



*Regular leatherbiz columnist **David Peters** makes it clear that, while last year was one of the best in a long time for automotive tanners (some of whom are likely to have to expand production), a malaise continues to hang over the leather industry as a whole because of the move towards synthetic materials among many footwear producers.*

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Sobriety

The hide market is attempting to coalesce around a concept that there is sufficient leather business to warrant prices becoming firmer. How is this possible when there are so many bearish indicators inundating the airwaves? The volatility witnessed in numerous global indices is intense and, together with bearish reports on several commodities, suggests a world lacking economic confidence and therefore buoyancy.

The key to establishing and maintaining a firm hide market is the leather shoe business and so far the news is not good. The weather, enhanced by El Niño, is not helping as unseasonably warm temperatures during the pre-Christmas shopping period encouraged consumers to remain outside and not enter the stores and spend on apparel items. As a result footwear inventories together with all other accoutrements have accumulated and retailers are now offering exceptional promotions to move stock. Even though winter returned in January few US consumers were sufficiently motivated to take advantage of all those so-called bargains.

While the US market is large and has a huge influence on leather demand, the key to the hide market lies more in Asia and specifically China. The 2013-14 bull market was driven mostly by the growth in Chinese domestic shoe consumption where consumers were encouraged, motivated and sold on improved lifestyles. The evolution of the Chinese millennial has shaped and propelled the high street into a new driving force of consumer demand. The traditional or historic concepts of retail have adopted to a large degree the US model but on a much larger scale, therefore the malls and coffee bars in Beijing, Shanghai and Guangzhou are a better example of what is in vogue rather than the US. Unfortunately leather is no longer a major fashion component in shoes, or at least to the extent seen a couple of years ago. As a consequence tanners have gone from a shortage of leather and hides to an abundance. None of these are positive attributes for the hide market.

The supply side would appear to complement availability where shippers are able to easily accommodate selections and deliveries. Container availability and corresponding shipping schedules are all functioning normally with no weather-related challenges or other such excuses being proffered to buyers. Cheap gas and a strong dollar are two additional ingredients that are diffusing any attempt at a short-term market rally,

although as we move into March, when supply typically reaches its nadir, we expect a slight bump in prices mostly centred on native steer and heifers, and butt branded steers.

The US auto industry set a sales record in 2015, as solid December gains by the biggest automakers pushed the annual tally above that of the year 2000, reaching 17,402,486. As reported by *Automotive News* these numbers may not be as strong as they suggest considering a calendar quirk that the December figure included the first weekend in January. Cautious optimism is a more accurate description for car sales as we look into the first half of 2016. According to *Automotive News*, leasing as a share of new vehicles sold stood at 27.8% for the first nine months of 2015, up from 25.7% in 2014. Prospects for off-lease vehicles in 2018 and beyond will drive decisions on whether to expand used car auctions. More used vehicles keep coming to market. US new light vehicle sales are expected to rise again in 2016 though at a slower pace, to more than 17 million units, but competition from more trade-ins and off lease vehicles might have a greater impact than currently envisioned. With oil sliding below the psychological level of \$30 a barrel auto executives are enthusiastically suggesting that sales will remain strong for the entire year; especially in trucks, SUVs and CUVs and, to support their contention, capacities are being expanded in the North American market: all positive signs for the supporting industries, specifically seating.

A good year for auto-tanners

From a leather and hide point of view we estimate that total auto-leather consumption in 2015 was around 2.5 billion square-feet, which represented close to 18% of the total bovine raw hide supply. Without question, for auto-tanners, last year was one of the best they have ever witnessed. With volumes remaining high and raw material prices declining most of the year, tanners were able to enjoy margins not experienced for more than a decade. Lagging sales price formulations in the face of a declining hide market made up for any operational or qualitative challenges and with a healthy balance sheet bonuses flowed to management in impressive doses.

This exuberance should be carefully moderated as during Q1 and Q2 prices will once again be adjusted in the face of a more stable or flat hide market. Producers will therefore see some margin impairment as profitability becomes squeezed. In the



meantime, as leather succeeds in gaining a larger percentage of new car sales, auto-tanners will have to seriously consider expanding capacity. This will in turn have a domino effect because although adding additional finishing and cutting lines to existing plants is fairly simple with relatively short lead times, locating suitable and compliant crust production is a different issue. While there is ample qualified crust supply in Brazil and Argentina this would only satisfy certain product segments and, with the seat designers and engineers looking for lighter finishes or semi aniline type leathers, focus will pivot to US raw material where, unfortunately, there is an absence of crust production. Mexico would therefore be the beneficiary of this increase in demand as the crusting infrastructure is established, but will require expansion.

Demand from the shoe market must strengthen

Two areas that will negatively impact the hide market are oil and the US currency, both of which remain under pressure although for different reasons. As fossil fuels remain abundant, transportation costs, together with general operating expenses, will decline and with global sourcing footprints, tanners will be able to leverage this opportunity in switching supply chains. Synthetics will continue to offer viable alternatives in product design, engineering and associated manufacturing. Companies managing branded products in all

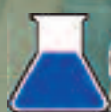
consumer segments will be able to maintain and potentially increase gross margins utilising alternative substrates, thereby diminishing the need for leather.

The strength in the US dollar will contribute to lowering commodity prices as the Chinese RMB weakens and buyers demonstrate their skills in bidding down due to increased conversion rates. Conversely any weakness in exchange rates, specifically versus the dollar, will be a precursor for attracting more interest in US hides.

From a supply perspective the numbers will further confuse as we do not anticipate increased hide production. The recent USDA report for December 2015 reflected a 3% increase in commercial red meat production compared to 2014, reaching 4.27 billion pounds. The increases were mostly attributable to higher production levels in pork, up 4%. While cattle slaughtered was marginally up, at 2.45 million head, meat poundage increases were the result of a 25 pounds per head increase versus 2014 with the average live weight being 1,388 pounds per head. This translates into heavier hides.

With the absence of a strong shoe leather business there is no solid reason why the hide market will not continue in its current trend. The weak demand undertone will prevail over the next six months and bring hide values down. The de-contenting of leather in shoes is the primary cause behind the market's malaise. ☹

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