



The recent narrative continues to emphasise the cause and effect of high hide prices: it is the move to alternative substrates of major shoe brand, which feeds assumptions that leather has become overpriced for the marketplace. The demands of the 'athleisure' trend have not helped; the growth big footwear groups are reporting has come mostly from casual shoes made from canvas.

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Metamorphosis

Spring has arrived and so the bizarre world of hides exhibited its traditional pre-Hong Kong move when sellers jumped onto their respective trampolines and took the market for a bounce. Tanners meanwhile remained at ground level and gazed in awe as prices came back down to earth.

As mentioned in previous communiqués the central core of the hide market resides in the changing of vamp coverage on shoes from synthetics to the real thing. Unfortunately margin and profits trumped at the shoe brands and the 2016 selling season was lost to leather.

But all is not absent as auto leather business appears to be impervious to any negative economic or political news. Year to date, light vehicle sales remain robust, suggesting that 2016 will be better than 2015.

As reported by *Automotive News*, March was on pace to be one of the strongest months ever for the US auto industry, with sales expected to rise at least 7% from a year ago, according to three forecasts. The predictions point to volumes of about 1.7 million, which would be the highest for any March since 2000.

It is also important to note that with leases now running at over a third of new vehicle sales and with the total outstanding balance of all new and used vehicle loans at around \$1 trillion at the end of last year, up 11% from 2014, there may be some clouds on the horizon. Having watched the movie 'The Big Short' we know how this story ends.

Returning to the heart and soul of the hide market, the shoe industry published results for the fourth quarter of 2015 that confirmed why underlying market sentiment is weak. The Famous Footwear division of Caleres posted results for the quarter that showed sales of casual lifestyle shoes, specifically canvas shoes, were up 23%. Sales of athletic footwear in general rose 5% and those of booties (mostly synthetic) were up 34%. Overall, sales of boots were down 4%. Generally the company's gross margin improved. This narrative continues to emphasise the cause and effect of high hide prices and the successful diversification of a major shoe brand to alternative substrates. This further validates the various assumptions made and underscores the fact that leather has become overpriced for the marketplace.

Compounding the lack of leather in shoe construction is the growing demand for athleisure. This is the catchall phrase for a

new classification within the apparel industry and is clearly establishing a new fashion trend. Two of the biggest names in this category are Nike and Under Armour and both are benefiting from the increased consumer preference for athleisure. Athletic-casual wear has become increasingly acceptable for use in a wide variety of social situations. With lifestyles in all the major global markets shifting to sports-type attire and associated footwear, companies such as Puma, Ecco, Cole Haan and Skechers are all providing products in this growing category. Unfortunately, all these shoes have a limited amount of leather.

Meanwhile, back at the old APLF Fair in Hong Kong participants looked a little tired, and not just from jet-lag. It was more a reflection of the tedious discussions with certain Zhongguo buyers regarding respect for contractual obligations. For centuries hide suppliers and tanneries have debated the condition and relative value of a specific delivery. New legislation being rolled out in Beijing is attempting to create a new condition for hide shippers to China. Decree 159 will provide tanners in the Middle Kingdom with the ability to declassify hide processing facilities and therefore potentially boycott certain shippers.

Compared to historic times when the market exhibited weakness, the current malaise is different. In 2008 hide prices disintegrated as the world's financial markets teetered on the edge of collapse. This began in August 2008 when the average price of HNS traded at around \$69 per hide and stopped eight months later, in April 2009, with prices firmly grounded and reaching a low of \$27. The current bear market is slightly different in that the decline lasted nearly twice as long (15 months), beginning in August 2014 when the same selection averaged nearly \$113 per hide FOB and by November 2015 it had bottomed out at \$68.45 per hide FOB. While prices improved slightly in December, the market continues to display bearish tendencies.

The 2015-2016 hide market is very different compared to 2008-2009 in that the value loss today is 40% compared to 60% at that time. In addition, the low point in prices, which was clearly exaggerated, sparked a renewed interest in leather and kicked-off the fashion in women's boots, casual handbags and other leather accessories. The reality of seeing hide prices reach the 2009 low point again are slim to none. However, we cannot



emphasise enough that without an active leather shoe business prices could potentially drift downward another 10-15% over the next six months. This would be in time for the 2017 design season when we are confident that the fashionistas will re-discover leather and embrace the new value proposition.

The volatility witnessed this year in various global equity and commodity markets has created a certain amount of stress and it follows that this turbulence will have consequences. There are two specific examples that are near and dear

to our business.

Prior to the last economic downturn there was a spate of acquisitions, one of which resulted in a Japanese private equity company, Advantage Partners, purchasing the then-leading automotive leather producer, Garden State Tanning. Recently, we read that the successor company, GST Autoleather, may be acquired by an as yet unconfirmed Korean company, the designer and manufacturer of handbags Simone, and Korean private equity firm MBK Partners. The Korean would-be buyers have signed a

memorandum of understanding with Advantage Partners to acquire its 100% stake in GST Autoleather.

As nothing is more constant than change we must view this transaction as a melding of two distinct leather segments looking to leverage the synergies of car seats and handbags. This is an interesting amalgamation when you consider the industry perception of an auto-parts supplier using leather as a substrate combining with a leather bag manufacturer who, according to press releases, is looking to enhance the company's brand.

In 2011 the previous owners of National Beef reached an agreement to sell the majority of their stake (79%) to investment firm Leucadia for nearly \$900 million. Fast forward to March 2016 and an article in the *Wall Street Journal* detailed a precipitous decline of the stock price. It said that Leucadia's largest revenue generator, National Beef, has lost money three years in a row. While it may be a stretch to connect the dots to the decline in hide prices over the past year, we can nevertheless envision a more concentrated approach by upper management to correct this negative path and provide the parent with a more promising enterprise.

Duress, anxiety, pressure and pain are all basic fundamentals behind change and the global economic conditions are a fertile breeding ground to precipitate revolution. We expect additional consolidation of various leather-related enterprises to surface in the coming months as nothing motivates the seller better than a challenging outlook for the future.

There is no question that with packers achieving greater meat yields from current slaughter the incentive to pump up the volume is lacking. As a result we must grow accustomed to larger, thicker hides with improved footage but lower volumes.

The reduction in the shoe leather business has created more competition among regional hide sellers as buyers exert their muscles to leverage one origin against another. This unusual circumstance, not witnessed since the eighties, is testing the fortitude of companies around the globe. Operating in a bear market requires dexterity and a first-rate customer service, which can only be achieved if the transformation is sincere. ☺

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