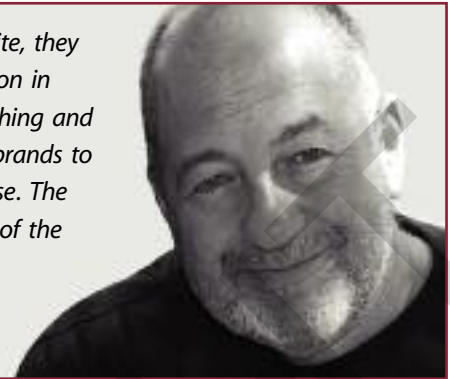




Consumers have grown so used to choosing shoes based on photographs on a website, they may "no longer connect with the sensory aspects of leather". This has led to a situation in which what the shoe feels like comes a distant second to what it looks like, and touching and feeling the product before buying is no longer necessary. This has made it easier for brands to "de-content leather from footwear". Profit margin is an important factor, too, of course. The record-setting hide prices of 2014 have caused leather to lose a meaningful segment of the shoe industry and it is doubtful that this sector will return any time soon.

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"I've fallen and I can't get up" The market is old and tired

Each and every year a tradition takes place that we all prepare for and all too often ignore the obvious implications. It's akin to stepping into the light, or escaping from the tunnel. We yearn for an improvement in our circumstance and then suddenly it occurs. Summer. We go from huddling inside, safe from the long nights. Protected by the comfort of our homes, we watch excessive amounts of TV, we text and e-mail ridiculous platitudes and speculative comments, all to alleviate cabin fever.

The theoretical bridge that we mentally cross provides an entrance to a more enticing and rewarding place and like all things in life there is a toll to pay. We therefore need to ask the following four questions. Why is this market different from all other markets? Why during this period does our diet change to alternative proteins? Why are we so influenced by the shoe business? And finally why should we lean in a new direction?

But first the transition to summer, a time when the entire American population receives a cholesterol boost as we gorge and binge on beef, pork and chicken. It's BBQ season and the race is on to satisfy the millions of grillers with ample supplies of saucy samplings, ice cream and apple pie. The consumer is headed for a stampede and in preparation for this seasonal event supply will pump up the volume and work hard to satiate an incredible desire to tantalise the taste buds. Packers have their captive bolt pistols locked and loaded as plants are being scheduled to run 5.5 to 6 days per week. Production numbers in terms of hide supply will increase by mid-May in preparation for loading the system for the official start of summer, namely Memorial Day, the last Monday in May. This inevitable event has been an American ritual since the day Bernie Sanders was born. It means increases in cattle slaughter through the summer months until Labor Day on September 5. So 2016 will be no different, there will be ample availability of our preferred by-product which will continue to exert pressure on prices.

Recent cattle chatter revealed an expansion in beef production and more specifically head numbers. However, in practical terms, is it feasible that any meaningful increase in herd size is an indicator of more production in the future? I for one question the practicalities of any significant growth in the number of cattle on feed. While there is proof of heifer

retention and an increase in the percentage of steers going to slaughter, the bottom line is that, with the advances in live weight, the production of beef is naturally increasing without adding to cattle numbers.

Since the year 2000 we have witnessed a 13.7% increase in meat yield per cattle slaughtered. In 2015 beef production in the US was 23.8 billion pounds. Based on the total number of head slaughtered, 28.8 million, this resulted in a yield of 828 pounds per head of cattle processed. By comparison in 2000 the production was 36.2 million head which produced 26.4 billion pounds, making the yield only 728 pounds. With the population expanding and, therefore, competition for available land coupled with increasing availability of alternative proteins such as chicken, pork and fish, the future for the beef business is not herd expansion but cattle performance in terms of increasing meat yields. Expect continued gains in animal size, not only in the US but also in the other major hide-producing regions.

So back to the questions: why is this market different from all other markets? Well, in previous markets shoe brands invigorated demand by using leather and synthetics. However in this market they are predominately using artificial materials. Why during this period does our diet change to alternative proteins? Because of the improved value proposition for chicken and pork. Why are we so influenced by the shoe business? Because until 2015 this leather segment represented over 60% of the bovine hide usage. And, finally why should we lean in a new direction? Because the influence of the footwear industry on leather is now approaching a point of no return as they are being driven away by the internet and auto leather business.

The face of retail is rapidly changing and as a result there is a paradigm shift in how footwear is being sold. The high street and shopping malls, famous for big box stores and multiple shoe retailers are now replaced by internet search engines and online businesses willing to provide a broad range of products delivered to your door in 24 hours or even less. The effect is a consumer who no longer connects with the sensory aspects of leather, preferring to select a style based on impulse and perception. The construction or substrate utilised is secondary when considering the panache and ability to obtain "just in time" for their use, without even leaving their home. This concept of purchasing is



broad based and utilised by a growing number of consumers to the point that some are predicting that online retail will soon eclipse that of bricks-and-mortar shopping. Ordering shoes via an android, galaxy or iPhone is second nature to a whole generation.

So how does this connect to the hide market? This has been a two-step transition.

Simply put, the shoe brand has taken complete control of materials used in footwear construction based on marketing and image or, more importantly, profit margin. The online image and marketing of a shoe obviates the need for the consumer to touch and feel the product. The human connection that is essential in making the case for leather uppers is by-passed when buying online. By losing the sensory marketing aspect, it became easier to de-content leather from footwear.

Secondly, large shoe brands that were faced with rapidly increasing leather prices from 2012 through 2014 logically switched their leather uppers to alternative materials. Demand for cotton, canvas and fabrics is scalable depending on finished product sales, unlike leather which is only a by-product of the beef business. The record-setting hide prices of 2014 have caused leather to lose a meaningful segment of the shoe industry and it is doubtful that this sector will return any time soon.

Our opinion on the future of the hide market has not changed these past few months as the direction is as clear as the air around Shanghai. Global hide markets are in the final stage of the adjustment that began back at the end of 2014. This is both in relative value and core pricing. We base this assumption on the influence of currency, the effect of by-product significance on the cost of live cattle, production numbers and the demand from the major leather segments. We expect that during the summer season, when production numbers increase, prices will drift into a new trading range between 10% and 15% below the prices of the first quarter of 2016. On the demand side we do not expect a recovery in leather footwear and we also anticipate an automotive slowdown in Q2 and Q3. This reduction will therefore exert pressure on producers to move inventories.

In addition to the above we cannot

forget the Zika effect. No, this is not a booty shaking hip-hop ditty but a more serious issue affecting South America and soon North America. This mosquito-borne virus is further complicating the world trade of hides as countries like China are issuing proclamations to safeguard the population from the potential infection of this virus. Raw material shippers in particular are rushing to resolve compliance criteria and ensure that raw hide shipments are prepared in accordance with Chinese regulations. The consequence of not being in

compliance will be quarantined cargo sitting on some dock by the bay awaiting disposition and fumigation, all at the expense of the shipper.

Assistance to help a fallen market will not arrive anytime soon. We must be patient and wait for the designers, engineers and fashionistas to rediscover the sensual appeal of leather. We trust summer will foster their creative juices and trigger a resurgence in demand for our fabulous raw material. In the meantime use your mobile phone and order some leather shoes. 📱

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