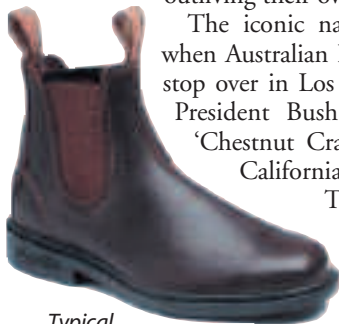


China is casting a shadow over the Australian Leather industry, and while some are benefiting from having a virtual neighbour growing so strongly, others are being forced to become more innovative, more desperate and more adaptable to survive.

China casts its shadow 'down under'

Legendary Australian leather man, Reginald Murray 'RM' Williams died recently aged 94, but he lives on, through the company he founded, and the typically Australian elastic sided boot. 'RM' is given credit for inventing the boot design while sitting beside an open camp fire in the South Australian outback in the early thirties.

The boot is made from one piece of leather, blocked into shape under high temperature and pressure. The resulting need for top quality selection and robust finishes are factors which challenge tanners wanting to supply RM Williams. The leather soles are screwed to the upper, and the boots have a reputation for outliving their owners.



*Typical
Australian elastic sided boot*

The iconic nature of the boots was confirmed when Australian Prime Minister John Howard, on a stop over in Los Angeles in June on his way to see President Bush, presented a pair of size 11½ 'Chestnut Craftsman' boots in vealer leather to California Governor Arnold Schwarzenegger.

The boot makers of Australia, with other well known brand names such as Blundstone, Rossiter, Oliver, Baxter, Red Back, Bata and Dunlop are perhaps the one dim light in an otherwise dark Australian shoe industry. These makers all have their own version of the elastic-sided boot, but also make safety, rural, military, hiking, motorcycle and dress boots, and young fashion items as well. This is one area where the Australian industry seems capable of standing toe to toe with China.

Most of the Australian shoe industry has become an assembly line for imported parts, many of them from China, and while the brands live on, the Australian content in design and manufacture is decreasing.

One of the major brands, Colorado, a locally owned public company (ranked 543 in Australia's top 2000 companies) started life as a shoe maker in 1987, and has expanded into a significant clothing retailer. Managing Director Rowan Webb recently reported that the company was flush with cash, but was waiting for tougher times to buy market share. They have just spent A\$10 million improving technology infrastructure. The company has annual revenue of nearly A\$450 million and over 2,000 employees.

Still a major raw material supplier

Australia's main impact on the world leather industry remains as a raw material supplier. Apart from being the only supplier of kangaroo skins, and a major source of sheep skins, Australia has been ranked as the eighth largest producer of beef in the world. These figures are based on 2003 statistics from the United States

Beef Facts

- Australia is the largest beef exporter in the world, exporting beef to over 100 countries.
- There are approximately 26.5 million beef cattle in Australia.
- 70% of total Australian beef production is sourced from Queensland and NSW.
- Each year Australia produces just over 2 million tonnes of beef and veal.
- The gross value of Australian cattle and calf production (including live cattle exports) is approximately A\$7.4 billion.
- Australians eat around 37.1kg of beef per person annually.

Sheep Facts

- There are approximately 97 million sheep in Australia.
- The prime lamb industry is mostly concentrated in New South Wales and Victoria.
- Australian exports of sheep meat were valued at over A\$1 billion in 2002.
- The gross value of Australian sheep, lamb and live sheep production is estimated at A\$2.1 billion.
- Australians eat 5.4kg of mutton and 11.5kg of lamb per person annually—amongst the highest consumption figures in the world.

Goat Facts

- Goat meat is the most widely consumed meat in the world, with Australia being the world's largest exporter.
- In 2002/03 Australia shipped 15,000 tonnes of goat meat valued at A\$14 million.

Department of Agriculture (USDA). The US is ranked number one, accounting for 24% of global beef production at 12 million tonnes, followed by Brazil (15%) and the European Union (15%). Collectively, the top ten countries produced 89.2% of the world's beef supply in 2003.

Australia has some unique beef producers, several with land areas larger than many countries.

S. Kidman & Co Ltd is Australia's second largest private landholder, with pastoral leases and agricultural holdings covering more than 112,000 square kilometres in four states. The company runs a herd of 160,000 grass-fed beef cattle produced for meat exports to Japan and the USA. Live cattle are exported to South East Asia and North Africa. In the spirit of its founder, rural innovator Sir Sidney Kidman, who helped pioneer the first Australian frozen beef and mutton exports, the company is still striving to be innovative. Today the company is run by Sir Sidney's descendants.

The largest beef producer, Stanbroke Pastoral Company, has undergone traumatic change in recent times. A consortium



bought the grazing giant from AMP Life for A\$490 million last September, however the consortium has fallen apart. Australia's Burger King chief Jack Cowin and fellow director Peter Hughes walked away with about A\$100 million each after they sold their stakes to Peter Menegazzo, an original partner in the consortium. The acquisition made the Menegazzo family—Mr Menegazzo and his sons Mark, David and Brendan—one of the world's largest beef producers, with about 25 properties totalling 10 million hectares and running 435,000 head of cattle. Mr Menegazzo was a potato grower in Swan Hill Victoria before buying up farm properties across Australia.

However in the weeks following the break up, Menegazzo began dismantling the Stanbroke empire that had been built up over several generations, and has so far sold eight properties totalling over 1.5 million hectares. Stanbroke however retains its interest in the Valley Beef abattoir at Grantham in Queensland, in partnership with another of the major pastoral companies, NAPCO, North Australian Pastoral Company.

...and the drought goes on

Although some relief from the drought has occurred in Australia, autumn rains failed across large areas of southeast and southern Australia. In addition, long-term rainfall deficiencies persist over the southeast of the mainland. Recent low falls in this area have added significance in that this general region has experienced below normal rainfall for most of the past eight years.

The impact of the low rainfall has been intensified by very much above average or record high maximum temperatures since the start of the year. For example, averaged over the Murray Darling Basin, the mean maximum temperature for the year to date is about 1.5 degrees above average, some 0.2 degrees above the previous record set in 2001.

The result will be a delay in the expected herd rebuilding, with some farmers forced to liquidate stock to maintain what little breeding herd they still have.

The wet blue and brine cure segment

The rise in value of the Australian dollar against the US dollar over the last two years has been a dominating feature of the market for local hide merchants and tanners. The rapid rise peaked in March 2004, but the uncertainty and rapid change that has made life tough for local traders remains.

The last two years has seen a period where the big got bigger and the medium size operators faced even more challenges. A.I. Topper, Nippon, AMH and Tey's continue to be dominant players, with large supplies of raw material moving through their hands.

Nippon Meats, the second largest meat producer in Australia, has pumped further capital into its New Wave Leathers wet blue plant in Toowoomba, Queensland, increasing both the quantity and the rate of throughput. Nippon not only access the 15,000 to 20,000 hides per week from their own works, but also compete fiercely on the open market to purchase further hides from surrounding meatworks.

A.I. Topper, whose turnover is reported to be over A\$200 million per annum, and who employs more than 200 people, is in the top 1,000 companies in Australia. It also continues to play a major role in the Australian industry, through facilities in every state, including a wet blue tannery, Walfertan Processors Pty Ltd, at Aberdeen in the Hunter Valley of NSW, and facilities for brinecuring in Tasmania, Queensland, Victoria and Western Australia. Kangaroo skins processed and exported by Toppers

After four years of drought, the Australian flock is running at 96 million, down from a recent high of 135 million," states John Gorman, president of AHSLEA, the country's association of hide, skin and leather exporters. "It's the lowest it's been for 55 years and there is no relief in sight yet. If the drought breaks this year, it will take at least another two years to build up the numbers significantly.



"This shortage of supplies has forced prices up to levels I haven't seen before. China is the main buyer for sheep and lambskins, along with Türkiye buying lambskins. There will be maintained price pressure with Russia and former USSR countries all trying to get a share of the market. In recent times we have seen an influx of Chinese and Russian companies starting up business here to ensure they can get sufficient supplies. On the other hand, two Australian tanneries have closed—one to relocate in China and the other considering a move to Vietnam...or thinking about expanding its wine interests in Victoria instead."

On this evidence, it appears that small sheepskin tanneries have a limited future. The association, which covers the established major shippers, has 48 members. The mood among them is that, while business may be difficult at present, there is a future for companies that deliver a quality product.

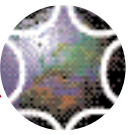
originate from four states—NSW, Qld, SA & WA—and with its associates, Packer Tanning, they are the largest kangaroo leather producers in Australia.

Australia Meat Holdings (AMH) is still the largest meat processor and is now a wholly owned subsidiary of Swift & Company, one of the leading producers of beef and pork products in the USA. AMH has four feedlots, two in Queensland and two in New South Wales, and four abattoirs, all in Queensland.

The medium size players, such as Michell, VHSP, Austanners and Murgon Leather, continue to operate in tight market conditions. The intervention of the Australian Government in the early 90s to provide support for the local wet blue industry was seen as a wonderful opportunity at the time, but has caused many problems in recent years. Premature investment in wet blue production brought about over capacity in the local industry. This, along with the awakening of the giant, China, has changed the Australian industry irrevocably.

The impact of China on the local industry cannot be overstated. There has been a significant 'brain drain' with several of the industry's most experienced executives being attracted to the new face of Chinese manufacturing. The level of technical support from the chemical industry for the tanning industry has also suffered, as the focus in the region shifts to China where the industry is growing, capital investment is high, and the future looks secure. But most of all, the improving quality of the Chinese leather industry output, and the low cost of inputs, especially labour, make the fight against Chinese tanners for raw material a tough one to win. The competition in the local market by China for unprocessed material, and the increase in the Australian \$ against the US\$ has made it difficult to convert local raw material to wet blue and remain competitive.

Local tanners cite the Chinese competition for raw material at inflated prices, consistently (they say) above world parity price, as the main problem. Just as Chinese traders sourcing for China



have had an effect in the European market, the same is happening in Australia.

Several new Chinese traders have set up in Australia, with a focussed business mission to source Australian sheepskins and cattle hides for the Chinese market. Typically they will be Australian citizens of Chinese origin, operating an Australian company, and will have personal or family ties to the Chinese tanning industry. They might be purchasing brine cured Australian cattle hides for lime fleshing and splitting in China. Their advantage is that few if any of the Australian tanners offer lime fleshed and split wet blue because of the high cost of labour.

Another result of the competition has been that some of the smaller abattoir operators are showing much greater interest in the fate of their major by-product. They are abandoning their hide alliance relationships, and opening up access to their hides through regular tenders to try to reap some of the benefits of the hot competition.

While wet blue plant closures have been kept to a minimum, the pressure is on for the existing operators to find ways to remain profitable.

Finished leather

Packer Leather is one of the few success stories in finished leather in Australia. They hold the view that the oil price crisis will only put more pressure on the cost of raw material for tanning. They also see the rise in China's living standards as fuelling the

demand for raw material for automotive leathers. Packer is exporting 90% of its finished leathers, and see the sourcing of raw material as one of its most important challenges. Even though its major raw material is kangaroo, it is not exempt from the price push, and has the added complication that being sourced from native animals, it has a large seasonal element, which is not always readily available when the customers demand it.

Schaffer Corp announced an A\$10.1 million profit for the first half of the 2003/2004 financial year. Lower returns from its automotive leather business, Howe & Co, were attributed to lower selling prices (a reduction of A\$11.6 million of which the \$/A\$ impact was A\$10.4 million) and lower volume (a reduction of A\$9.7 million, of which the loss of the Mitsubishi contract contributed A\$5.2 million). 70% of Howe's revenue is in US\$, and a 1 cent appreciation in the A\$ results in A\$500,000 reduction of income. On the positive side, Howe is ranked 6th globally in the world automotive market which is growing at 7% per annum, and it has a 15% penetration of the market representing 6.5 million vehicles per annum. Its sales focus is on the high growth European and Chinese markets, and it plans to establish an additional cutting plant, possibly in China by the end of 2004.

How the unfolding scenario of having the world's major tanning nation on its doorstep will end is uncertain. One thing that is certain is that China's growth is affecting every aspect of Australia's leather industry. ●