Marketing our Product

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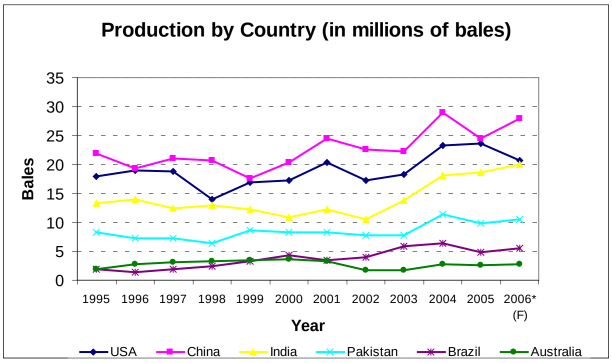
Markets for Australian Cotton

My presentation today is titled "Marketing our Product". I intend to briefly discuss the markets for Australian cotton, the market outlook for our cotton, make come comments on our crop quality this year and then outline some challenges that I see for our industry.

Cotton is a global business and we have no shortage of competitors. The June USDA Supply and Demand report estimated world cotton production at 114.6 million bales with Australia producing 2.5 million bales of these. We are more important than those numbers imply if you consider that the world's cotton exports are 43.5 million bales and we compete at the top end of this. We therefore compete against 15 million bales of the world's premium cotton. Figure 1. details the world's major cotton producers.

Figure I. Cotton Production by Country



The next three figures (2, 3 and 4) show the major markets for our cotton in 1994, 1999 and 2005. The changes are interesting and demonstrate the willingness of apparel manufacturers to move from country to country to take advantage of lower labour costs. In 1994 Japan was the major market for Australian cotton taking 32% of our crop (Figure 2.). Japan was our earliest export market with sales having commenced in 1969. Our Australian cotton exports peaked to Japan in 1992 at 750,000 bales. The characteristic of the Japanese of sticking to what they trust has helped our Australian cotton industry. As high costs of labour forced Japanese manufacturers to move to Indonesia, Thailand and more recently China, they have continued to use a high percentage of Australian cotton. In these new countries local spinners wanted to improve their products and learned from the Japanese, helping to create new markets for Australian cotton.

Figure 2. Australian Cotton 1994 Export Markets

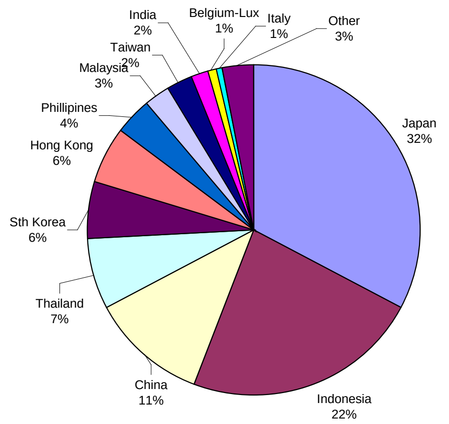


Figure 3. Australian Cotton 1999 Export Markets

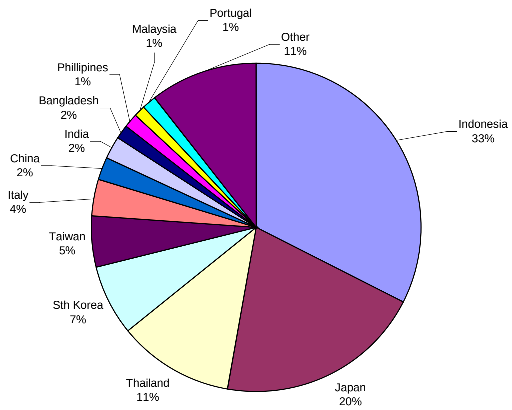
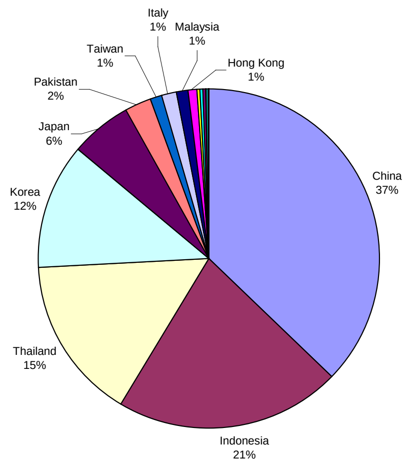


Figure 4. Australian Cotton 2005 Export Markets



From 1999 (Figure 3.) Indonesia became the major destination for Australian cotton and took around 33% of our product from 1999 to 2004. Japan remained an important market for our cotton during this period as did Korea, Thailand and Italy. The major change in the cotton business over the last few years has been the emergence of China as the world's largest cotton market and the largest market for Australian cotton. In 2004 China took 15% of our crop and in 2005 our exports to China were over 1 million bales or 36% of production. China is expected to import a record 20 million bales of the world's cotton in the current marketing year with total cotton consumption estimated to be 51 million bales or almost 1 million bales per week. It is likely that China will be Australia's most important market for the foreseeable future.

The Australian cotton industry has done an excellent job of developing markets for our product and developing customers into repeat buyers. Some mill buyers in Japan, Korea, Indonesia and Thailand have, over the years continued to buy Australian cotton in many cases regardless of its relative cost. Customers in these markets have seen the characteristics of Australian cotton improve considerably over the last 10 to 15 years and they expect that this will continue. Mills in these markets have paid a premium of US 4cents/lb for Australian high grade cotton versus Fibremax and US 7-9cents/lb premium versus Brazilian cotton in this current year. We need to develop that same loyalty to our product in China.

Overview of Australian Crop Quality

A speaker from our spinning mill customer PT Apac, will provide details of why they buy Australian cotton and what we need to change for them to buy more. I believe that customers buy Australian cotton for the following reasons:-

a) Shipment time. Australia is the only country in the world where cotton can be landed in our major markets within 2-3 weeks of the letter of credit being opened. This is a result of our excellent infrastructure and short voyage times. Cotton from Brazil will take 4-6 weeks and from parts of the US up to 3 months. A short shipment time is important to customers as it improves their use of working capital.
b) Low contamination. The percentage of bales contaminated by foreign matter is lower than for most of our competitors. Contaminants can include leaves, paper, hair, plastic or oils.
c) Fibre characteristics. Our seed breeders have been able to keep pace with the increased fibre specifications demanded by our customers.

Surveys conducted by the CSIRO Textile & Fibre centre identify customer complaints about Australian cotton as:-

a) Levels of contamination are not improving
b) Short fibre content. Mills complain that the SFC of Australian cotton is high versus hand picked cotton.
c) Neps. Also higher than some other growths, especially those that are hand picked.
d) Price. Australian cotton commands a price premium of 5-15% over many of our competitors.

In 2005 Australian cotton growers produced the best quality crop they had ever grown (Figure 5.)

- 97% of this crop was base grade or better.
- 80% of our cotton tested 29 gpt or better for strength with 17% 32 gpt and above.
- In the 2005 crop, 85% of cotton was 1 1/8" or longer with almost 50% 1 5/32" or above.
- 65% of cotton grown in 2005 tested in the premium mic range of 3.8 - 4.5 with virtually the total crop in the G5 range.

Figure 5. Australian Classing Statistics 2005

GRADE	Australia
21 - 2 & Better	53.06%
21 - 3	27.19%
31 - 3	16.69%
31 - 4	1.03%
41 - 4	1.78%
41 - 5 & Below	0.25%
STAPLE	
37 & Above	49.00%
36	35.20%
35	12.90%
34	2.20%
33 & Shorter	0.70%
MICRONAIRE	
5.3 & Above	0.04%
5.0 - 5.2	1.13%
4.6 - 4.9	30.94%
3.8 - 4.5	64.82%
3.5 - 3.7	2.59%
3.3 - 3.4	0.31%
3.0 - 3.2	0.16%
2.9 & Below	0.02%
STRENGTH	
Below 25	0.01%
25.1 - 27	0.26%
27.1 - 28	2.27%
28.1 - 29	17.47%
29.1 - 30	25.62%
30.1 - 31.9	37.81%
32 & Above	16.56%
UNIFORMITY	
Below 80	7.40%
Above 80	92.60%
TOTAL BALES	**2,498,273**

So far in 2006 (Figure 6.):

- Grade is excellent with over 90% base grade or better.
- Over 80% our cotton tested 29 gpt or better for strength with 24%, 32 gpt and above.
- Length has held up with 86%, 11/8" or longer and 44% 1 5/32" and above.
- Where we have an issue is the fact that only 25% of our cotton is in the preferred mic range of 3.8 - 4. 5 (vs. 65% in 05) with around 75% of our cotton higher than this.

Figure 6. Australian Classing Statistics 2006 (to May 31st)

GRADE	Australia
21 - 2 & Better	35.60%
21 - 3	31.88%
31 - 3	26.01%
31 - 4	2.64%
41 - 4	3.11%
41 - 5 & Below	0.75%
STAPLE	
37 & Above	44.3%
36	42.0%
35	12.9%
34	0.7%
33 & Shorter	0.1%
MICRONAIRE	
5.3 & Above	1.16%
5.0 - 5.2	16.09%
4.6 - 4.9	56.95%
3.8 - 4.5	25.45%
3.5 - 3.7	0.30%
3.3 - 3.4	0.03%
3.0 - 3.2	0.02%
2.9 & Below	0.00%
STRENGTH	
Below 25	0.00%
25.1 - 27	0.20%
27.1 - 28	2.14%
28.1 - 29	14.50%
29.1 - 30	17.34%
30.1 - 31.9	41.85%
32 & Above	23.96%
UNIFORMITY	
Below 80	6.6%
Above 80	93.4%
TOTAL BALES	**589,827**

Major ‘premium growth’ competitors, including SJV and Brazil, are able to deliver premium micronaire. For example statistics from the Visalia classing office in California show the proportion of the Californian Crop falling in the premium 3.8 - 4.5 NCL band was 68.8%. Australia compared favourably, with 65% in 2005. Australian micronaire has been erratic in recent years as demonstrated in Figure 7.

Figure 7. Percentage of Australian cotton in Premium mic. range

Season	3.8-4.5NCL
2001	48%
2002	61%
2003	36%
2004	61%
2005	65%
2006	25% (to date)

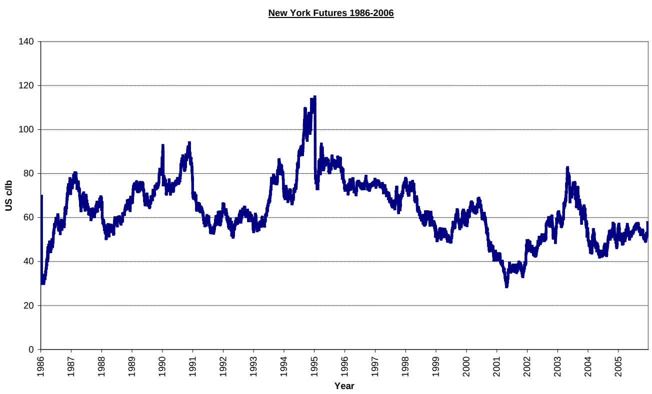
The change in base from 1 3/32” to 1-1/8” has progressed relatively smoothly this year probably assisted by seed companies working closely with agronomists and growers on water management of new varieties. The real issue we have now is micronaire and the fact that the percentage of our cotton falling in the premium micronaire range has fluctuated widely in the last 6 years, being lower than 50% in 3 of these and only 25% in this year.

Although we can blame environmental issues, high mic provides our competitors in Brazil and the US with opportunities to replace our Australian cotton in established markets.

Australian Cotton Market Outlook

The combination of drought and low cotton prices have been a great challenge. Prior to the drought growers sold 2 years or so forward on price spikes and merchants had stock on the books and time to sell to mills (Figure 8.). The current drought / low cotton price combination has changed the market dynamics where growers now wait until late in the year of delivery to fix prices. Merchants are then restricted to selling significant volumes when growers are prepared to sell. This change has created periods where our spinning mill customers are unable to purchase Australian cotton or only able to purchase it at extremely high prices, providing a ready made access for competitor growths.

Figure 8. New York Futures 1986- 2006



I estimate that 800,000 bales of Australian cotton remain unsold from merchant or grower hands as of July 1st. Where the rest of our crop goes will to depend on a number of factors but the most important of these is the timing of the release of additional import quota from China. China is not a free market where cotton is concerned, with import quota allocated by the Chinese government in an attempt to keep the prices of China’s domestic cotton high. This is a means of price support for China’s cotton farmers. At the present time spinning mills in China are waiting for new quota to be allocated with this expected sometime between July and September. Our best estimate is that China to date has purchased 500,000 bales of Australian cotton. We expect China to take 1 million bales from this crop so we need the Chinese government to allocate further cotton import quota so additional sales and shipments can be made.

Two factors working in favour of our Australian cotton at the moment are the continuing dry weather in Texas and the poor crop start to China's premium cotton in Xingjiang. If West Texas does not receive drought breaking rain by mid July, the amount of high quality Fibremax will be severely reduced. Texas Fibremax has competed with our Australian cotton for the last 5 years and has become a major competitor. Xinjiang cotton is the top quality cotton produced in China with 4 million bales produced each year. Any delay or quality problem in this crop is significant.

The one factor that is an issue for further Australian Cotton sales this year is micronaire. Competitor growths from the Northern Hemisphere will compete with our second half sales of Australian cotton with Fibremax, Brazilian, West African and Indian top grades likely to be well sought after.

As mentioned earlier, I believe that we still have 800,000 bales to sell out of our current crop as of July 1st. To sell out our crop it is likely that we will need to sell an additional 500,000 bales to China, 100,000 bales to Indonesia, 70,000 bales to Thailand and another 60,000 bales to Korea. Japan and Japanese joint venture mills will probably also take an additional 70,000 bales of 2006 crop cotton.

Marketing Challenges for the Industry

Those who were in the cotton business throughout the 1990's will agree with me when I say that we did not realise how good things were then. In most years it rained sufficiently to provide water for the next season's crop and some extreme price volatility enabled growers to lock in good returns 2 and 3 years forward. The current lack of water and low prices is a terrible combination.

The reality in the market is that more than ever retailers are setting the quality standards for manufacturers with the increasingly stringent standards making their way back to the farmer in the form of discounts or lack of demand for inferior product.

Going forward we must be able to maintain the position we have held as a quality leader. That will not happen if every 2 or 3 years we produce a crop well outside the mills acceptable standards. Traditionally the benchmark of the premium cotton growths has been SJV Acala. This year spinning mills paid around US 3 or 4cents/lb premium for SJV Acala over our Australian cotton. The good news is that SJV production has been dropping because growers in California are switching to growing almonds or extra long staple Pima cotton for greater returns. SJV Acala production has fallen to 1 million bales in 2005 from almost 3 million bales 10 years ago. I believe that our Australian cotton needs to be seen as the clear upland cotton benchmark. Achieving this will require assistance from our plant breeders and our agronomists to ensure that in virtually all conditions we can produce cotton with the grade and characteristics that SJV has provided and that spinning mills want. This will require an improvement in the strength of our current Australian varieties (Figure 9.)

Figure 9. Australia vs Californian Classing Statistics 2005

GRADE	Australia	California SJV*	% Diff
21 - 2 & Better	53.06%	40.30%	12.76%
21 - 3	27.19%	19.60%	7.59%
31 - 3	16.69%	7.50%	9.19%
31 - 4	1.03%	8.30%	-7.27%
41 - 4	1.78%	3.10%	-1.32%
41 - 5 & Below	0.25%	1.20%	-0.95%
STAPLE			
37 & Above	49.00%	48.50%	0.50%
36	35.20%	28.40%	6.80%
35	12.90%	17.60%	-4.70%
34	2.20%	4.20%	-2.00%
33 & Shorter	0.70%	0.10%	0.60%
MICRONAIRE			
5.3 & Above	0.04%	0.10%	-0.06%
5.0 - 5.2	1.13%	3.30%	-2.17%
4.6 - 4.9	30.94%	25.30%	5.64%
3.8 - 4.5	64.82%	67.10%	-2.28%
3.5 - 3.7	2.59%	3.40%	-0.81%
3.3 - 3.4	0.31%	0.50%	-0.19%
3.0 - 3.2	0.16%	0.01%	0.15%
2.9 & Below	0.02%	0.00%	0.02%
STRENGTH			
Below 25	0.01%	0.01%	0.00%
25.1 - 27	0.26%	0.90%	-0.64%
27.1 - 28	2.27%	1.60%	0.67%
28.1 - 29	17.47%	2.90%	14.57%
29.1 - 30	25.62%	6.90%	18.72%
30.1 - 31.9	37.81%	14.70%	23.11%
32 & Above	16.56%	72.90%	-56.34%
UNIFORMITY			
Below 80	7.40%	2.30%	5.10%
Above 80	92.60%	97.70%	-5.10%
TOTAL BALES	**2,498,273**	**1,615,697**	

* Cotton Classed at Visalia Classing Office

The other opportunity that may exist has resulted from new elite cotton varieties like Sicala 350B. This cotton in initial commercial usage this year has produced cotton of 1.25 length (1 1/4”), 30g/tex and higher strength and 3.8-4.5 mic. Marc Lewkowitz from Supima will shortly talk about extra long staple US Pima cotton. US Pima cotton has sold for around US $1.35/lb, almost double our Australian upland product. What appears to be developing is a market between our current 1-1/8” Australian and the ELS Pima product as mills search for a cheaper mix for yarn counts of 60 and above. Although Sicala 350B so far has produced lower yields than conventional varieties it offers the opportunity to produce an Australian cotton that really is superior to our competitors. This superior cotton segment demands a tight mic range of 3.8 to 4.5 and strength min. 33g/tex.

Marc Lewkowitz will talk about the success the US has had branding US Pima. In Australia, we have led the way in the development of a program (BMP) for growing cotton in a sustainable way. All of the members of the Australian Cotton Shippers Association are committed to supporting the BMP program and believe that there is value in branding the quality and sustainability aspects of our product. As I mentioned earlier in my presentation, our Australian cotton is rated as excellent by most spinners but not perfect. The implementation of BMP at the grower level and the use of it throughout our supply chain provides a vehicle for the improvement of our Australian cotton product. We believe that the BMP program is a risk management program for our growers and that the establishment of standards that will result from post farm gate implementation will improve the quality of our product and its presentation in our markets. An ACIC and ACSA working team are in the process of establishing standards for ginning such as bale moisture levels, bale wraps and ties and warehousing standards for the prevention of country damage. ACSA has long supported the need for the industry to develop post-farm gate BMP’s, now being co-ordinated through the industry’s EMS Pathways project. Sustainability is ‘in’ with consumers and although we may feel that we are breaking new ground with our branding program, our competition is right with us.

In the US the National Cotton Council recently announced that it was commencing a program to prove the 'sustainable' credentials of US cotton because customers for cotton are requiring it. The NCC stated that developing an environmental story for US cotton is a real opportunity to be proactive and that "sustainability is equivalent to survival" for the US cotton industry.

In Brazil the ANEA premium quality program aims to brand the premium quality Brazilian cotton by guaranteeing fibre characteristics and the absence of contaminants. The program aims to: "promote the wider production, consumption, and exports of Brazilian cotton, segmenting an increasing volume of 'premium' quality for the export market with an enhanced perception of reliability and a relative improvement in value compared to the other growths worldwide."

In Africa, the CMIA project or Cotton Made in Africa Project seeks to foster sustainable growing of cotton to increase market share for African cotton in the international textile trade. The program will target US and European retailers.

What the programs that I have just described demonstrate, is that many of our competitors are aiming for the 'sustainable' brand that we are attempting to develop for Australian cotton. We need to bring this project to fruition and be able to sell our unique quality/sustainability message for Australian cotton. This however, requires a significant increase in the commitment from growers to BMP to provide the integrity for our claims.

So where to from here? I am confident that our plant breeders, researchers and agronomists will develop varieties and growing techniques that will make Australian cotton less variable and fulfil the fibre characteristics required by our spinning mill customers. Building on our earlier plant breeding success, the likely availability of new elite cotton varieties like Sicala 350B presents us with an opportunity to produce an Australian cotton that really is superior to our upland competition.

The branding of the quality and sustainability aspects of our cotton is something that we must do for it provides the story that manufacturers can use to develop 'demand pull' for our cotton. Sustainability and high quality are 'in' with consumers. The "what's in it for growers" question often asked can best be answered by looking at the premium our cotton currently obtains versus Brazilian and Fibremax cotton and considering the additional US 3-4cents/lb that some mills will pay for SJV cotton. A premium on our basis is "what's in it for the growers" and is necessary to keep Australian cotton viable. Our industry working together will develop a superior product in the eyes of our customers.

Our new major market China is likely to be taking 50% of Australian cotton each year. China is a market that we must understand and develop. Whatever challenges we see in having such a dominant market needs to be balanced by the opportunity that its rapid rate of cotton consumption presents. In the last 2 years China has contributed 92% of the worlds increased cotton consumption, or 12.5 million bales of additional use. In 2001 a large China cotton crop helped throw the world's supply / demand balance out of kilter and NYF cotton prices fell to a low of US 28cents/lb. This year the world will consume about 7 million bales more than is produced mainly because of China. Hopefully, the next big move to higher cotton prices is now underway fuelled by China's rapidly increasing cotton consumption.