

COUNTRY PROFILE

Area: 8,514,215,3 km²

Population: 175.6 million

Language: Portuguese

Capital city: Brasília

Main cities: Sao Paulo, Rio de Janeiro, Belo Horizonte, Porto Alegre

Member of MERCOSUR, Common Market of the South (Brazil, Argentina, Uruguay and Paraguay)

Cattle breeds: Zebu and European breeds

Bovine herd: 170.7 million



Update on the Brazilian tanning sector

Brazil has the second largest commercial bovine herd in the world with over 175 million cattle and is therefore one of the main hide suppliers with around 15% of the total global hide offer.

Brazil actually ranks third in hide production with 35.5 million raw pelts per year, being surpassed only by the USA and China. The Brazilian tanning industry occupies fourth place in the world's ranking of leather manufacturers behind China, the USA and Italy. It is estimated that in 2010, Brazil will be producing 45 million hides per year achieving first place in bovine hide production.

The country has an installed production capacity capable of processing its entire hide offer. Approximately 800 tanneries currently operate, with modern, technologically up-to-date leather processing businesses present all over the country. Many are equipped with state-of-the-art machinery and they all employ highly qualified labour. Finance is available to purchase equipment both locally and abroad.

The Brazilian Federal Government recently reduced its Tax on Industrialised Products (IPI) in relation to 643 different types of manufacturing equipment. The leather and shoe, plastics and textile sectors are among those to which the tax reduction applies. The reductions have been taken as part of the Government's Policy for Industry, Technology and

Foreign Trade which includes the complete phasing out of the tax by 2006. The sectors to which the reductions apply were selected according to their potential to generate employment, increase exports and improve local infrastructure. Some machines were also chosen for their potential to enhance the competitiveness of small- and medium-sized companies and contribute to the modernisation of those businesses.

In general, tanneries tend to operate near the sources of raw materials and wet blue hides have always been produced very close to slaughter areas in the states of Goiás, Mato Grosso and Mato Grosso do Sul. Semi-finished leathers are frequently produced in larger quantities in these same states but when it comes to fashion articles, finished leather production remains near the traditional final goods manufacturing clusters such as the Vale do Sinos.

Brazil also breeds sheep and pigs mainly in the south and goats and hair sheep in the warmer northern and northeastern regions. The skins of these animals are processed and used locally in the production of garments, rugs and footwear.

CICB

The Brazilian tanning sector is represented by CICB — Centre for the Brazilian Tanning Industry.

One of CICB's main tasks is to promote

Brazilian leather abroad. To do so it has signed an agreement with APEX — Brazilian Export Promotion Agency which provides the funds for various promotion actions such as tanners' participation in international fairs.

In order to give Brazilian leather its own identity, CICB has created the brand BRAZILIAN LEATHER that is carried by all products especially those for export.

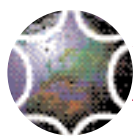
Brazilian leather exports break through the \$1 billion barrier in 2003

For some years now, the Brazilian tanning sector has been working hard to increase its participation in the international market. The efforts were rewarded in 2003 when 21 million pelts were exported, generating a turnover exceeding \$1 billion.

Final figures from the Brazilian Foreign Trade Department, Secex, show that the country's leather exports increased 10% in value and 9% in volume in 2003, reaching just over \$1 billion.

Italy accounted for 40% of the total, even though exports to that country were down 7% in volume terms (8% by value) while China including Hong Kong was the destination for 32%.

Exports to Canada leapt 144% in value terms, with garment leathers accounting for the bulk of the increase. Japanese exports meanwhile rose 76%. Wet blue exports climbed 6% (-1% in value) and



Country Commentary: Brazil

COUNTRY	VALUE (\$)		PERCENTAGE		VOLUME (Kg)		PERCENTAGE	
	Jan-Dec/03	Jan-Dec/02	SHARE 03	GROWTH 03	Jan-Dec/03 02/03	Jan-Dec/02	SHARE 03	GROWTH 02/03
Italy	312,117,586	318,414,634	29.39%	-2%	106,074,588	114,820,164	40.29%	-8%
Hong Kong	171,705,142	33,722,550	16.17%	409%	52,047,554	33,722,550	19.77%	54%
China	116,485,302	88,198,722	10.97%	32%	32,773,692	23,242,324	12.45%	41%
USA	94,312,993	105,014,314	8.88%	-10%	7,702,161	6,964,428	2.93%	11%
Portugal	47,181,713	50,776,811	4.44%	-7%	11,269,714	12,610,284	4.28%	-11%
Canada	36,308,151	14,888,392	3.42%	144%	2,550,634	1,049,176	0.97%	143%
Taiwan	25,766,047	23,803,085	2.43%	8%	10,007,661	9,051,876	3.80%	11%
Japan	24,165,684	13,752,922	2.28%	76%	3,579,182	2,106,573	1.36%	70%
Spain	22,409,752	23,488,328	2.11%	-5%	6,693,412	8,553,611	2.54%	-22%
Singapore	22,378,250	25,919,543	2.11%	-14%	1,612,646	2,486,450	0.61%	-35%
SUB-TOTAL	872,830,620	697,979,301	82.19%	25%	234,311,244	214,607,436	89.00%	9%
Other countries	189,172,274	265,718,769	17.81%	-29%	28,971,934	26,891,650	11.00%	8%
TOTAL	1,062,002,894	963,698,070	100%	10%	263,283,178	241,499,086	100%	9%

finished leather exports rose 48% in volume (+29% in value).

On the road to Asia

Amadeu Pedrosa Fernandes, president of CICB and vice-president of ICT – International Council of Tanners – says that the growing demand for leather by the Chinese market, or rather, the Asian market as a whole, will force tanners to intensify their marketing actions especially in logistics so that the distance between Brazil and the Asian continent may be “shortened”.

Talking about the profile of the Brazilian tanning business in the next five years, Mr Fernandes believes that “it will change significantly. Current exports to Italy should shift to Asia. In Brazil, business in the domestic market should grow through an increased production of leather goods in general.”

Hide quality is not good enough

Brazilian tanners are constantly faced with the low grading of locally produced hides and certainly have to meet the challenge of producing good quality leathers from quite poor raw materials. Unfortunately for tanners in Brazil, cattle are still bred mainly for beef and milk so little attention is paid to the quality of hides. Simple solutions, such as eliminating barbed wire, fighting skin parasites and using modern branding methods, (earrings or microchips) are being promoted. These, together with the training of meat-packing plant personnel to do a better job of fleshing and transporting animals in suitable conditions, etc., are some of the steps that are being taken to improve hide quality.

The “Hide Quality Improvement Program” set up a few years ago in order to

make farmers aware of the economic importance of hides proposes that raw hide suppliers be paid according to the quality of their hides, that is, the better the quality the higher the compensation. Some tanners are already paying according to quality and some good results have emerged.

Brazilian tanners lose \$1 billion per year because of hide defects

César Müller, president of the AICSul - Association of Tanners of the State of Rio Grande do Sul - has called on suppliers to the industry to exercise greater quality control, as avoidable defects are a major cause of lost revenue.

Speaking at a recent “Beef Symposium” in São Borja/RS, Müller put the total losses attributable to hide defects at around \$1 billion per year. Of these, around 60% were avoidable, being related to cattle breeding and slaughter activities. If fewer defects were generated, everyone along the production chain would benefit, not just the tanners, he reasoned.

Mr. Müller said that if defects were eliminated altogether, the average price paid for Brazilian hides would double to \$60.00, in turn doubling the industry's revenues to \$2.1 billion a year.

“Adding value to leather means giving priority to quality, especially during the early stages of the process. Replacing the current volume of wet blue exported, with crust, would generate an additional \$527million a year for Brazil. If we opted for finished leather, then the added value would rise to \$749 million per year”, he added.

“Just 8% of Brazil's total output of 34.5 million hides were classified as high quality in 2002,” Müller said, “while 85% of hides in the USA were given a “Grade A” rating.”

Brazilian finished leather exports up

In spite of raw material quality problems, in 2003, exports of Brazilian finished leather were up by a massive 47.8% in volume and 29.5% in value if compared with the year before.

César Müller attributes the rise to the deliberate efforts made by manufacturers and trade bodies in recent years to improve the competitiveness of the product in the international marketplace, as well as the duty imposed on the export of wet blue at the end of 2001. He also cites the increased co-operation between the industry and government bodies, something which has made the industry better geared to the production of finished leather that already accounts for over 25% of the volume of all Brazilian leather exports.

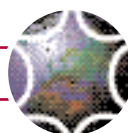
According to Arnaldo Frizzo, managing director of the Braspelco Group of Uberlândia/MG, the times when Brazil had to open foreign markets through wet blue exports are long gone. There are no more barriers to Brazilian leather that should now be exported only with high added value.

Brazilian government moves to eliminate 9% wet blue export duty

The Brazilian leather trade has reacted with dismay to the Government's recent decision to phase out the 9% duty that applies to the export of wet blue.

Camex, the Brazilian Chamber for Foreign Trade, has approved a resolution that will see the duty reduced from its current level to 7% in 2004, 4% in 2005 and its complete elimination by the end of 2006. The chamber cites “disappointing” growth in footwear exports.

Introduced in December 2000, the duty is widely credited with the fantastic



Brazilian leather exports January/November 2002/2003

Type of Leather	%age of total	
	Jan-Nov 2003	Jan-Nov 2002
Wet salted	1.21%	1.74%
Wet blue	60.60%	65.74%
Crust	11.48%	12.16%
Finished	26.71%	20.36%
Total	100.00%	100.00%

increase seen in Brazilian finished leather exports, which were previously hamstrung by the country's supply of wet blue being snapped up by overseas buyers.

César Müller, described the government's decision as a backward step. "The wet blue export duty was adopted because the tanneries agreed to it. Last October a survey was carried out and 70% of the companies decided that the 9% duty should be kept in place.

"The Government has demonstrated its lack of concern for a sector that generates wealth and jobs for the country. We are going back to a time when we were denied fair access to raw materials that are rightfully ours."

In the three years the duty has been in place, Brazilian finished leather exports have risen 230% from \$138.7 million to \$458 million, with the duty being viewed as the main engine for the growth. The industry had been expecting the same rate of growth over the next three years, reaching the \$1 billion mark by the end of 2006. In that wet blue only fetches a third of the price of its finished counterpart however (\$30 a piece vs. \$90.00), those projections have now been thrown into disarray.

Müller asserted that the Camex decision would only serve to create unemployment and, at the same time, prevent the generation of new jobs. Only 300 new jobs were created for every one million units of wet blue produced, he explained, increasing to 650 for crust and 1,000 for finished leather. As it was, one million manufactured products were enough to support 25 to 30,000 jobs.

Amadeu Pedrosa Fernandes, said the decision was at odds with the stated aim of President Luiz Inácio Lula da Silva, which was to reduce unemployment. It had also been taken without the necessary consultation. In his estimation, instead of preparing the country for development, the Camex decision would take the country back to colonial times.

In a recently issued document, Abicalçados-Brazilian Association of

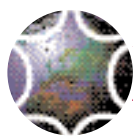
Footwear Manufacturers outlined the benefits brought about by the duty. These included a greater willingness among European tanners to negotiate the elimination of duties that apply to the import of Brazilian finished leather, footwear and leather goods, plus increased interest from European tanners in setting up joint ventures with their Brazilian counterparts.

Heitor Klein, managing director of Abicalçados, said Brazil should not relinquish the competitive advantage brought about by the duty - especially in view of the opportunities presented by the recent BSE case in the US. "Giving up

such an important negotiation tool as the wet blue export duty is commercial naivety to say the least," he emphasised.

Brazil as a major upholstery leather supplier

In recent times, Brazil had significantly increased production of upholstery whole hides that were exported and finished in other countries' tanneries. But more recently still, Brazilian tanners became highly qualified. This, together with state-of-the-art equipment and the application of products and processes that impart the levels of quality expected by the most



Comparison of wet-blue and finished leather export growth 2002-2003

Type of leather	Increase in volume exported		Increase in value	
	2002	2003	2002	2003
Finished leather	76%	50%	69%	33%
Wet blue	20%	5%	-1%	-1%

demanding markets, Brazil is showing all its potential to become a major producer and exporter of finished and semi-finished upholstery leather.

Also, the growing percentage of low grade hides has forced tanners to produce articles that may give them some profit and upholstery leather is one such alternatives.

Brazil and the international upholstery leather market

Whether it is a passing fashion or a preference that is here to stay, the fact is that the world appears to want more and more leather upholstered goods. Few countries can produce large enough hides from which large patterns may be cut out in one piece. Brazil can and that is one of the reasons why the upholstery leather business is growing so fast.

Italy has always been *the* specialist in this area. But things are not going so well for Italian tanners anymore. The exchange rate of the euro, high production costs and shortage of raw materials in Europe favour the development of the Brazilian upholstery leather industry.

Because of the new situation at home, some prominent Italian tanners, such as the Dino Mastroto Group, have taken measures to mitigate the problem. A few years ago they either set up branches of their tanneries in Brazil and Argentina or went into joint-ventures with local tanners in order to guarantee a good supply of raw material and low labour costs. Most of these tanners produce affordable goods for the American market in their new locations.

Production of upholstery leather is growing steadily in Brazil. Large local companies devote a large slice of their production capacity to upholstery leather and some of them also produce cut and sewn seat covers for the furniture and motor industries. Some good examples are the Braspelco Group, of Uberlândia/MG; Arthur Lange S/A, of Turuçú/RS; Bartos Ind. & Com., of Fernandópolis/SP; Bier, Scharlau & Cia, of Novo Hamburgo/RS; Couros Bom Retiro, of Teutônia/RS; Curtidora itaúna, of itaúna/MG; Curtume Viposa, of Caçador/SC; and Bermas – the partnership of Dino Mastroto with Brazilian tannery Bertin, of

Maracanaú/CE.

There have never been so many favourable conditions for Brazilian tanners as there are now. In the USA many tanneries have closed down in the last few years. Just a few large ones remain and mainly target the automotive sector. High production capacity tanneries have emigrated to Mexico, South Africa and China.

Regarding production of whole hides for upholstery leather, at the moment, China is just a step behind Brazil. Experts say that Brazil has better possibilities of developing its upholstery leather industry because it has the largest bovine herd in the world.

New finished leather tannery for Braspelco

One of Brazil's largest producers of finished leather, Braspelco Industria & Comercio Ltda, has opened a new state-of-the-art tannery serving the automotive and furniture upholstery markets.

Located in the town of Itumbiara in the central state of Goiás, the \$30 million facility occupies a 650-hectare area and comprises industrial, utility and office buildings, an effluent treatment plant, an irrigation system that uses recycled water (nothing goes into the nearby rivers) as well as associated prairies for the grazing of dairy cattle. The complex has a workforce of 2,000 and employs a further 5,500 indirectly.

The town of Itumbiara was carefully chosen, being located at the hub of the Brazilian cattle-breeding region. Goiás accounts for 12% of the national herd and has an annual slaughter of four million

head, while over 20 million head are slaughtered annually within a 1,000 km, radius. Other advantages attached to the location include a good regional transport infrastructure, an abundance of hydroelectric power and a state Government that is supportive of the beef and leather industries. Itumbiara lies 200km from the state capital of Goiânia, 130km from Braspelco's Uberlândia headquarters in Brazil's central region and 250 km from the state of Sao Paulo.

Though production is currently focused on finished leather for the motor and upholstery export markets, as well as leather for shoe uppers, Braspelco also has its eye on the market for higher added value articles such as ready-cut pieces for sofas and seat covers. Annual production is in the region of 1.5 to 2 million hides, with wet blue being sourced from 10 associated tanneries located in central Brazil, as well as suppliers operating in Goiás and neighbouring states.

Founded in 1986 by a group of Brazilian entrepreneurs with a strong track record in the leather sector, Braspelco today operates 13 tanneries in Brazil, as well as two cattle farms, a footwear factory and chain of retail outlets.

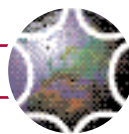
Chemical products

A network of strong chemical product suppliers and an innovative and competitive machinery and equipment sector back the Brazilian tanning industry. Besides Brazil's own manufacturers most international suppliers are present in this market either with their own factories or through representatives or joint ventures with local companies.

All multinational chemical product suppliers operate in Brazil one way or the other: Bayer, Basf, Clariant, TFL, Rohm & Haas, Münzing Chemie GmbH, Cognis, Buckmann, Mathiesen, Boehme, American Química, Quimargen, Stahl, Rhodia, Stoppani, Titanchim, Units, Indinor and Dupont among others



The new Braspelco tannery



efficiently serve the Brazilian tanning sector. And local companies such as Fischborn & Andrade, MK, Killing, Corium, Faxon, CCE, Noko, Poliviny, Tan Química, Coraquim, Enia, Ecovita, Copenor do not fall behind in terms of technology and service.

Two of the world's main producers and exporters of mimosa extracts are located in the south of Brazil. They are Tanac S/A and Seta S/A.

TANAC S/A

Tanac S/A is a fully Brazilian company founded 1948 in Montenegro, Rio Grande do Sul, the southern-most Brazilian state. It is one of the few producers and exporters of vegetable extracts for the tanning industry. Besides vegetable extracts, Tanac also produces a range of syntans offering various different properties that are suitable to the pre-tanning, tanning and re-tanning processes. The company is leader in Brazil enjoying a market share of approximately 65% and exports its products to approximately 70 countries around the world. In total, Tanac produces 30,000 tons of extracts per year and employs some 260 people.

Tanac's Mimosa extract is well known for its excellent tanning properties and stability characteristics. It is well suited for pre-tanning, tanning and retanning. Product applications are diverse ranging from sole, belting and saddlery to upholstery and garment leather, etc.

In order to supply its factories with prime quality raw materials Tanac has its own reforestation programme covering approximately 27,500 ha (61 million trees) where Mimosa trees are grown. This programme employs 1,100 people and helps to ensure consistent quality of the raw material.

Besides their own mimosa forests Tanac uses raw material supplied by small farmers that grow the trees in their own properties under contract. 35 rural families benefit from this scheme.

Tanac has a mimosa wood chip factory in the city of Rio Grande where 65 people work. The whole wood chip production is sold to the Japanese cellulose industry.

In 1996, Tanac was ISO 9002 certified for its Quality Management System. In 2000, the company was awarded its ISO 14001 Environmental Management certification. In 2003, it received its ISO 9001/2000 certificate.

Since 2001, Tanac has run its "Abrace a Natureza" ("Let's hug Nature") Environmental Education Project at its mimosa extract unit, where students from

all over the region learn that the extraction process is carried out with environmental preservation in mind. Since last year, Tanac's Camboatá Ecological Path in the Piratini region has been open to public visitation. There, students from nearby communities learn about native forests and environmental preservation.

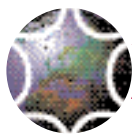
MK: 25 YEARS EXPERIENCE IN THE LEATHER SECTOR

Twenty-five years ago, the lack of some leather chemicals supplied by multinational companies encouraged Milton Kogler, a leather technician and

tanning consultant at the time to seek solutions that might fill that market gap. That idea was the basis for setting up MK, a company devoted to finding solutions to tanners' specific needs.

Since 1989, the year of its foundation, MK has been working on the development, production and distribution of leather chemicals for all the stages of the tanning process including finishing.

MK has two industrial units currently in operation; one in Portão/RS, the same location as its Head Office and another one in Juazeiro do Norte/BA. A third factory is being built in the state of Mato



Country Commentary: Brazil

Grosso and should soon start operations thus turning MK into the largest leather chemical producer in Brazil.

The development of efficient, ecological and inexpensive solutions for its customers together with the high quality support offered by its technical team has guaranteed MK national and international recognition for its technological innovation and social responsibility.

In 1999, the company's quality management system was ISO 9001 certified.

MK has conquered a large share of the tanning chemical specialty market both in Brazil and abroad and is a Brazilian market leader in beamhouse chemicals. In 2003, Brazilian sales increased 30% compared to the previous year.

The international presence of MK is growing fast even in the most demanding and competitive markets in the world. With buyers in thirty countries, in 2003, exports of MK's products went up 56% and accounted for 35% of the volume produced.

MK's investment in research,

production processes and management will continue to be the basis of the company's achievements.

SETA S/A

In November 2003, Seta S/A celebrated its 62nd anniversary. The company was founded in 1941 in Estância Velha/RS to try and fill in a market gap in the supply of vegetable tannin extracted from mimosa tree bark. Taking advantage of the mimosa forests available in the region, Seta operated only locally until 1946 when it set up its first branch upon the Taquari River which facilitated carriage of both outward goods and inward raw materials.

Today Seta produces and sells, both locally and abroad, vegetable tannins and other specialty chemical products to the leather industry and is also the Brazilian representative of Bayer Chemical and River Chimica.

The company constantly invests in technical Research & Development so that its tannins can comply with the demands of the most rigorous markets.

Seta's industrial plant is second to none.

State-of-the-art equipment and modern laboratories guarantee the quality of the products offered. Consistency and reliability in the production process and the work of highly trained technicians mean an all-round world-class service.

SETA CH - HIGH ASTRINGENCY MIMOSA EXTRACT

Seta has recently launched a new high astringency mimosa extract, the Seta CH. This extract is a product that has been modified for increased astringency without losing the high penetration speed common to all mimosa extracts. In addition to its astringency and fast penetration, Seta CH has a greenish yellow colouration, (red 1.8 and yellow 16/0.6% w/v solution) and therefore it may partly replace chestnut extracts commonly used in sole leather tanning.

By adding Seta CH to the tannage liquor, sludge formation is reduced to a minimum and fibre compaction, the degree of tannage, water absorption and density properties are considerably increased. 