THE CHANGING GLOBAL COTTON MARKET

DUNAVANT
Enterprises, Inc.

It is truly an honor and pleasure to address and be with you today at this conference.

It was May of 1984 while living in Japan; I received a call that our company had bought George H. McFadden Co. I was told we had a 50% ownership in a gin in Australia and I was to go check it out ASAP. I had never been to Australia so I set off an excited 25 year old. My destination was a place called Bourke. Being the adventurous type, I rented a car at Sydney airport to drive to this place called Bourke so I could see a bit of country on the way. I remember thinking 7 to 8 hours into the drive, where the hell is Bourke?

To make a long, story short, I left this country, which was producing 648,000 bales in 1984, after two weeks I was a real believer in what your growth potential was. This was because I met so many good young progressive, independent thinking farmers who believed in what they were doing. That spirit is alive and well today in this room. Albeit older, wiser and much more gray hair.

It is again an honor to address you.

This Australian cotton industry has a relatively short history compared to the rest of the cotton world, yet your history is the one, people throughout the world most acknowledge as the world's best production model.

I would like to point out that this model could be your worst enemy to your future success if you are not flexible and adaptable to the topic of my speech, "The Changing Global Cotton Market".

I will first address the global shifts of production and consumption from ten years ago, to today and attempt to forecast ten years forward. "Who said cotton traders don't take risks."

Secondly, investigate who your global competitors are, today and in the future. Thirdly, investigate market price volatility from last year, immediately the question begs - was it an aberration of a normal cotton year or the norm for the future of cotton? I would like to close with what your mill customers want and require, as well as the importance of global cotton promotion.

Global Trade Shifts

If we look at the past ten years and the next ten years we are seeing an interesting and clear pattern. The global cotton trade is consolidating into six specific countries that are the biggest producers and consumers of raw cotton in the world today.

I would like to draw your attention to the screen which presents the supply/demand numbers from 1994.

World Supply and Demand Estimates

	Production	Consumption	Exports	Imports
	1994	1994	1994	1994
World	85.93	84.37	28.45	30.57
China	19.90	20.00	0.18	4.06
U.S.	19.66	11.20	9.40	0.00
India	11.15	10.55	0.10	0.44
Pakistan	6.25	6.75	0.15	0.70
Brazil	2.47	3.75	0.15	1.61
Turkey	2.89	3.90	0.00	1.08
Total	62.32	56.15	9.98	7.85

As you can see, China, United States, India, Pakistan, Brazil, and Turkey, these six countries, accounted for 72% of the world production, and 66% of the world consumption.

World Supply and Demand Estimates

	Production		Consumption		Exports		Imports	
	1994	2004	1994	2004	1994	2004	1994	2004
World	85.93	104.19	84.37	99.66	28.45	30.37	30.57	30.37
China	19.90	29.00	20.00	33.75	0.18	0.20	4.06	5.75
U.S.	19.66	18.85	11.20	5.90	9.40	11.25	0.00	0.04
India	11.15	12.75	10.55	13.60	0.10	0.18	0.44	1.00
Pakistan	6.25	8.40	6.75	10.00	0.15	0.05	0.70	1.75
Brazil	2. 47	5.75	3.75	3.80	0.15	2.00	1.61	0.30
Turkey	2.89	4.25	3.90	6.10	0.00	0.20	1.08	2.20
Total	62.32	79.00	56.15	73.15	9.98	13.88	7.85	11.04

Moving onto the next slide, we will overlay the projected 2004 numbers on the same six countries. You immediately can see that production has grown 27% in the ten years versus consumption, which has shot up by 30%. Now, as we overlay, a difficult to predict, projection of 2014, you will see the trend continuing.

World Supply and Demand Estimates

	Production			Consumption			Exports			Imports		
	1994	2004	2014	1994	2004	2014	1994	2004	2014	1994	2004	2014
World	85.93	104.19	111.00	84.30	99.66	110.00	28.45	30.37	35.00	30.57	30.37	35.00
China	19.90	29.00	32.50	20.00	33.75	40.50	0.18	0.20	0.50	4.06	5.75	8.20
U.S.	19.66	18.85	16.00	11.20	5.90	4.30	9.40	11.25	12.20	0.00	0.04	0.00
India	11.15	12.75	15.00	10.55	13.60	15.80	0.10	0.18	0.25	0.44	1.00	1.00
Pakistan	6.25	8.40	9.50	6.75	10.00	11.50	0.15	0.05	0.25	0.70	1.75	2.10
Brazil	2.47	5.75	9.60	3.75	3.85	4.70	0.15	2.00	5.00	1.61	0.30	0.10
Turkey	2.89	4.25	4.60	3.90	6.10	6.60	0.00	0.20	0.25	1.08	2.20	2.10
Total	62.32	79.00	87.20	56.15	73.15	83.40	9.98	13.88	18.45	7.85	11.04	13.50

At a minimum, these six countries have consolidated over 76% of all world production and consumption.

When we analyze these numbers you see that world consumption share is expected to shift by over 27% to these six large producers of raw cotton over a twenty-year period.

These countries internal production will almost satisfy the needs of their consumption, except China. This internal production will keep these countries away from the global market place in the critical Oct-Mar shipping period. The pressure on cotton pricing will become more apparent with northern hemisphere exporting countries shipping cotton later and later running more and more into the Apr – Sept period of Australia and Brazil.

The problem is, if the world was made up of free and fair trade, then these six countries would always be in the import market twelve months a year. Unfortunately, not all these countries will be free to import at anytime, from anywhere, at any price. Remember there is very little free or fair trade in the world today. Perhaps we should have hope from the current WTO round?

COMPETITION

So let's take a look at your competition. You are, and will always be, an exporter of raw cotton. In my mind you have two types of competitors. One is based on quantity and the other is based on quality. First let's look at quantity as far as world exports. Using the same data from earlier

World Exports

	1994		2004		2014	
	1000 BALES	% SHARE	1000 BALES	% SHARE	1000 BALES	% SHARE
WORLD CONSUMPTION	84.37		99.66		110.00	
WORLD EXPORTS	28.45	34.0	30.37	30.0	35.00	32.0
U.S.	9.40	33.0	11.25	37.0	12.20	35.0
AFRICA	3.70	13.0	6.40	21.0	9.00	26.0
C.I.S.	8.70	31.0	5.18	17.0	4.00	11.0
AUSTRALIA	1.40	5.0	2.00	7.0	3.00	9.0
BRAZIL	0.20	1.0	2.00	7.0	5.00	14.0
OTHER	5.05	18.0	3.54	12.0	1.80	5.0

As you can see, your competitors are very much the same over the twenty-year history presented. The good news for the future of the Australian producer is world exports for 2004 will remain strong at 30.4 million bales. As we look to the future 2014, exports should stay strong, at a projected 32 million bales.

Briefly, let us look closely at my assumptions and the chart:

1. I assume about a 1% annual growth in consumption.
2. Exports maintain a 32% share of world consumption. Obviously this estimate is very difficult to predict.

3. For the sake of this chart, I assume the United States will lose nearly three million bales of production due to decreases in subsidies.
4. China will remain the world's largest importer of raw cotton.
5. The C.I.S. countries including Russia will gain more consumption and lose export share. These countries will attempt to increase their foreign currency reserves by value added textile spinning and production, selling textile products versus raw cotton. This will mirror what Pakistan very successfully did in the early 90's.
6. Australia will struggle! In the future, I hope we see production going back to 3.5 to 4.0 million bales. The Australian producers will continue to feel pressure from water and environmental issues. I believe Australia, subject to water, will again consistently export 2.5 to 3.5 million bales.

The next area of great interest and concern as producers should be the growth of Brazilian production.

Brazil, as you can see from this chart will be the new export player of the future. In 1994 Brazil exported just 200,000 bales, 2004 – 2.0 million bales are projected. By 2014 Brazil will export nearly 5.0 million bales to become the world's 3rd largest exporter.

Supply and Demand Estimates

Brazil	1994	2004	2014
Production	2.50	5.75	9.60
Exports	0.20	2.00	5.00
Consumption	3.95	3.80	4.70

There is no question in my mind that they will become one of your major competitors in quantity first, and potentially in quality later. In the late 90's Brazil's cotton industry moved west to Mato Grosso. A new type of producer/businessman went there to make things happen and boy … did they.

I had an opportunity in June and July to spend two weeks looking at Mato Grasso; I was as amazed, as I was with Australia in 1984.

Farming in Brazil, today, is not a cultural issue; it is a business issue and a big one. The Brazilian producer's practices are very similar to ours in America and yours in Australia, the way they manage their farms are equal, and in some cases better than ours. They have copied our models of producing, researching, picking, ginning and other uses of our technology and adapted to their areas of production. The results are "extraordinary" and in the last five years they have created one of the greatest expansion areas in the cotton world. We do have to remember that the cotton acreage in this part of the world can double even before 2010.

The Brazilian base quality now is SLM 1-3/32 and their yields are around 1,400 pounds per acre and their cost of production is 45¢ costs per lb F.O.B. ports Brazilian farmers are beginning to witness the problems of success. Everyone from seed distributors to chemical and insecticide dealers, to consultants, to workers, to equipment dealers are all raising prices to share the Brazilian producer's new success.

What are their real advantages?

1. No water costs, it comes timely from the sky.
2. No rain at harvest, from May onward, when the picking season begins.
3. Land cost in developing areas is still very cheap.
4. The future potential of B.T. seeds is not known and currently outlawed in Brazil.

As far as disadvantages:

1. The huge problems for growth of this magnitude in Brazil, is the infrastructure in their transportation systems. They could and will collapse if something is not done soon and I mean very soon. Please do not forget that this country could also become the number one soybean producer and exporter of the world.
2. Quality – the Brazilian cotton is no where near your quality. But beware they can and will adapt. Your risk today is real and I am not talking to just producers here but also to all the marketers in Australia.

When I look at Brazilian prices for SLM and MID 1 1/8 landed Far East. Brazilian qualities consistently are at a minimum 6 to 8 cents cheaper. When, not if, you get a

wet harvest Down Under, the Australian Middling and lower grades will simply not compete.
In the future Brazil will force marketers of your cotton to adjust your base quality up and increase discounts for lower qualities your of cotton.

My fear for you, by not adapting, could be the loss of your ability to sell forward. For the future marketers cannot and should not take on such huge quality risk from the present system

I would hope you as producers can adapt to a higher base grade and look at this point in history to take the lead, in the world of high quality fiber. Please do not become a follower as other countries pass you by in the export world. That statement might sound like bad medicine to take, but that medicine may just save your life looking ahead.

Is being a quality competitor important today? In our business, price is always relative to quality. If a mill in tough times can buy quality cheaper and value spin, he will. The Australian drought is having an unknown or unquantifiable effect on your industry.

Buyers who purchased the 2.1 million bales you exported in 2003 have been forced to source from other countries in the world because of your crop of 1.5 million bales this year. The unanswered question is will they come back to Australia, or have they learned to value spin a piece of Uzbek or Greece, Burkina Faso or Zambian, Mato Grosso, or Paraguayan, will this create a problem for your basis long term? Only time will tell!

I know Australian cotton is the most contamination free, I know the shipping industry is among the world's most reliable, the packaging one of the world's best, the transit time to Asia one of the shortest. You can bet, when it rains that my competitors and our company will be out in the world markets working for all Australian producers to put your cotton back on the top of the world.

Price

Last year was one of the more challenging years for price, as far as, market volatility or the trade in raw cotton. We saw prices for the July contract top out at 85.50 on October 30. Then in 18 big moves, up and down, over 166¢, the next 8 months, it finished at a low of 44.20, a drop of over 41¢.

Why did we see such volatility when the market fundamental picture was pointing higher, not lower?

1. At the high, we saw a majority of the trade, mills, growers, merchants, co-ops and the spec/hedge fund community all record long raw cotton, a dangerous mix in itself.
2. We now see the dynamics of the New York futures contract changing, with the amount of money flowing from speculative hedge funds. These funds have added so much more volatility, not to just cotton, but to all commodity futures the last few years.

According to a recently released report from the Hennessee consulting group, hedge fund assets grew 34% in 2003 as the number of funds increased to 7,000 from 5,700 with this record amounts in the billions are moving into these investment vehicles. Yet it still only represents less than 2% of global financial markets. I am afraid, that as we look at the cotton market today, the speculative hedge funds have more money than the world trade has cotton. Therefore, as volatility rises, everyone's risk will also. Just look at what prices have done the last twelve months.

Yes there are limits in futures for speculators, but not in cotton options. There also is a big push to remove all speculative limits which will only increase the gambling element to your livelihood.

The Chinese market has also caused price volatility and pain to many in the trade. China is going through an industrial revolution not seen since the United States boom in the late 19th century. Double digit growth rate, over 60% growth in oil consumption in two years, Chinese exports have doubled in less than five years. Already the world's second largest consumer of energy, yet per capita the Chinese consume scarcely 10% used by Americans. Their appetite for all commodities is booming, amazingly now consuming over 30% of the world's steel. At this year's world economic forum in Davos, Switzerland, it was predicted that the Chinese economy, by 2010, will surpass the German economy and by 2040 the United States!

In 2001, we saw China's textile industry emerge from WTO. Pre-WTO the world's cotton trade was selling to one buyer, Chinatex, a sovereign risk, today with China's WTO accession we now have 6000 new Chinese customers, of which you probably only want to do business with about 150. Right now many traders wish they had sold only a handful.

The Chinese government put the brakes on their economy in April and the repercussions are still being felt. The cotton market was not spared with the credit squeeze, with the futures price fall, it has given the cotton trade to China a perfect storm of delays, letter of credit problems, quality problems, defaults, documentation problems all to the detriment of the world cotton and banking trade.

This is where it is imperative, that you, the Australian cotton industry and your government work closely with the rest of the world trade; to not let China hurt the world's cotton producers.

The world of cotton has a problem with China, as their legal system is nearly non-existent. As our biggest market, we, the trade, need to work with the Chinese on trade rules that benefit both sides. China is our future in the export market, but playing by unilateral rules is unacceptable.

Thus with, the current forecast of world production at 105 million bales and all crops looking strong, it is no wonder prices have collapsed to 45.00 cents. I am afraid to say, you will be the first country to plant from these new world prices. The world is facing a huge carryout in July of 2005 of over 38 million. We could be in this price structure for the foreseeable future. Remember, tomorrow, all of these numbers will change with the USDA's first crop report of the season.

Spinning and Competition

Finally, the world of spinning which has changed so much over the past ten years. We can talk about WTO, subsidies and this cotton versus that cotton, but we the world cotton trade has got to realize who our real competitor is - Man Made Fiber. Man-Made Fiber is hurting you and every other cotton producer in the world. That is the biggest threat we face today. With the new generation of textile equipment your customers require more and more from your fiber due to the high speeds they run. Synthetic fiber meets the high-speed test.

Mills are now pushing you hard on quality such as HVI data, strength, uniformity, neps, and short fiber content. We did not have those words in or vocabulary twenty years ago. As I said earlier, I believe you need to lead, to a SM 1 1/8 to stay ahead of the world, and do not forget Brazil is coming quickly with their sights on you.

The world cotton industry does not promote cotton, it is just too dis-jointed. The most successful and well-funded promotional effort is from the United States with "Cotton Incorporated" and "Cotton Council International."

Cotton Council International, I would encourage your industry to partner with them and create a global promotional partnership. If not we will be overwhelmed by the dollars Man-Made Fiber is spending promoting their products. Please take note that some of CCI's funds come from the U.S. agricultural subsidies you are always questioning.

In closing, I would like to thank this great industry for the opportunity to come to your great country over 40 times in my career. To be a small part in building a business, becoming a producer in Emerald and being a part of this industry. I would especially like to thank my friend, David Montgomery for all of his friendship and leadership through the many years of fun we enjoyed together.

My thanks also, to the Dunavant Australian team for their continued leadership and help in being a part of this Australian cotton industry.

There are not many places that I have traveled in the world, where I have met and made so many friends. You have all been so kind in helping me get established in this country.

Thank you very much.