

## Delivery Confidence = Forward Market

By Tim Storck, Australian Cotton Shippers Association

The Australian cotton industry is sophisticated in almost every facet of how it operates. From the extraordinary Australian bred varieties; machinery and tools used to plant, nurture and harvest the crop; to the technology available within those machines - right through to the way cotton is marketed.

Growers enjoy a forward marketing system that allows them to sell cotton up to 3-4 years in advance, negating much of the risk of taking a chance on the spot market.

The benefits of this forward marketing system are obvious. It allows growers to lock in a sale at a profitable level before having even planted a seed. It allows them to budget and work with their finance provider and it gives them peace of mind in knowing that despite fluctuations in pricing, they have secured a forward contract which will be honoured upon delivery - even if the cash bid at the time of delivery is lower than the forward contracted price. A great system indeed.

For all of this to take place, the merchant will lock in the basis level they have offered the grower by hedging the AUD/USD foreign exchange requirements and by selling the relevant number of ICE futures contracts to hedge the purchase.

In hedging futures, the merchant will most commonly utilise the March, May, July or December contracts, noting that whilst the October contract is an option, it usually trades at too small a volume to be considered a viable option. The merchant will choose the most appropriate cover month based on the expected delivery date of the bales.

The merchant in determining the appropriate hedging contract will factor in the likely picking and ginning dates. For early bales (say, first sold bales from Central Queensland which will usually be picked and ginned very early in the calendar year) the merchant may choose to sell May futures. This is in anticipation of receiving those bales in February, March or April, upon which the merchant will unwind the hedge by purchasing the same number of ICE futures contracts, prior to expiry of the May futures contract to close out the position.

If there is a delay in delivery of those bales, which could arise for any number of reasons – including crop damage, harvest delay, a break down at the gin, delayed ginning, etc, then the merchant may need to roll the futures position. The need to roll futures could also be required if the grower does not deliver bales in strict order of sale.

The spread between contracts varies but as I write this news story, there is an invert between the July 22 and December 22 futures contracts of 19.03 points.

What this means in simple terms is that bales that are hedged on the July 22 futures month (which is probably the vast majority of the Australian crop) and are not delivered before the July 22 contract expires, will need to be rolled to December 22. At today's exchange rate (0.7235), this would result in a cost of approximately \$131.50 AUD per bale to the merchant.

As can be seen from this example, it is extremely important that the grower does all he can to determine when the bales should reasonably be expected to be delivered (this best guess would be

based on anticipated harvest date and where in line the contracted bales are in terms of any previous bales sold). Added to this, merchants too forward sell cotton and are relying on the timely delivery of contracted purchases so that they can meet the contracted delivery requirements for their sales.

It is also extremely important that the grower allocates the bales in correct sequential order of sale/s, regardless of the contract price. The merchant has factored this into his risk equation at the time of purchase and has hedged accordingly.

Considering the costs and risks associated with maintaining futures contracts - sometimes years in advance of the bales being delivered - it is only reasonable that the merchant with whom the grower has forward sold cotton, receives the bales that they have purchased in strict chronological order of sale by the grower.

In order for the grower to continue to enjoy a forward marketing system with robust competition between merchants, it is imperative that growers always deliver their sold bales to each and every buyer in strict order of sale.

Provided that this happens, Australian growers will be able to enjoy competitive bidding between merchants for their lint as well the other benefits which come from a forward market - a fair and equitable outcome for all parties concerned.

Please do your part to keep this great system workable, by always delivering your cotton in strict chronological order of sales. The future of competitive bidding for your cotton depends upon it.

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