

David Peters warns that the industry must find a new home for the abundant supply of hides in the wake of leather's drop in popularity among footwear manufacturers.

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Houston, we have a problem

According to the *Washington Post*, Hurricane Harvey unloaded 33 trillion gallons of water. The amount of rain that fell in Texas and Louisiana would have ended the historic California drought twice over. Hurricane Irma dumped around 10 trillion gallons of water on the whole state of Florida; that's the equivalent of 500,000 gallons for each resident. Now we have had Hurricane Maria causing additional havoc and destruction on Puerto Rico and several other Caribbean Islands.

While the hurricanes made land and pounded coastal cities in both Texas and Florida, a similar effect was taking place in Asia as high-priced contracts washed ashore in South Korea, China and Thailand. Anticipating the damage these deliveries could do to their operating results, certain companies chose evacuation and simply fled the scene.

The so-called innocent shippers were left to manage their way through the stale bureaucracy, writing another chapter, no doubt Chapter 11, on the effects of market change. While an attempt to reach some type of accord during the ACLE Shanghai meetings was intimated, once participants had departed any consensus quickly evaporated and was trumped by personal agendas.

Radical changes

The temperature of the hide market is also radically changing. Utilising the traditional barometer for measuring prices (Jacobsen), the average price for HTS has plummeted 30% compared with the price in January. Not since September 2009 have we seen HTS prices so low.

What is more indicative of a shift in demand is the spread between the various selections. Asian shoe and side leather tanners have typically adopted HTS as their principal source of raw material, but it seems the traditional spreads with other selections have changed radically. The premium being paid for HTS in relation to CBS or BBS has eroded compared to previous years. It would appear that the historic value associated with HTS has changed drastically. There has no doubt been corrosion in the qualitative aspects, in part attributed to the influx of "M" branded cattle from south of the border.

In addition, with a healthy majority of HTS being converted to wet blue, one can draw the logical conclusion that the remaining hides sold in the hair have different characteristics and therefore value. With renewed global competition from multiple regions, tanners have numerous choices for raw

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material which are, in many cases, considerably cheaper than HTS. While tanners can source similar grade hides at a consistent discount from non-US origins, it is doubtful HTS will return to a premium market selection.

The climate of the market has changed; substrate replacements, which are being directly influenced by larger profit margins, combined with increases in global beef production, are putting excessive pressure on hide prices. This is exacerbated by contrarians who hold steadfast to their belief in supply-side economics. This diminishing crowd of "build it and they will come" speculators are a wishful-thinking group of traders profiting from the arbitrage of market nuances.

Ample supply

The delicate balance between supply and demand, so artfully played the past few years, has changed as global demand for beef has expanded. A shift in cattle cycles, along with producers moving away from consolidation, means production is now clearly scheduled to increase.

USDA announced that, on July 1, the US cattle herd expanded to 102.6 million head, the largest number since 2008. More cattle are available outside feedlots and a larger calf crop will provide an ample supply of cattle for placement into 2018. Commercial beef production is forecast to be higher in 2018 at 27.4 billion pounds. US beef exports for 2017 have been revised slightly lower and 2018 is unchanged.

This year's calf crop is estimated at 36.3 million head, which is 3.5% larger than in 2016 and 6.5% larger than in 2015. On January 1, 2017, the cattle and calves inventory was up 5% compared to January 1, 2015. The number of beef cows was



up almost 7% over the same period. The US cattle herd began the expansion phase of its production cycle in 2014. The herd on July 1, 2017 was 6.9 million head, 7.2% larger than on July 1, 2014.

The estimate for commercial beef production in 2017 was revised up to 26.7 billion pounds, mainly due to relatively large second-quarter cattle placements and the forecast impact on fourth-quarter cattle slaughter. Based on the relatively large number of cattle available outside feedlots, it is anticipated that a greater number of cattle will be placed on feed in the remainder of 2017 to bolster commercial beef production in 2018. As noted, the 2018 forecast has been raised to 27.4 billion pounds, so we are looking at abundant supplies of US hides for the next 18 months.

Fears for footwear

Demand is not keeping pace with supply. This is the time of year when tanners begin receiving indications of future leather demand and provide forward pricing to their major customers. Historically, the fourth quarter kicks off the annual round of customer presentations, with the introduction of new designs and suggestions of new colour palettes. Books containing colour swatches, sketches and seasonal collections are circulated among various brands, supported by design shows and exhibitions.

As the 2018 selling season ramps up, the inclusion of leather in staple items remains limited. The general concern is that leather has lost its traditional place as the substrate of choice for the shoe business. Compounding this issue is the fact that the appeal of leather in its conventional sense is not attracting the attention of shoe and boot designers. While high-end or luxury footwear will always include leather, the mass market remains focused on cheaper, more mundane materials and, in certain cases, wannabe substrates masquerading as leather.

A case in point is the Flyleather innovation recently announced by Nike. As reported by *GQ* magazine: "In an effort to reduce the amount of leather waste during sneaker manufacturing (which can be up to 30% of a cow's hide, according to Nike), the swoosh brand developed the new recycled material. Think of Flyleather as the Spam of leather. Basically, it is leather scraps formed into new leather that can be used in new shoes."

According to Nike, here is what happens: "Nike gathers the discarded leather scraps from the floor of tanneries and turns them into fibres. Then, those recycled leather fibres are combined with synthetic fibres and a fabric infrastructure via a hydro process with a force that's so strong it fuses everything into one material. The material then goes through a finishing process, which can include things like pigmentation, and is completed by being put on a roll to be cut."

'Flyleather' is therefore just another name for bonded or reconstituted leather.

Other avenues

On the automotive leather side of the business, while US vehicle sales are expected to remain down for the rest of the year, global new vehicle registrations rose 2.0% compared to



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a year ago. Industrialised countries, in particular Japan and parts of Europe, enjoyed noteworthy gains. Growth continued in China, albeit at a more modest rate, with new registrations rising 1.4%.

A report by *Automotive News* following the landfall of Harvey stated that up to 500,000 vehicles were estimated to be lost, a figure that will likely exceed the annual new vehicle sales total of the Houston area. The likelihood that any of these vehicles will be recovered is remote due to the abundance of electronics and other controls that will have been rendered useless. While Harvey's impact sent US light vehicle sales down 1.8% in August, long-term replacements will make for an improvement in numbers.

The US Department of Commerce provided some good news as July's furniture sales were 5.6% higher than during the same month of last year. Considering that we have witnessed an increase in leather seating surfaces, this is a small slice of optimism that we have the pleasure of reporting.

So, let's have an intervention. Let's address the elephant in the room. We should not attempt to put lipstick on a pig. The Shanghai show failed to stimulate a new round of business. Global hide markets are bearish and prices are weak. Sellers are building inventory, buyers are missing new volume orders.

The shoe and side leather segments are the determining factor in the health and well-being of global hide markets. Until this sector regains lost ground and leather is reintroduced to the mainstream footwear markets, the increased hide supply will need to find a new home. Unfortunately, the auto and residential upholstery businesses represent, at best, around 35% of the total demand for hides. We must therefore pound the streets for new sales of shoes made from real leather.

Even from a satellite perspective, there is a disturbance in the force. ☹