



Automotive leather in 2019

Long the saving grace of the global leather industry, the automotive sector is undergoing significant changes now and questions have arisen over leather's future in automotive. There are grounds for optimism as high-end original equipment manufacturers still prefer, and make money out of, leather upholstery. It is also the case that sports utility vehicles and crossover utility vehicles are still voracious users of leather in their interiors and amongst the car brands' biggest sellers. But sales growth is slowing across the board. With the importance of leather in other markets waning, these recent developments in automotive are making the mood darker.

The automotive leather sector has enjoyed an unprecedented period of success in this decade. Car sales have been strong in the key markets of North America, Europe and China and specialist tanners making automotive leather have expanded production. There is consensus among leather manufacturers that this period of growth cannot last for ever, but those who have been able to meet the demands of automotive customers are determined to make the most of it while they can.

Since 2013, rising demand for leather from original equipment manufacturers (OEMs) in the automotive industry has helped compensate for declines in orders from footwear companies. Tanners frequently describe their automotive customers as being demanding in terms of price and standards, but rewarding too because they decide their purchasing programmes years in advance and keep their promises, allowing leather manufacturers to plan for the future and make investments in necessary new technology.

Across this timeframe, predictions that automotive's consumption of the total number of cattle hides being processed at the moment would reach at least 25% by 2020 appear unlikely to come true. In large part, this is because these have also been boom years for meat companies and cattle slaughter, and therefore hide supplies have risen. At

most, automotive leather manufacturers tanned, finished and cut (or sent for cutting) 49.5 million hides in 2013. The figure for 2018 could be as high as 60 million. With more than 10 million extra hides requiring cutting now, and the requirements of OEMs for speed, accuracy and efficiency more stringent than ever, the need for investment in the best available technology seems clear.

Consumers' appetite for certain types of new vehicles appears healthy and most big automotive groups have posted growth in sales year after year for most of this decade, and even if this growth has slowed now, the industry's figures are still good from a historical perspective. Premium car manufacturers have fared particularly well and, across the board, there has been a large increase in demand for sports utility vehicles (SUVs) and crossover utility vehicles (CUVs), which are more likely to use leather in the interior than many previous models of passenger car.

Hide availability

At the same time, hides have been available to automotive tanners in large volumes as demand from rival sectors, notably footwear, has diminished while supply of raw material has gone up because of meat companies' growth. Hide prices were high in 2014 and 2015, which exacerbated

Growth in the automotive sector seemed set to continue as the end of 2018 approached, but a combination of declining demand, scandal and trade tensions led to a change in the mood among OEMs. CREDIT: BMW



the plight of leather in the price-sensitive footwear market, but have come down dramatically since then, boosting the revenues and profits of automotive tanners and allowing them to invest in production expansion and new technology.

For the future, industry experts believe that the advance of shared ownership and autonomous driving platforms will boost automotive leather further in some vehicle segments. Leather will offer car companies durability and ease of care, while passengers will enjoy the luxurious environment leather can provide, completing the transition from traditional car interiors to the mobile living-rooms that consumers will demand in the 2020s. However, with global groups including General Motors and Honda closing factories in long-established manufacturing locations to focus, elsewhere, on advancing their ability to produce electric vehicles, leather's extra weight compared to many synthetic materials may count against it.

In 2015, across the globe, a total of 90 million light vehicles were built in total. The corresponding figure for 2017

was 95.5 million and, in the first half of 2018, specialist publisher *WardsAuto's* projections were for the industry to produce 100 million light vehicles for the first time in 2019, reaching 106 million by 2023. If this happens, between 2015 and 2023, the industry will have added 16 million vehicles annually, which is roughly the same as adding one 'US' to the global market in that time.

According to these predictions, there will be growth in Europe, too, with the 2023 volume of vehicles purchased there likely to be 10% higher than 2015's, while South America will grow by 37% over the same period (which will still leave it short of the levels the market there reached before the dip of 2014). At the same time, there were

predictions halfway through 2018 that the market in China was on course to reach 33 million vehicles by 2025, if not sooner. *WardsAuto's* director of information content, John Sousanis, is optimistic about the car industry's immediate future but acknowledges that some in the automotive sector seem reluctant to share this positive outlook because, he explains, this is also a period of great change.

Trade wars

For the first half of 2018, at least, most groups continued their run of steady results. Volkswagen delivered 5.5 million vehicles between the start of January and the end of June, an increase of 4.4% compared to the same months the previous year. The Renault-Nissan-Mitsubishi Alliance achieved sales of more than 5.5 million in the same six-month period, an increase of 5.1% compared to the same months in 2017. Figures Toyota released about the same time were for the first three months of its 2018-2019 business year, the months of April, May and June 2018. During that time, it sold just over 2.2 million vehicles, an increase of about 1% year on year. However, Ford's figures were over 3.1 million vehicles for the first six months of 2018, a decline of almost 6%. General Motors' figures for the first half of 2018 showed sales of just over 4.1 million vehicles. This represents a decline year on year of 11.3%. These figures are only the start of the story, though. In the second half of 2018, some important developments have taken place in the global automotive industry. The trade dispute between China and the US that built up over the whole of 2018 has affected raw material prices and consumer confidence. Nowhere, it seems, has this happened more quickly than in China itself, especially after the threats and counter-threats of new tariffs became reality in July.





Audi is one of the car manufacturers to have set up new factories in Mexico. CREDIT: AUDI

Air of scandal

Repercussions continue from the emissions scandal that erupted in September 2015, when Volkswagen admitted for the first time that it had used software to manipulate the emissions controls for its turbocharged direct injection (TDI) diesel engines. This has cost Volkswagen and other OEMs millions, but there have been knock-on effects on most of the industry. A technical standard for measuring emissions in cars in Europe, the New European Driving Cycle, has had to be replaced. Starting in September 2018, it began to give way, in stages, to the worldwide harmonised light vehicles test procedure (WLTP), which provide what the standards authorities describe as “more realistic test conditions”. Fuel consumption and carbon emissions measured according to the WLTP will, in many cases, be higher than those measured according to the old standard, creating confusion among consumers and leaving OEMs finding extra budget for the new testing regime and with concerns about appearing to an increasingly environmentally conscious public to be committing the sin of growing rather than reducing carbon footprint.

This change had been in the pipeline for some time (the European Commission proposed “a fundamental reform of the system” in January 2016), but there have been surprises, too, not least for Carlos Ghosn, the chairman and chief executive of the cross-party agreement that is the Renault–Nissan–Mitsubishi Alliance. He was arrested at Tokyo’s Haneda Airport on November 19, last year, for allegedly misusing company assets and under-reporting his earnings to the tax authorities in Japan. The Nissan and Mitsubishi boards both dismissed him as their chairman in the week that followed. In January this year, Carlos Ghosn resigned as chief executive and chairman of Renault. He had held both roles simultaneously since 2005.

Carlos Ghosn became the chief executive of Nissan in 2001 when it was facing debt of \$20 billion and possible bankruptcy. Industry observers give him the credit for saving one of Japan’s flagship companies. Other comments suggest that, whatever the rights or wrongs of the alleged financial scandal, Nissan had become unhappy about the dynamic of the Alliance, first set up between Renault and Nissan in 1999. There has been talk of turning it into a merger of the OEMs involved, which many senior figures in Nissan and in the Japanese car industry more widely appear to oppose. A merger seems unlikely now and the future of the Alliance, which Mr Ghosn put together and, in the eyes of many, held together, could also be in doubt, despite assurances from all three OEMs.

In the wake of the unexpected news from Japan came an announcement from General Motors on November 26 that five plants in North America (four in the US and one in Canada) will close in 2019. A plant in South Korea was already earmarked for closure before the end of 2019 and the group said in the November announcement that two additional plants outside North America will also cease operations by the end of 2019. These closures will mean cutting around 14,000 jobs and the announcement brought stinging criticism, including from President Donald Trump. However, not everyone thinks this is a bad strategy.

Right-sizing

Industry editor at business weekly *The Economist*, Simon Wright, said that what GM intends to do is “right-size” its business for the automotive industry of the 2020s. “The car markets in China and the US have been buoyant,” he said, “but China is slowing down now and the US is at its peak and will start to slow down very soon. At the same time, there has been a move away from saloon cars and everyone wants to



Table 1:

Company Name	Home Market	Units sold in 2018 (million)	Increase/decrease (%) compared to 2017
Volkswagen Group	Germany	10.8	+0.9
Toyota Motor Corp.	Japan	10.6	+2.0
General Motors Group	US	8.4	-12.7
Ford Motor Company	US	6.0	-9.0
Nissan Motor Co.	Japan	5.7	-2.8
Honda Motor Co.	Japan	5.4	+2.3
Fiat Chrysler Auto.	Italy/US	4.8	+2.0
Hyundai Motor Co.	South Korea	4.6	+1.8
Renault Group	France	3.9	+3.2
PSA Group	France	3.9	+6.8
BMW Group	Germany	2.5	+1.1
Mercedes-Benz Cars	Germany	2.3	+0.9

buy SUVs these days. GM is realigning its industrial footprint to knock out more SUVs.” He explained that this is really about profit and that SUVs and trucks are more profitable vehicles.

Mr Wright’s view is that the automotive industry as a whole is now having to change the way it operates. From “selling cars and forgetting about them”,

it is now having to prepare itself to deliver what he calls “mobility services”, providing electric vehicles and, a little further down the line, self-driving cars that most people will share. “This means vehicles with a different architecture to that of the cars it is currently making,” Mr Wright says. “Two of the factories GM is closing produce internal combustion

engines. GM has been at the forefront of making electric vehicles and I think it just wants to move resources away from the old world of motoring into the industry’s new world.”

When full-year figures became available for 2018, they showed that, in terms of units sold, the Volkswagen group, whose brands include Audi, Seat and Porsche, delivered more than 10.8 million vehicles, an increase of 0.9% compared to the previous year. This put it ahead of Japanese group Toyota, which delivered 10.6 million vehicles, growth of 2% compared to 2017. These were the only two OEMs to break the ten-million mark.

The two leading US carmakers, General Motors and the Ford Motor Company, both recorded decreases in sales during 2018. During the 12 months, General Motors delivered 8.4 million vehicles, a drop of 12.7% year-on-year. Ford’s sales were down 9% to 6 million vehicles. Nissan sold 5.7 million cars, down 2.8% year on year but Renault saw its sales increase 3.2% during the year to 3.9 million vehicles. Two premium German automobile groups, BMW and Mercedes-Benz, both delivered more than two million vehicles in 2018. Table 1 offers an overview of selected automotive sales by group in 2018.



Higher-end brands, such as Mercedes-Benz, are likely to continue to be avid users of leather. CREDIT: MERCEDES-BENZ



From all of this it is clear that there are arguments for and against optimism among automotive tanners at the beginning of 2019.

Shoe blues

Previous reports we have published on this subject have shown the link between the increasing importance of the automotive segment to tanners and the diminishing appetite to use leather among other potential buyers of the material. In no application is this more obvious than in footwear. A perfect storm hit tanners selling to the mainstream footwear sector in the middle of this decade. Hide prices soared. In 2015, tanners acquired a combined total of, roughly, 275 million hides (adding together material from bulls, steer and cows) and paid \$18.75 billion for them. Athletic shoe brands and price-conscious mainstream footwear companies refused to pay increased prices for the privilege of using leather in many of the styles in their collections, opting increasingly for synthetic material for their uppers instead.

This reaction came as no surprise to seasoned observers of both the leather and the footwear markets. Hide prices have always gone up and down in a reasonably regular cycle and when the price of leather is high, the shoe industry usually looks for more affordable alternatives. If that is what shoe companies were doing in 2015, it was in keeping with the natural order of things, the usual dynamics of the footwear supply chain. Hide prices would go lower again in due course and the buyers would return.

The volume of hides available, globally, has gone up and their price today is much lower. In 2018, more than 275 million hides changed hands, but if we look at that same figure, 275 million, for the sake of comparison, we can see that this volume cost tanners around \$9 billion. This means that, compared to three years ago, today's tanners will make

a saving on 275 million hides of almost \$10 billion. Accepting that this is an over-simplification and that chemicals, water, energy and labour costs have all gone up, it is still a huge difference in price.

The truth is that 2018's total is likely to be slightly more than 300 million and the total amount tanners would have had to pay if they acquired it all would be \$9.8 billion, an enormous saving. Leather demand has been sluggish, automotive excepted, but demand for meat has been strong. Packer companies have been making record profits and cattle have gone to slaughter in larger numbers to keep the cash flowing. Supply of hides, therefore, is more plentiful than demand for finished leather and the likelihood is that the meat industry is currently producing 10% too many hides, 30 million a year that the leather industry cannot use, the equivalent to the number of hides US abattoirs produce in a year. Packers are unperturbed because the meat business continues to be so successful.

Automotive's share of the total, according to expert observers of the sector, is currently at 18% or 19%. This means car companies are consuming at least 58 million and possibly around 60 million hides per year. This is at a time when the shoe industry's consumption of the world's total number of hides is likely to have fallen below 50% for the first time in living memory.

Increasing hide prices coincided with the launch and broad acceptance of thousands of styles of shoes constructed using new techniques for knitting uppers. Brands benefited from the growing popularity and acceptability of casual, athletic and leisure shoes in previously unlikely settings such as the office, formal business events, even weddings. They benefited from increased use of automation in footwear manufacture, to which synthetic materials are well suited because of their



Leather predominates in the interior of this Porsche. CREDIT: PORSCHE CARS NORTH AMERICA, INC.



predictability and uniformity. There has been no need for these brands to look at leather again, or at least not at the levels of years gone by.

For tanners who have been able to adapt and meet the standards required by OEMs, automotive has provided consolation. Whether or not that consolation can continue in the face of some of the new challenges described is the big question.

Automotive tanners' outlook

Automotive tanners based in Asia agree with assessments that say sales appear to be slowing in China and have been since the 2018 tariff regime began to take effect. "This is starting to have a negative effect on our business," one tanner said in the final weeks of 2018, expressing hope, if little confidence, that the US and China can resolve their differences soon and allow trade to return to normal.

Similarly, tanners in Europe who serve automotive customers there have said the extra costs involved in meeting the requirements of the WLTP test could have an effect on business. OEMs have admitted to an impact on profits, if not so much on sales, but this in turn can upset the plans they have put in place with suppliers. They will move planned programmes in a different direction if they convince themselves that makes economic sense. New launches may be delayed; planned production may be scaled back.

These points aside, though, these have been good times for specialist automotive leather producers. Leather is a given in the luxury segment; brands in this part of the market are selling well and their customers want high-quality, rich-looking interiors. Leather's share of the overall automotive interiors market varies from region to region, and may be at its highest in the US, with current use of leather in between 25% and 30% of all cars, but rates are relatively high in

Europe and in China, too. Therefore, the seasons of success are not yet over for automotive tanners.

Mexico emerges as the major player

Nowhere is this more true than in Mexico. The continued success of automotive leather production and cutting in Mexico will require OEMs from outside Mexico to keep assembling cars there. By the start of 2017, there were 20 car factories being run by ten OEMs, with further projects planned. Big US-based players Chrysler, General Motors and Ford are there, as are Asian OEMs Toyota, Honda, Kia, Nissan and Mazda. The remaining two manufacturers are Audi and Volkswagen. Mostly, they are making cars to ship across the border to the US, a practice made easy and cheap by the North America Free Trade Agreement (NAFTA). That same year, though, President Donald Trump said he wanted to reform NAFTA because it was more beneficial to Mexico and Canada than to the US. Negotiations for its renewal generated less tension than the trade dispute with China, but there have still been periods of doubt and discord, which is never good news for overseas companies who have invested in manufacturing plants in a particular place, or who have committed to doing so in the future.

As a result of the renegotiation, NAFTA changed its name at the end of September last year, to the United States–Mexico–Canada Agreement (USMCA). Comments from the automotive leather sector in the region suggest that, apart from the name, little else has changed and smooth access to customers in the US for OEMs assembling cars in Mexico will continue. This is of great importance to the southern partner because some estimates suggest 40% of the entire Mexican economy has a connection to the automotive industry. The concentration and the pace of investment in car factories and in automotive leather manufacturing and cutting plants in



Quality materials and attention to detail in the interior of vehicles is helping brands such as Lexus stand out from the crowd. CREDIT: LEXUS



Leather's share of the overall automotive interiors market may be at its highest in the US, with leather in 25%-30% of all cars there. CREDIT: BMW

different regions of Mexico are set to continue with little or no interruption. There is an enormous installed capacity for the whole automotive supply chain in Mexico now, including for in-demand SUVs and CUVs. "That's good news for making automotive leather in Mexico," one industry commentator says. "Leather consumption in SUVs is greater and the extra square-footage required for all the SUVs will help compensate for any downturn in automotive sales in general. Mexico is solidly leading automotive leather production and growth and suppliers there, including Lear, Bader and Midori, are expanding. GST AutoLeather appears to be coming back [following its exit from bankruptcy protection in May 2018] and others, including Wollsdorf Leather, are opening there for the first time. It's a pity it's not more Mexican-driven, but it's a very positive story in Mexico in automotive leather. If there were a decline in volumes globally, Mexico would be the last place to feel it."

Sources also suggest that the types of leather Mexican automotive tanners can produce are what the market is demanding now, namely nappa and tight-grain, flat leathers made from raw material such as South German bull hides, or heavy native steers from the US. Heavily stuccoed buffed hides from Brazil have dominated the market in the recent past, but in the course of 2018 that began to change.

The appeal of leather in cars

Anecdotal evidence suggests the length of time consumers will typically keep a car before buying a new one seems to be shortening, from an average of seven years a few years ago to five or, perhaps, even four years now. Interiors are driving this more than engines or body-shapes. OEMs are adding more comfort and technology to their car interiors all the time: the acoustics, cameras to help you park, soft-touch doors, new lighting options and the layout and

design of the interior are among the improvements car companies have used to encourage consumers to buy.

This applies in every segment of the market and leather always adds value. OEMs will never stop attempting to add value so as to stand out from the competition. There appears to be no limit to their appetite. Audi, BMW and Rolls-Royce have begun fitting some of their models with a night-vision camera, allowing drivers to be much more aware of pedestrians, runners or cyclists or animals than they would be just with their eyes and the car's headlights in poor visibility.

Common ground

Cars are becoming a shared resource, whether through app-driven services such as Uber or through the subscription models that some OEMs introduced in 2018. Customers pay a monthly or weekly fee, which covers use of a car, plus insurance, maintenance and breakdown cover. Users of the service can upgrade to more expensive models or downgrade to less expensive ones depending on the journeys they plan to take in a given period, and they can unsubscribe when like. BMW and Mini are the first to offer this to consumers but a new brand, Polestar, will use this model as the "primary offer" to its customers. Polestar is a new electric car brand from the Volvo Group. It aims to start full production in mid-2019 and to begin delivering cars soon after.

The likelihood is that if self-driving cars become more commonplace a model like this would work well for them, too. "Shared is potentially good news for leather," industry commentators say. "While people are in those cars, they want something luxurious; they want it to be like a mobile living-room, or at least for that to be an option. You see this on aircraft in first or business class, and you see it in movie



If your home is your castle, your car can become your living-room. CREDIT: ROLLS-ROYCE

theatres now. When you buy a ticket to see the film, you choose the type of seat you want and some seats are lay-flat armchairs. Leather works well in those contexts because it's luxurious and durable. People will embrace the same concepts in shared cars."

One caveat concerning electric vehicles is that a key focus for makers and drivers of electric cars is how far they can run on one battery charge. Weight is a crucial question here because the more weight the vehicle has to carry, the faster it will use up battery power. It is true that tanners and leather chemicals manufacturers have been working hard to develop lighter-weight collections for automotive, but if this is the number-one consideration for OEMs, there will always be synthetic materials that can offer a greater saving in weight. Here, suppliers of leather will have to use other arguments to win the day.

Autonomous driving and leather

Dutch trends expert Nicoline van Enter points out that much of the growth in demand for shared vehicles will come from people who live in hotter climates than northern Europe's and says this will make an impact on car interiors. "Lighter colours will become more and more popular, and there will be more ostentation," she insists. "People in Asia, for example, can be much more decorative in these things than we Europeans are these days. In China recently I was offered a lift by the chief executive of a big company and was amazed to see that, inside his car, he had Swarovski crystals everywhere." She says this reminds her of old-fashioned transportation such as horse-drawn carriages, in which very rich people often liked to show off their wealth, but not on the outside. "If your house is your castle, your car will be your living-room," Nicoline van Enter says, "and it will start to look like it."



CREDIT: ROLLS-ROYCE

She predicts screens everywhere, saying any surface in a car's interior will, potentially, become a space that travellers can use for work or play during the journey. Surfaces will undergo an enormous amount of touching. "Because people will touch it all the time, the material will need to be pleasant to touch," she argues, "and that gets overlooked."

Not only is Ms van Enter convinced that leather will have a big role to play in enabling touchscreen surfaces inside the cars of the future, she says work to develop leather with the technical capabilities required is already under way. Efforts to make leather a part of the burgeoning wearable technology scene ought to help tanners prepare for supplying materials for the car interior of tomorrow, she says. 🌐