

Hermann Oak Leather Co.



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SKIRTING
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 SPLITS

February 10, 2013

Dear Customer,

We are finally seeing the same thing happen to hides that happened to metals and grains a few years back.

First some details. While the cattle population is down around 5% over the past few years, beef production remains roughly the same. This is generally attributed to use of new growth hormones in feedlots, although the drought has had some effect. The new hormones are producing heavier hides, though they may also be less mature. The shoulder and bellies are the last areas to mature and thicken up. This decline in the US hide production is offset by increases in India and China. However, hide prices in my view are set by demand, not supply.

Hide prices started rising late last fall, and continue to rise slowly but steadily, a few dollars each and every month, like the tortoise in the race. This increase is now more than our January price increase, which was meant to cover continuing cost increases for things like effluent treatment and extract.

My read: China is consuming more goods with their newfound wealth and ever-strengthening currency (up 33% over the last several years), meaning more shoes/purses/autos, meaning more demand for leather. Our suppliers are saying that Chinese hide buyers plan on coming back early from their Chinese New Year, indicating their business is good and they know they can't put off booking hides.

On the demand side, leather competes primarily with two products: Cotton Canvas and Nylon. Both of these are up, which means leather can (and will) increase as well. Comparable price increases of raw materials (as near as I've been able to find out, though don't take it as gospel) would be as follows, all compared to their historic (pre-2007) costs:

<u>Base Fiber</u>		<u>Finished Raw</u>		
		<u>Material</u>		
Cotton	32%	Canvas	15%	est
Nylon Fiber	?	Nylon	35%	
Hides	41%	Leather	20%	

This would indicate that hides are up for good, since the "competition" is up. The question is where the new normal will be. If anything will cause hides to fall, it will be cotton, as people switch to it at the margin. But the demand for high-end goods (i.e. leather) in China may counteract this.

I have heard that the average Chinese person is now buying 2.5 pairs of shoes per year. (In the US, we consume roughly 6 pair of non-rubber shoes each year.) This is born out by a website that gives the Chinese per capita consumption of footwear in US\$ as:

- \$7.50 billion in 2008
- \$25.8 billion in 2010
- \$40.00 billion in 2013 projected
- \$49.00 billion in 2015 projected

Average this all out, and I believe that hides will stay up at this level, if not go a little higher.

What we are seeing now is exactly what happened to raw materials in the building trade over the past seven years (copper, steel, etc.) as the Chinese went on their building boom. The Chinese government now says the country needs to switch away from reliance on exports and building infrastructure, and over to consumer purchases. Leather is a consumer product.

Given this market, we need to add on a 3% surcharge on shipments after April 1. If hide prices continue to rise from here, there may be need for an increased surcharge later on. I do not believe there will be a spike and fall as when previous speculation took hold. This feels like a steady trend that we must all cover in our pricing.

We appreciate everyone's understanding. We will work to keep prices as steady as possible, as we have this winter even though hides started their climb last October. Our desire is to keep you as well informed as possible.

Regards,



Shep Hermann