production in some facilities (note: factories are owned by multimillion dollar corporate parents)
  - Positive: leverage
  - Negative: impact when things go wrong
- Visibility into capacity, production plans, costing
- Visibility/tighter control of materials & mat. suppliers
- Close partnership with strategic partners
  - Compliance team may be stationed in core factories
  - Monthly or bi-weekly meetings, sometimes with sourcing
  - Not a typical audit model; real-time management of issues and quarterly meetings on scorecard ratings; labor built into costing; training, etc. part of sourcing negotiations
- Worker “intellectual property” viewed as key tenant of LEAN manufacturing (*kaizen* events)/productivity
  - Hard evidence from domestic manufacturing
  - Easy to understand, *very* hard to execute well

Our experience in domestic manufacturing has been instructive
FOOTWEAR SUBCONTRACTORS

• The nature of footwear production requires NB to focus on sole & upper subcontractors, in addition to final assembly manufacturers.
  • High potential for supply chain disruption
  • Risk to brand (components all have brand logos)
  • Core subcontractors held to same standard as apparel and non-core factories; managed by internal CSR team

1. Uppers stitching and/or hot melt
2. Outsole manufacturing
3. Assembly
BUT WE STILL GET SURPRISED…

• In February 2012, our #3 sole supplier in China went bankrupt unexpectedly, putting hundreds of workers out of a job and holding hostage millions of dollars of NB sole molds. We had not had visibility into its ongoing financial problems.
  • Doors locked unexpectedly; factory management left for Taiwan
  • CSR team facilitated discussions with local authorities to ensure workers’ needs were addressed
  • Millions of dollars in sole molds were “held hostage”; paid $$ to have them released in a timely enough fashion to be able to use them elsewhere
  • Significant disruption to footwear production

• LEARNINGS:
  • Issues in subcontractors below top tier level can significantly disrupt business
  • Need for better and more direct management of molds
  • Need for more visibility into and closer management of even our more “remote” subcontractors
  • Need to define “Subcontractor” vs. “Tier 2” vs. “Tier 3” and develop strategy to cover highest risk suppliers
WE’VE MADE SOME PROGRESS, BUT THERE IS A LONG WAY TO GO...

• NB has invested in larger Materials team, based primarily in Asia, to build relationships and negotiate directly with subcontractors and Tier 2, 3 suppliers
  • “Early warning system” alerts us to a potential problem if materials suppliers aren’t being paid by Tier 1 or vice versa; can be factored into cost negotiations

• NB CSR continues to manage highest visibility subcontractors and directly manages “Tier 2” facilities in vertically integrated set ups (rubber rooms, spinning mills, etc.).
  • We have noted that these areas are often not visited by 3rd party auditors working for other brands, which creates challenges in the remediation process.

• Suppliers required to disclose what subcontractors they are using
  • NB CSR reviews production records and time cards as basic part of audit protocol; standard calculations may reveal if subcontracting may be taking place
  • Formalized subcontractor policy (penalties for unauthorized subcontracting)

• NB CSR has spent more time training core footwear suppliers and building their internal capacity to manage their own subcontractors
  • Tier 1 footwear suppliers now periodically ask us to follow up on their audits

• Partnership with Trade Compliance / Customs team, especially in high-risk countries
  • Duty-free claims from most countries require proof of compliance with yarn-forward rules; this requires visibility into subcontractors and Tier 2, 3, 4 suppliers
PROGRESS (cont.)…

• CSR team and RSL/Materials team currently in discussion about how to expand compliance requirements strategically into more levels of the supply chain
  • Possibility to share / leverage each others’ resources?
• Assessing value and applicability of industry groups (e.g. BSR Mills & Sundries Working Group) to lower tiers of the supply chain
• Allegations of unauthorized subcontracting do arise; important to investigate these situations and use them as “teachable moments”
  • Perfection is unlikely but progress is possible!
ONGOING CHALLENGES

- **BREADTH VS. DEPTH?**
  - NB is a dynamic business, regularly adding new product categories (not just footwear and apparel, but also sporting equipment, accessories, etc.)
  - We have expanded our CSR team, but even so, it isn’t big enough to cover all layers of the supply chain for all product categories
  - Do we go wider or deeper? How do we do both?

- **LACK OF LEVERAGE**
  - In product categories where NB isn’t a big player yet (apparel, equipment), how do we bring about change in subcontractors and Tier 2 where we have almost no leverage?
  - What about licensed products (one more layer removed)?

- **DON’T REPEAT TIER 1 MISTAKES**
  - How do we align requirements to reduce Code proliferation and audit fatigue?
  - CSR team and Materials team currently working together to expand compliance requirements into more levels of the supply chain (can self-assessments / affidavits help?)

- **MORE REGULATION / VISIBILITY BRINGS ONGOING URGENCY**
  - Conflict minerals / CA Supply Chains Transparency Act
  - Social media / speed of news reports

This continues to be an area of focus and challenges for us.
On January 10, 1860, the Pemberton Mills garment factory in Lawrence, MA, collapsed without warning. 145 workers were killed, mostly immigrant women & children. The collapse was due to substandard construction and negligence and became a rallying point for better industrial safety.

The mill was rebuilt and today sits just across the river from New Balance’s Lawrence, MA, headquarters.

Solutions are neither easy nor quick, but they do exist. Things we once thought impossible are now standard practice.
Thank You!
• 31,000 + employee-partners
• 4.32B in revenue (FY 2013)
• 400 + locations throughout US
• 11 Manufacturing facilities
• International – Canada, Netherlands, Germany, UK, China, Hong Kong, Mexico, Honduras
• Various business lines – uniform rental, facility services, promotional products, first aid and safety, fire, and document management.
Subcontracting Approach

• \( \approx 1000 \) Vendors in 26 countries
• Keep Chain as narrow as possible
• Our Model
• Many are Agents
• Subcontracting may not be done without our approval
• Vetting
• Full Assessment Annually
Continuous Monitoring

• Global Field Managers
• Skills
  – Quality
  – Manufacturing & Construction
  – Engineering
    • Plant Loading
    • Production Management
  – ERCA Trained
Guarding Against Subcontracting

- Construction & SAM’s
- Calculate/Know
  - Production demand – UPD Expectation
  - Product SAM’s
  - Calculate Ops Needed
  - Compare
  - Challenge Management
- Validate
Challenges

• Culture Clash
• Smaller Contractors
• Varying Contractor Commitment Levels
• Spikes in Demand
• Owner/Manager Over-commitment
• Migrating Industry
  – Emerging Economies
  – High Tech Push