



*It's customary for commentators to offer predictions at the start of a new year. Regular leatherbiz columnist **David Peters** did just that in the blog section of World Leather's partner website at the end of 2015. This is an edited version of his account of what is likely to happen in the hide and leather industry in the course of this year and launches a new, regular comment section in World Leather.*

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Predictions for 2016

In predicting what's in store for the industry in 2016, we have focused our attention on nine distinct areas of interest, all having a direct influence and connection with the hide and leather industries. These nine are:

- Automotive
- Footwear
- Furniture
- Supply
- Cattle
- Climate change
- Hide Prices
- Consolidation
- Challenges

The automotive world will continue to occupy headlines, not only by challenging existing sales records but more importantly because of the type of vehicles being sold. There are two segments that share particular meaning for the leather industry, namely the luxury market and SUVs or CUVs. In both of these areas we see continued growth in leather content. In addition, with the convergence of high tech and mechanics the so-called connected car will take on more automated features allowing the driver to concentrate on the vehicle's interior. It is in this area that leather has the opportunity to propagate.

Designers will push the suppliers to find more imaginative and attractive uses for leather. The historical stucco-buffed painted finishes will be challenged by semi-aniline products. While wet white constructions will remain available, the focus will shift more towards lighter-weight leathers, meaning a reduction in fuel consumption by lowering the overall weight of the vehicle. Leather has been absent in meeting reduced thickness levels while maintaining existing strength and wear properties. This translates into possibly a greater use of US steer hides, which can provide the tanner with more consistent thicknesses.

Cautious optimism

Overall we remain cautiously optimistic for 2016, at least for the first half of the year. Referenced in a recent *Wall Street Journal* article, sub-prime auto lending has now reached \$70 billion and the total sum of US auto loans exceeded \$1 trillion in Q2 2015. With a potential saturation point being reached in new car sales, OEMs will be hard-pressed to maintain the sales pace of last year. We anticipate that Q3 and Q4 of 2016 will prove challenging as the 2017 model year gets introduced and the economies in the US and EU react to the US election.

Prices are influenced more by the footwear side of the leather business than any other market segment. With a share of over

50%, the shoe business is the clear demand driver. Global hide markets rise and fall with the use of leather in shoes and until we see either a broad return to utilising leather as a core material, the hide market will struggle. Last year, 2015, was not a good year for leather content in shoes. Faced with high raw material costs and the desire to protect profit margins most of the leading brands utilised canvas and various synthetics, but this de-contenting of leather was not the only reason for the bear market. In concert with other base commodities, 2015 was a bearish year primarily due to China adopting a more conservative approach to nearly all commodities. To a large degree this is a reflection of a decline in the domestic market, and associated speculators licking their wounds and refraining from participating in the markets.

The 2017 Summer Olympics in Rio de Janeiro (August 5-21) could potentially kick-start the footwear business, together with the broad appeal of the lifestyle category where designer sneakers use mostly leather. Cooler weather patterns this winter in Europe, Asia and parts of the US could also give the boot a boost, giving tanners extra incentives to intensify production.

Residential furniture improved in 2015 and in all likelihood will remain positive through 2016 Q2 as the real estate markets in the US and Europe remain active and home owners replace aging furniture. According to financial holding company CIT: "Growth in the US furniture industry continues to outpace the US economy, due in large part to strong performances in bedroom and dining room furnishing sales. While housing continues to improve and discretionary spending increases, the sector should continue to improve."

False-positive signals

The supply side of the equation has been sending false-positive signals. Recent forecasts from various global economists and protein industry executives suggest a continued growth in meat production. It is important to clarify their use of the word "meat" here. Often we have seen this term merely bundling beef, pork and lamb together and while we are witnessing a continued expansion of pork and beef production it is important to translate this into usable raw material for leather production.

In terms of increased slaughter numbers, therefore hide production, we do not believe we will see any appreciable increases in any of the major markets. In fact we could see some minor adjustments in Australia and certain European countries.



In the US we expect hide production numbers to flatten out at the 2015 levels. We do however see a continued trend for heavier cattle. According to the US Department of Agriculture (USDA) weights will continue to be an important factor to watch in the months ahead. Cattle are remaining on feed longer and are currently being marketed at record weights. This is being heightened by the increase in the proportion of heavier-weight steers versus heifers and cows, resulting in near-term year-over-year increases in beef production despite the continuing constraint of cattle supplies.

USDA projects 2015 beef production will have reached about 23.8 billion pounds. Higher cattle slaughter levels, in conjunction with heavy carcass weights, are expected to increase beef production in 2016. USDA's current forecast for total beef production is nearly 25 billion pounds, up 5% relative to 2015. The conclusion to the above is that we will see consistent slaughter levels and heavier hides.

The reduction in US cattle inventory has been well publicised, dropping to 89.8 million head in 2015 or 8.4% lower compared to the year 2000 when inventories were 98 million head. The more interesting detail is the location change. Over the past 15 years there has been a gradual shift in where the cattle are raised, with the change mostly coming from Texas, dropping by around one million head to 13% of total cattle on feed, from 14.2%. The areas that have grown are a group of five states (Iowa, Minnesota, Wisconsin, Illinois and Ohio) that today, when combined, represent 13.5% of the cattle on feed, which is more than Texas. The importance here for hides comprises two factors: less branding and better grain. Historically these five states have produced some of the better, cleaner and more suitable full grain leathers. We expect this trend of cattle migration to the northern states to continue.

Global footprint

With leather-related companies having a strong global footprint, the discussion of climate change will likely escalate. According to the CDP (Carbon Disclosure Project) more than 50% of an average corporation's carbon emissions are from its supply chain. From OEMs to retail brands and then throughout the various tiers of providers the recognition and acceptance of a shift in weather patterns and resulting climate change is a basic test in managing across the supply chain. Our raw material is sensitive to seasonal change, especially in North America. With a vast array of leather products relying on high-quality hides, any adverse change or shift in weather patterns will directly impact availability and specifically the ability to utilise traditional supplies.

A recent study by luxury group Kering focused on leather. It says cattle production in general is "at risk from increasing water scarcity, degradation of pasture and livestock feed, and increasing heat stress for the animals". It lists extreme and prolonged droughts, restricted availability of water for feed and warming climates spreading pests and disease into new regions as factors that will impact cattle productivity and hide availability and quality. The timeframe it has looked at for this is the period between 2036 and 2060. It claims its analysis shows that the number of bovine heat stress days will increase in many sourcing countries with consequences for the dairy, meat, and hide production industries. Brazil demonstrates "particularly high

exposure to climate threats", Kering has said.

So what about the hide market? The demand side of the equation will continue to rule the day. While hide production will remain on a par with 2015 there does not appear to be sufficient interest on the buying or demand side to reverse the bearish market trend initiated last year. History suggests supply will be greatest during the first two quarters of 2016 and, traditionally, increased activity more than compensates and propels prices higher. However with the absence of a decent leather footwear business we see total demand being insufficient to absorb available supply. The key to reversing the market's bearish trend resides in shoes and we do not expect to see any turnaround until the end of 2016 and into 2017.

The oil factor

The build-up in split inventories and the lacklustre outlook coupled with low oil costs will also weigh down any significant change in market direction. The US dollar's sustained strength does not bode well for the US hide market changing its current direction. Recently, the *Wall Street Journal* commented that the dollar is trading near its highest level in 13 years against the currencies of major trading partners. Brazil, Australia and the EU will be the beneficiaries as, from a volume and qualitative point of view, their hides will become the flavours of choice for most tanneries. With the potential for the auto-leather business to ease in Q3 and Q4 the best we can hope for is for the market to remain in the current trading range. While the bearish arguments can easily be embraced we should not forget the continuing downward spiral of the Middle East and the actions being taken by the western developed nations, initiatives that will ultimately exert positive influences on commodities.

There should also be an increase in merger and acquisition activity in 2016 as the industry struggles to achieve a more cohesive operating platform. Economic, environmental and contraction forces observed in China will drive some of these changes. Attrition will play a role in rationalising the leather manufacturing base as some companies struggle with succession plans and succumb to the temptation to monetise family assets. The announcement in November that the owners of JBS took a controlling stake in shoe group Alpargatas raises the question if this is the start of a new strategy in added-value product integration. Looking forward, we expect the auto and shoe segments to be the two areas where the landscape will alter.

The economic disruption perpetuated by the West Coast dock dispute at the start of 2015 continues to reverberate. There is no question that market share for US hides was impacted as containers were stuck and the market declined, both very negative events that contributed to nefarious behaviour. A reduction in shoe leather use exacerbated the situation and today Asian tanners are leveraging their needs with options from numerous origins. The success of US producers in either retaining or regaining their market share will rest in their acceptance that the world of sourcing hides has subtly changed. This is not only in terms of product consistency and convertibility but in terms of an additional facet gaining traction: sustainability. More and more retail products and their associated brands are influencing the entire supply chain and in this respect the hide industry cannot ignore their role and responsibility. 🌱