Defining Aussie Cotton – Mainstream or Niche?

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Introduction

Cotton is a global business and we have no shortage of competitors. The June USDA supply and demand report estimated world cotton production at 120 million bales with Australia producing only 0.6 million bales of these. The world's total cotton exports are 38 million bales. We compete at the top end of export cotton, in a segment of 4 million bales. If we can produce over 2 million bales of Australian cotton each year, we are a significant producer of these bales of higher quality exports. Figure 1 details the world's major cotton producers.

***Figure 1*

Perception of Australian Cotton

Data obtained from the ICAC (International Cotton Advisory Committee) show that based on official offer prices over the three most recent seasons, market participants place Australian cotton in the highest category of Upland cotton quality. Only one other Upland growth carries a premium as high, and that is SJV. The quotes taken from Cotton Outlook *(Figure 2)* show that offer prices for Australian SM 1-1/8" averaged 116% of the Cotlook 'A' Index, up from an average premium of 8% 10 years ago.

***Figure 2*

Some of the increase in premium for Australian cotton may arise because of the decline in the Australian crop size. The Australian crop fell from an average of 2.5 million bales in the three seasons to 1997/98 to an average of 1.5 million bales during the three seasons ending in 2007/08. However, cotton production in California fell even more, from 2.2 million bales through 1997/98 to 0.8 million bales during the three most recent seasons. And yet the premium for SJV SM 1-1/8" is essentially unchanged from ten years ago, indicating that changes in perception of Australian cotton's quality, rather than changes in quantity, available have had the biggest impact.

The ICAC data in *Figure 2* shows that the premium for Australian SM 1-1/8" is higher than the premiums received by comparable growths of high grade cotton from West and East Africa, Central Asia, or other cotton from the US.

Cotton Categories

Statistics on the world's spinnable cotton have historically been organised by the ICAC into five categories based on perceived value. These days, the ICAC is less willing to classify cotton because of potential complaints when drawing a line between two growths with a similar price premium. I have therefore utilized the ICAC categories and pricing data and compiled my own ranking of the world's cotton. This is presented in Figure 3.

***Figure 3*

Extra Fine Cotton: Is also called extra long staple. This covers the longer staple cotton from Egypt, US Pima, Xinjiang ELS, Sudan Barracat and Pima from Israel and Australia. This category is 3% of world production.
Fine Cotton: Historically this segment was made up of SJV cotton from California as the standout performer, with Australian high grades, Xinjiang 129 from China and high grades from West and East Africa and Central Asia. This category used to make up around 10% of world production. I believe that quality improvements of Australian cotton have created a clear break between SJV and Australian and the rest of the cotton growths here. I am suggesting that the Fine Cotton category should be made up of SJV and Australian cotton, and include Zimbabwe SM 1-1/8". This claim is supported by the price premiums of these growths. In a normal year, this category will make up 3% of world production.

High/Medium Cotton: Under my classification, the cotton dropped from the Fine Cotton category will appear here. This category will, therefore include Strict Middling cotton from East and West Africa, and CIS. Also included will be Brasilian, Texas Fibremax, CA cotton and Australian high grade 1-3/32". This cotton makes up around 20% of total cotton production.
Medium: The medium category includes Indian cotton such as Shankar 6. This is here because of contamination issues as are some 1-1/8" cotton from Sudan, Chad and Cameroon (stickiness issues). Memphis cotton appears here also together with Australian SLM. Medium cotton makes up 34% of the world's cotton.
Coarse: Cotton from the coarse cotton category includes low-grade cotton from India, Pakistan, US and CIS. This segment contains 40% of the world's cotton.

The 'Cotton Category' template used previously by ICAC attempted to show the likely end use of cotton from each cotton category. I have overlaid the end uses over the cotton categories shown in *Figure 3* in the table shown as *Figure 4*. The data presented is a guide only as spinners who have attempted to develop innovative products have taken ELS or Extra Fine cotton from the top category, and used it to make luxury, fine denim with an appropriate premium. As a general rule however, the finer the cotton, the lighter and more 'breathable' the garment. In contrast, cotton from the 'coarse' segment is usually used to make jeans and drill work clothes where durability, strength and abrasion resistance are important.

Uses of Australian Cotton

Australian cotton being 'fine' cotton is used for making garments that are toward the top of the quality and cost scale. Our cotton is normally used to spin yarn that is from Ne 30 to 50 English cotton count[1]. As a comparison, yarn for jeans is between Ne 6 and 10 count.

As part of this presentation, we recently surveyed, through our agents, mills that are using Australian cotton to determine the final use of our product. The previous speaker, Mr Shimazaki, confirmed that the mills who have been buying Australian cotton recently have been paying an increased premium versus competitors' growths. These mills are therefore the 'true believers' in the value of Australian cotton. Identifying the products they make from our cotton should therefore highlight where the real value in Australian cotton lies.

Japan was the original major market for Australian cotton. Over half of our cotton is used here in high quality combed yarns that are knitted. These yarns (Ne 30 to 50 count) go into high quality sports shirts and underwear. Virtually all knitted garments produced in Japan contain Australian cotton. Other Australian cotton is used in weaving to make high quality business and casual shirts, and casual wear called 'Yukata' for ladies and children.

Indonesia has been a major market for Australian cotton for the past 10 years. A number of mills here produce 100% Australian cotton yarn for top quality polo shirts (Tommy Hilfiger), underwear and sleepwear. Yarn from one Indonesian customer produces high-quality bras for Victoria's Secrets.

China has become the largest market for Australian cotton in recent years. In this market, as in Japan, the very white colour, low contamination and high strength of our cotton sees it used in high quality knitted polo shirts (such as Ralph Lauren Polo) and high quality business wear. One of our customers in China has a contract with Esquel, the largest shirt maker in the world who stipulate they produce 100% Australian cotton yarn. Esquel uses this yarn to make high grade shirts for Calvin Klein, Gap, Tommy Hilfiger etc. Some of our cotton is used with synthetic fibres like polyester. Normally this will be high mic cotton or slightly shorter staple, where the resultant lower yarn strength will be compensated for by the polyester.

[1] Ne or English cotton count is the number of 840 yard wraps of yarn in one pound of that yarn. Eg. There are 30 x 840 yard wraps in one pound of Ne 30 yarn.

The Answer

The title of this presentation is a question**. 'Is Australian cotton mainstream or niche?'** Below are some definitions of a niche market:

About.com says 'a niche market' is a focused, targetable portion of a market… or a narrowly defined group of potential customers.' Australian cotton is utilised in Ne 30 – 50 count yarns of the counts from Ne 6 – 120. Our cotton, even in a crop over 2 million bales will be sold to 300 customers of the 2000 or so spinning mills in the world. Our cotton is part of a segment that makes up 3% of the world's cotton at most. I believe that Australian cotton is a niche player and that it needs to be a niche player attracting suitable premiums to survive. It occupies this niche because of its specialised characteristics and the services we can provide in this country, like low contamination, short shipment duration and on-time delivery.

The Future

We should not take the current high rating of our Australian cotton for granted. If you consider any significant inventions or new technology in the last 20 years, the breakthrough was probably not in response to requests from a customer. The new technology therefore fulfils a need the customer does not yet know he has. Our customers will not necessarily guide us toward producing cotton that they will require or use in the future, therefore it is up to us to create this new product niche. I believe that superior products create their own markets. We therefore need to continue improving our Australian cotton while not sacrificing yield. Quality improvement is not the only answer because yield is critical to the profitability of our growers and to cotton's competitiveness against alternative crops. By a happy coincidence however, improvements in the quality of our new varieties have tended to ultimately come with improved yields.

I believe that our industry needs to continue to support the '40-40-40' initiative (1-1/4" length, 40 GPT strength, 4.0 mic). My belief that superior products create their own markets is supported by history in our industry. Some 30 years ago in the US, Acala 1517 was produced in El Paso, Texas. This cotton was area-specific as it required a unique climate (hot days, cool nights). The fibre characteristics were also unique at 1-1/4" length, 3.5 average mic and 95,000 Pressley. Approximately 200,000 bales of this cotton were sold to Europe each year at an average 5 USc/lb premium over SJV cotton. Ultimately, Acala 1517 ceased to be produced because it suffered from heavy downgrades in the one year in four that harvest weather was not suitable. This combined with its low yield saw it replaced.

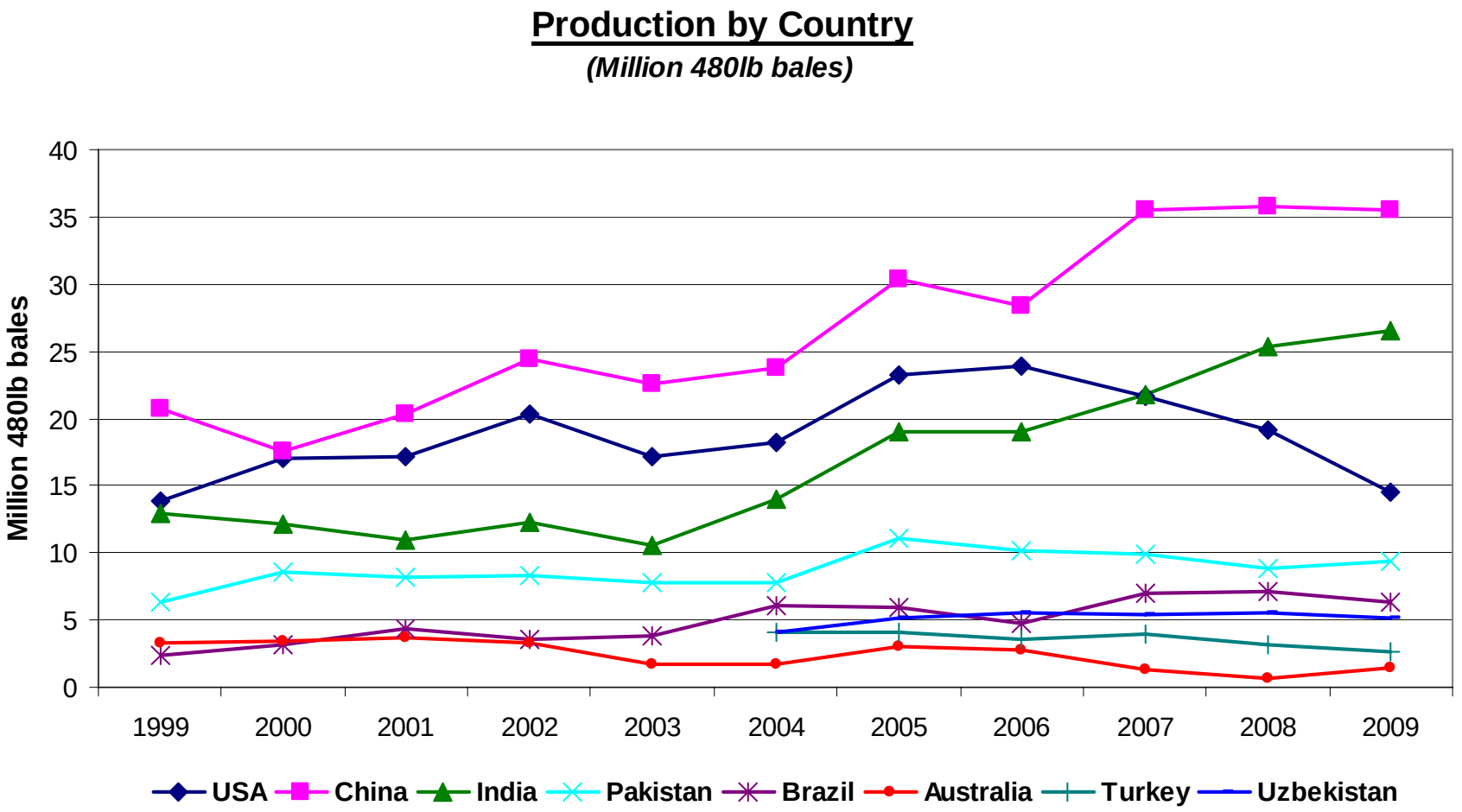
Last year at the ACSA Conference, Edy Hegetschweiler of Reinhart classified the Extra Fine cotton or ELS segment into separate niches (*Figure 5*). Edy stated that there was a 'market gap'

between the prices paid for Upland cotton (up to 1.17 x 'A' Index) and for Extra Fine cotton (1.7 to 2.03 x 'A' Index). This 'market gap' is a 25 c/lb difference. Although an Upland long staple cotton may not be able to extract all of this difference, roller-ginned Acala in the US obtains a 5-10 c/lb premium over the saw ginned equivalent. Combined with a large decline in global Extra Fine cotton production this season (40% lower), an expansion of Australian cotton into the long staple sub-segment is an opportunity.

The 'long staple' cottons contain mostly cotton that is roller-ginned. Roller-ginning preserves fibre length and results in less neps, important considerations for fine-count yarns. Demand for roller-ginned Upland cotton in the US has proven to be variable and less predictable than for the saw ginned equivalent. At various times, it moves well but this erratic demand pattern means that we need some local experience before we embark on large-scale capital expenditure on roller-gins. Access to the 'market gap' will be dependent on access to improved varieties likely to result from our "40-40-40" program. Any permanent change in the supply situation of extra-fine cotton could increase opportunities for these new varieties.

In conclusion, I believe that Australian cotton is a niche player, not just because of our drought-induced small crop. Our cotton has a reputation for top quality and is priced accordingly. In addition to excellent fibre characteristics, we have the respect of our buyers for the excellence of our logistics and marketing services. Our cotton is used by the world's premium spinners to produce high quality yarn (mainly Ne 30 – 50 counts), fabric and garments. But we are not yet in the 'hall of fame'. To get there, we need to grow over 2 million bales every year. We need volume to be relevant. We also need to enhance our position by improving our quality and extending our market into the Extra Fine segment of the cotton business. Your next speaker, Geoff Naylor will tell you how we are going to do this.

***Figure 1*



Source: USDA June 2008

Figure 2 - World Cotton Values

Average Ratio to A index		
Growth	**Average Ratio 2005/06 - 07/08**	**Average Ratio 1995/96 - 97/98**
Egyptian Giza 76	n/q	2.11
Egyptian Giza 77	n/q	1.96
Egyptian Giza 85	n/q	1.56
Egyptian Giza 75	n/q	1.50
Egyptian Giza 84	n/q	1.23
Australian, MIDD 1-3/32	n/q	0.99
Argentine, Grade C-12, 1-1/16	n/q	0.94
Central Asian, SLM 1-1/16	n/q	0.93
Egyptian Giza 88	2.03	1.23
US Pima, Grade 2, 1-7/16	1.96	1.72
Israeli, Pima H1, 1-7/16	1.83	n/q
Egyptian Giza 86	1.71	1.56
Sudan Barakat Grade X3B	1.59	n/q
Sudan Barakat Grade X4B	1.42	n/q
California, ACALA SJV SM 1-1/8	1.17	1.18
Australian, SM 1-1/8	1.16	1.08
Zimbabwe, SM 1-1/8	1.14	n/q
Zambian, 1-1/8	1.10	n/q
California Arizina, DPL MIDD 1-3/32	1.09	1.10
Chad, KERO A5 1-5/32	1.08	n/q
Cameroon, PLEBE 1-1/8	1.07	n/q
Spanish, SM 1-1/8	1.06	n/q
Uzbekistan, SM 1-1/8	1.06	n/q
Ugandan, RG1	1.06	n/q
Brazilian Mato Grosso, MIDD 1-3/32	1.05	n/q
Orleans / Texas, SM	1.05	1.05
Ivory Coast, MAMBO/S 1-1/8	1.04	n/q
Benin, KABA/s 1-1/8	1.03	n/q
Cameroon, IRMA/s 1-1/8	1.03	n/q
Mali, Juli/s 1-1/8	1.03	n/q
Brazilian, SLM 1-1/16	1.03	n/q
Burkina Faso, RUDY 1-3/32	1.03	n/q
Memphis / Eastern, MIDD 1-3/32	1.02	1.08
Paraguayan, MIDD 1-3/32	1.02	1.01
Sudan, ACALA 1RG	1.02	n/q
Ivory Coast, BEMA 1-3/32	1.02	n/q
Tanzanian, AR' TYPE 2	1.02	1.10
Uzbekistan, MIDD 1-3/32	1.02	0.98
Memphis / Orleans / Texas, MIDD 1-3	1.02	n/q
Greek, MIDD 1-3/32	1.02	0.99
Benin, BELA/s 1-3/32	1.01	n/q
Mali, ROKY / KATI 1-3/32	1.01	n/q
Burkina Faso, Bola/s 1-1/8	1.01	n/q
Indian, H-4/Mech-1/Bunny Brahma 1-3	1.01	n/q
Syrian, SLM 1-1/16	1.00	1.02
Indian Shankar 6	1.00	1.01
Tanzanian, RG1	1.00	n/q
African Franc Zone, M 1-3/32	0.99	0.99
Uzbekistan, SLM 1-1/16	0.99	0.95
Mexican, MIDD	0.99	n/q
Syrian, MIDD 1-3/32	0.99	n/q
Spanish, MIDD 1-3/32	0.98	1.00
Tanzanian, SG1	0.98	n/q
Memphis / Eastern, SLM 1-1/32	0.98	n/q
Central Asian, MIDD 1-3/32	0.97	0.95
Pakistan, Punjub SG 1503, 1-3/32	0.97	0.99
Indian, J-34 SG 1-1/32	0.96	0.94
Pakistan, Sind / Punjub	0.95	0.97
Memphis / Orleans / Texas, SLM 1-1/3	0.94	1.02
Pakistan AFZAL 1-1/16	0.92	n/q

***Figure 3* – <u>Cotton Value Chart</u>**

Cotton Category	Growth	Estimated Value (% of "A" Index)
Extra Fine Cotton	Egyptian ELS Pima Sudan Barakat	1-42 - 2.03
Fine Cotton	SJV Australian SM 1-1/8" Zimbabwe SM 1-1/8"	1.14 - 1.17
High Medium Cotton	East Africa SM West Africa SM Australian SM/M 1-3/32" CIS SM C/A Texas Fibermax SM Brasil M	1.04 - 1.10
Medium Cotton	Australian SLM Brasilian SLM African 1-3/32" Indian Memphis 1-3/32"	0.99 - 1.03
Coarse Cotton	CIS SLM Syrian Uzbek SLM Memphis SLM MOT SLM Pakistan Indian J34	0.92 - 0.98

***Figure 4* – Cotton Use By Category**

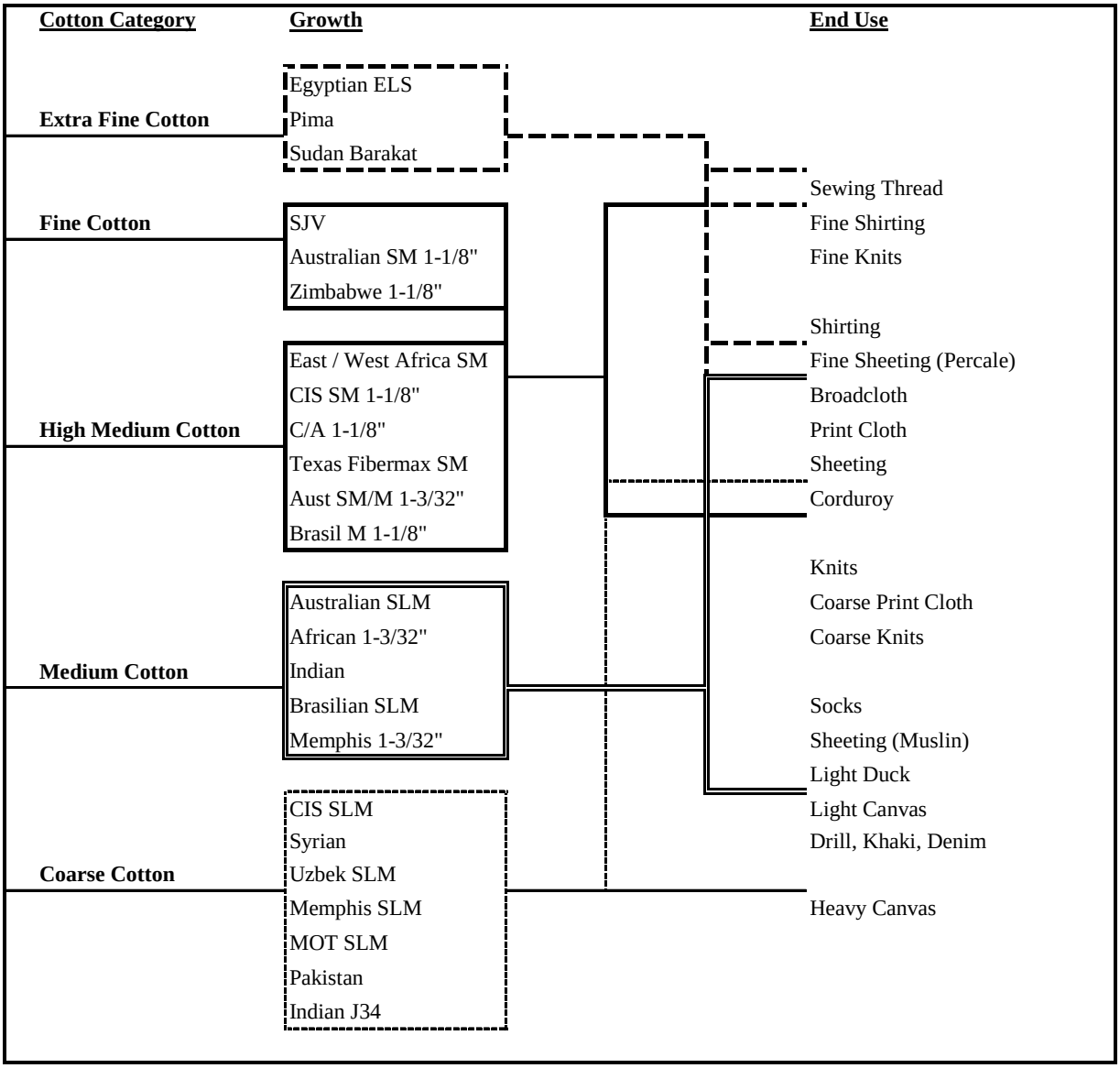


***Figure 5 –* <u>Extra Fine Cotton Niches</u>**

a)	**High End ELS** Egyptian Giza 45, 87, 88 Peruvian ELS	50,000 tons	105+ counts
b)	**Regular ELS** US Pima Chinese ELS Egyptian Giz 86 Israel / Australian Pima	400,000 tons	60 - 105 counts
c)	**Long Staple** Lower grade Pima Barakat Giza 89 and 85 LS Upland California Australia China Rollerginned Sawginned	200,000 tons	50 - 80 counts