

# Hermann Oak Leather Co.



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SKIRTING  
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WAISTBELT  
SPLITS

January 5, 2012

Dear Customer,

We bid goodbye to a tumultuous 2011. The hide market took one of its periodic swings into the stratosphere, and has now settled back down part way. We figured it would, which was why a good portion of our price increase this past year was in the form of a hide surcharge. While the hide market started taking off a year ago October, we held off as long as we could last spring, then had to buckle and raise prices. We thank you for bearing with us, and helping us pay for these high hide prices.

Our second largest tanning expense is the actual tanning material. Tannin is “extracted” from the tree bark and wood by boiling in water, a process just like that used to make spray-dried coffee or tea. The trees are grown either by cultivation (the Wattle-Acacia-Mimosa tree in South Africa and Brazil, Chestnut in France) or in the wild (Quebracho in Argentina). Prices for tannin have been steadily increasing 10% per year for the past nine years running, meaning they’ve more than doubled. Given the few increases in leather prices over the past decade, it has been difficult to keep up.

The reasons for these tannin price increases are varied, but have some common themes:

- Tannin trees are grown on land which can also be used to grow corn, soybeans or cotton. With the doubling and tripling of food and cotton prices, there is a huge incentive to plant crops instead of trees. The payback for crops is every year, compared to every seven for Wattle, 25 for Chestnut and 80 years for Quebracho.
- Tannin extract has found new uses. It has historically been used in tanning (vegetable leathers like ours and shoe-sole leather, and “retan” in the chrome leather field), adhesives, and oil drilling (an ingredient in the “mud”). It is now being used in animal feed and in rust inhibitors, both large industries. While use of tannin had been declining for years, usage is now increasing. Where loss of land was tolerable in the past, tannin producers now have to pay up to get farmers to replant in trees instead of corn/soybeans/cotton.

- The situation in Argentina (for Quebracho) is made worse by government actions as the country goes increasingly socialistic. While the peso is devaluing 15% a year (based on the government's official inflation rate), real inflation is 30%, and wages are increasing 30% per year (along with the yearly strikes), for a net 15% increase in labor cost. Logs near the extracting plants have been harvested and the land clear-cut and replanted in crops, meaning higher transportation costs to bring in the logs from farther away. The government has also inserted itself into the log-buying business, requiring permits and fees negotiated yearly with local officials, with predictable results.
- There are very few producers of tannin extract: one for Chestnut, two for Quebracho, and three for Wattle.

The current year for extract pricing is no different, and the increases are coming earlier in the year. In order to cover this and other cost increases, we are finding it necessary to increase our prices by 2%, or \$3 per side. This will be effective for orders placed after February 1, 2012, and orders shipped after February 29, 2012.

Please know that we are doing everything we can to keep our quality up, our costs down, and our service as good as possible. We appreciate your continued business, and we trust we are giving you everything you need.

Regards,

A handwritten signature in cursive script that reads "Shep Hermann".

Shep Hermann