Winning Back Markets for Australian Cotton

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My presentation ‘Winning back markets for Australian cotton is an important topic. I have been buying Australian cotton for over 20 years and supplying it to spinning mills in Japan and other countries also. My company Toyoshima has been operating as a cotton and textile merchant for over 175 years, so we are committed to the cotton business.

As you know, Japan has a very long history. In ancient times, Japan was a very structured society with defined classes of people.

1. The shogun was at the top of our society. The military were part of the ruling class providing protection and acting as administrators.

2. Farmers were the second highest class because they provided food and fibre. In Japan, as in Australia, farmers have always been seen as a very important class of people.

3. Next came people with crafts or trades. The people who work for your ginning companies would fit here.

4. The lowest class in Japan was the merchants. Merchants have always been the workhorses and, as in Australia, probably not valued and respected as much as they should be.

The value that merchants provide however was demonstrated by events that occurred in March of this year. At that time, the New York Futures market, the hedging mechanism for most cotton traders, increased by over 40 cents in 10 days. It is estimated that merchants had to pay out collectively in excess of $1.7 billion in margin calls on one single day. Margin calls are paid out on sold futures to ensure that the counterparty is protected in a rising market. Those of us in the business had to continue to fund these margin calls by borrowing from a banking system already stressed by the sub-prime crisis.

The March price spike and the requirement for margin funds impacted the financial health of many players in the cotton industry and some merchants have already ceased operating. In the US and Brazil, forward purchasing of cotton virtually ceased and has not recovered. There may be long-term consequences on the way cotton is sold going forward. During the March price spike, New York Futures prices and the price of physical cotton lost all relationship. Merchants can not operate in that environment.

I understand that after a brief period, Australian merchants continued to offer prices for forward contracts. This confirms earlier what I said about your workhorses. Your Australian merchants deserve plenty of respect, and so do the Japanese ones too.

Now, let's get to business. I agree with the next speaker that Australian cotton is a niche product. Australian cotton is the most likely heir to SJV cotton as the premium cotton for medium count yarn. Competition from almonds and other crops in California has seen the size of the SJV crop drop from 1.2 million bales in 1998 to 400,000 bales in 2008. It is also interesting to note the changing trends between SJV Upland and SJV Pima. In 1998, Upland acreage was 650,000 where Pima was 180,000 acres. Today in 2008, SJV Pima has become like a competitor to the Upland crop taking 180,000 of the total 280,000 Californian cotton acres. Although the crop statistics for SJV show a decline as in Australia, I am assuming that a return to more normal rainfall will see your Australian cotton crop return to something over 2 million bales consistently. The SJV crop is however expected to continue to decrease in size under the pressure of competing crops.

***Figure 1*

Australia vs Californian SJV Classing Statistics 2007

GRADE	Australia	California SJV*	% Diff
21 - 2 & Better	57%	46%	11%
21 - 3	25%	27%	-2%
31 - 3	15%	17%	-2%
31 - 4	1%	11%	-9%
41 - 4	2%		
41 - 5 & Below	0%		
STAPLE			
37 & Above	68%	76%	-8%
36	24%	15%	9%
35	6%	7%	-1%
34	1%	2%	
33 & Shorter	1%	0%	
MICRONAIRE			
5.3 & Above	0%	0%	
5.0 - 5.2	7%	1%	6%
4.6 - 4.9	46%	21%	25%
3.8 - 4.5	44%	71%	-27%
3.5 - 3.7	2%	5%	-3%
3.3 - 3.4	0%	1%	
3.0 - 3.2	0%	0%	
2.9 & Below	0%		
STRENGTH			
Below 25	0%		
25.1 - 27	0%		
27.1 - 28	2%		
28.1 - 29	11%	2%	9%
29.1 - 30	18%	5%	13%
30.1 - 31.9	46%	5%	42%
32 & Above	23%	89%	-66%
UNIFORMITY			
Below 80	5%	1%	
Above 80	95%	96%	

In recent years, the length of Australian cotton has been equal to that of the SJV crop. Your micronaire, which has been an issue in some years, now has a higher percentage fit into the premium cotton range; however SJV is still finer with over 70% in the preferred 3.8-4.5 range vs 44% for Australian. As statistics on *Figure 1* also show, Australian cotton has some catching up when it comes to strength. Note that almost 90% of the SJV crop has a strength of 32 GPT and above, compared to around 20% for Australian cotton. What these statistics for the SJV crop show is that you still have work to do! This is also the case for Uniformity. Although the data in *Figure 1* would appear to show that length uniformity is similar for Australian and SJV, in actual fact this is not so. Data that I have seen from mills suggests that uniformity for SJV (at 82.5% average) is over 1% higher than for Australian (81.4%).

***Figure 2*

		Length	**Strength**	**Mic**	**Uni**	**Leaf**	**SFC**
Australian SM 1-1/8"	03/04	1.15	30.5	4.2	81.4	10	9.0
	04/05	1.17	29.5	4.25	82.40	8	7.5
	05/06	1.17	30.0	4.45	81.2	20	9.0
	06/07	1.16	29.7	4.32	81.2	18	9.1
	07/08	1.15	30.2	4.34	81.3	8	9.1
Brasilian Mid 1-1/8"	03/04	1.15	28.5	3.98	81.5	24	8.0
	04/05	1.17	28.4	3.99	82.8	27	7.0
	05/06	1.17	28.6	4.10	82.8	29	7.1
	06/07	1.15	28.3	3.95	82.7	21	7.3
	07/08	1.14	29.3	4.25	82.7	23	7.4
Texas Fibermax 31-3-36	03/04	-	-	-	-	-	-
	04/05	1.10	28.2	4.31	79.7	23	9.0
	05/06	1.13	28.9	4.15	80.7	18	9.1
	06/07	1.13	29.0	4.22	80.1	19	9.0
	07/08	1.14	29.8	4.02	79.2	19	8.5

Just as the world changes, so does our cotton business. Drought in Australia has provided an opportunity for other competitors. The pretenders to the Australian position as the premium medium-staple growth are the Texas Fibremax and Brasilian cotton growths. These have expanded into the void left by the smaller Australian crop. *Figure 2* provides a comparison of fibre characteristics of Australian, Texas Fibremax and Brasilian cotton over the last 5 years. These statistics are based on actual shipments received by our two largest spinning mills in Japan. They show how your competition has been improving. Look particularly at the increase in length of Texas Fibremax over the last 5 years. My summary of the characteristics for each growth is as follows:

1. Length	Brasilian = Aussie > Fibremax
2. Strength	Aussie is the best > Brasilian and Fibremax are almost the same
3. Mic	Almost all the same, but Brasilian is a bit lower than the others
4. Uni	Brasilian > Aussie > then Fibremax
5. Leaf	Aussie > then Fibremax, Brasilian is leafier
6. SFC	Brasilian is the best > Aussie and Fibremax are almost the same

This summary versus competitors may provide some cause for alarm. I should add however, that the numbers do not tell the whole story. The additional value that Australian cotton provides to a spinner is the result of a combination of fibre characteristics, location advantages and a reputation for service and quality reliability. In addition to its excellent fibre characteristics, you are in the same time zone as most of your Asian markets and you can land cotton in any of these destinations within 10-14 days, versus 30-45 days for your competition.

Figure 3 provides a comparison of the exports of Australian, Texas Fibremax (1-1/8" and longer) and Brasilian cotton from 2004 to 2008. I have also included Indian cotton to show its increased availability. Your Australian cotton crop is in danger of being replaced by these competitors because of the relative volumes available.

***Figure 3*

Cotton Export Statistics ('000 227kg Bales)					
	03/04	**04/05**	**05/06**	**06/07**	**07/08**
Australia	1,454	2,731	2,599	1,894	573
Brasil	925	1,498	1,894	1,850	2,291
Texas Fibremax	700	600	1,350	1,790	3,800
India	661	661	3,304	4,405	6,167

An additional factor supporting the competitor growths has been the increase in the Australian sales basis. In 2005 when I made a presentation to the ACSA conference here at the Gold Coast, I noted that Australian cotton traded at a premium of 4-6 USc/lb above Brasilian cotton. Over the last year or so, this premium has been as much as 10 USc/lb. Similarly, the minimum premium above Texas Fibremax used to be 2-3 USc/lb. This has been up to 6 USc/lb recently. This increase in relative pricing has seen many previously loyal buyers of Australian cotton go to these other growths.

The tables presented in *Figures 4 to 8* compare the market shares of Australian, Brasilian and Texas Fibremax cotton in major cotton export markets over the last 5 years. Please note that the US Fibremax numbers are my best estimate of the portion of Texas Fibremax that is high grade, 1-1/8" and longer, taken from total US cotton import numbers in each country. The share of Indian cotton is included where it is significant (China and Indonesia).

***Figure 4*

Japan Cotton Imports						
	2003	**2004**	**2005**	**2006**	**2007**	**2008 Fcst**
Australia	41%	30%	26%	25%	26%	27%
Brasil	2%	16%	19%	20%	20%	27%
Texas Fibremax	0%	25%	25%	25%	25%	27%
Other	57%	29%	30%	30%	29%	19%

Market differences are shown in Japan (*Figure 4*) where, despite the decrease in cotton consumption, Australian cotton still maintains a reasonable share of the market at 26%. In Japan, almost 100% of knitted yarns are made from Australian cotton. Japanese spinners commenced using Australian cotton in 1969. Always sticking to what we know is a characteristic of Japanese and this has been good for the Australian industry. Compare this with *Figure 5* for Korea where Australian cotton imports in 2008 have become negligible. The Korean Spinners have virtually abandoned Australian cotton because of the increased premium for your cotton in your small crop years.

***Figure 5*

Korea Cotton Imports						
	2003	**2004**	**2005**	**2006**	**2007**	**2008 Fcst**
Australia	20%	24%	23%	23%	11%	1%
Brasilian	1%	7%	10%	33%	32%	50%
Texas Fibremax	0%	31%	39%	30%	30%	30%
Other	79%	38%	28%	14%	27%	19%

In Indonesia, another important market for Australian cotton, imports have declined from a share of 38% Australian to around 10% now *(Figure 6).*

***Figure 6*

Indonesia Cotton Imports						
	2003	**2004**	**2005**	**2006**	**2007**	**2008 Fcst**
Australia	32%	20%	19%	20%	15%	10%
Brasilian	2%	9%	9%	8%	10%	12%
Texas Fibremax	0%	16%	20%	17%	18%	20%
India	0%	3%	3%	9%	9%	10%
Other	66%	52%	49%	46%	53%	48%

China has become an important market for Australian cotton. Although the market share shown in *Figure 7* may appear negligible it is important to note that China imported over 1million bales of Australian cotton in 2006 and that imports were still almost 500,000 bales in 2007. The real fact to note

in China is the impact of imports from India. In 2004 imports from India were less than 200,000 bales, but reached 3 million bales in 2008, a 40% share of imports. I have not identified Indian cotton as an immediate threat to Australian cotton because Indian cotton is contaminated. In China, contamination is not as significant an issue as cheap labour allows it to be removed manually. The increased uptake of Indian cotton in China does however demonstrate the potential Indian cotton has if it can overcome this contamination issue.

***Figure 7*

China Cotton Imports						
	2003	**2004**	**2005**	**2006**	**2007**	**2008 Fcst**
Australia	3%	5%	8%	6%	4%	3%
Brasil	1%	1%	2%	1%	1%	1%
Texas Fibermax	0%	0%	2%	3%	9%	17%
Other US Growths	59%	56%	45%	44%	37%	18%
Indian	0%	2%	5%	16%	26%	40%
Other	37%	36%	38%	29%	23%	21%

I have attempted to lay out the facts as I see them. Despite the negatives, Australian cotton still has supporters including me. Japanese spinning mills and Japanese joint venture mills in China, Indonesia, Thailand and Vietnam are still buying some Australian cotton. This is in addition to strong support from some other mills in China, Indonesia and Thailand. These mills are paying a substantial premium for Australian cotton because they believe that it is better. We need to build on the support of these stalwart supporters and to win back markets for Australian cotton by:

- Improving quality. I love Australian cotton. It has been good to me and to our mill customers. Your technology is the best, and your average yields have increased at double the world rate over the last 40 years. You have improved the fibre characteristics of your cotton over the 20 plus years I have been involved in your industry, but there is more to be done.

  I believe that spinning mills will continue to seek high-spinability cotton that is of high quality fineness and strength. Your 40-40-40 project can expand the scope of Australian cotton beyond the 30-50 counts into the 60 count yarns completely replacing SJV.

  There is also a market for eco-friendly cotton and Australia is one of the few countries where this can be produced with complete reliability and transparency. Your BMP cotton provides a great story for retailers to build on, and although this may initially only be of interest in developed countries like Japan, acceptance here will help spread the message of BMP to other countries. Japan's spinners were among the first to use significant volumes of Australian cotton with imports commencing in 1969. As joint ventures were set up in other Asian

countries, the use of Australian cotton was expanded. Hopefully Japan can help initiate an increased acceptance of BMP cotton in a similar way.

- Winning back markets will see an adjustment in the selling basis of your Australian cotton. It can not sustain a premium of 6 and 10 cents over Texas Fibremax and Brasilian respectively and will return to the 2-3 cents premium above Fibremax and 4-6 cents above Brasilian. In a market like Korea where the use of Australian cotton has almost ceased, your premium may need to be even lower to wean spinners off the replacement growths they are using.

- To win back markets we will need volume. We need to have the Australian cotton crop above 2 million bales every year. I understand that this requires water and is beyond your control but everything I have said up to now is based on the need for your cotton crop to be relevant to the world's cotton spinners.

As I said earlier, buyers are prepared to pay a premium for Australian cotton. The value of this is not just based on fibre characteristics but on the total package of environment, technology and the excellent services that you can provide. The worlds' cotton spinners are waiting for your cotton - they desire it. There are many motivated and passionate merchants like me who will ensure that we win back markets for Australian cotton. The limitation is provided not by what we can sell, but by what you will grow.

Thank you very much.