

Tenders, Tenders & More Tenders

by Roger Tomkins, Australian Cotton Shippers Association

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Given the gamut of tendered recaps offered out on a daily basis this season, is this the start of an evolution of our domestic cotton market? Is our traditional forward selling focus evolving to be more aligned with that of the US? Is this change a result of the shift to full HVI classing or other more isolated factors? If this season is anything to go by then we are definitely seeing a momentum shift in the selling processes being employed by Australian growers.

While there is no doubt tendering out a recap, or selling cotton based on known quality, is gaining favour, the volumes sold by this method this season are more likely an outlier to a more gradual incline. There are many reasons for this year's tender stampede - starting firstly with market factors. The first trigger likely appeared early this year when merchants started to focus on the widening July- December ICE Futures spread. The front months were aggressively bid on the back of tightening supplies of physical and certified stock of the then US current crop. At the same time the polish was coming off global economies and this combined with the predicted increase in size of future production was leaving most unenthusiastic about the price prospects for the December Futures and later months.

The July-December spread traded inversely at levels in excess of 15 US cents/lb by the end of February, leaving traders less enthusiastic about buying cotton for later ginning. The early crop was already well sold but merchants became nervous buyers of anything that may be delivered after the July Futures went off the board. The resulting big price discounts for later delivered cotton led to subdued grower selling. This lack of desire to sell the second half of the crop was further compounded with a steady Futures decline starting mid-March resulting in weakening prices offered to growers. To me this resulted in one of the least forward sold crops come the start of the pick for many years.

Another contributing factor was the later than preferred start to ginning as a result of a delayed crop and wet April weather across the central valleys. This exposed merchants to having insufficient stocks of bales sitting in warehouses to meet their high-priced forward sales to spinning mills. The previously discussed fall in cotton prices had left mills with large amounts of high priced purchases on their books. In general such differences between the price of forward sales and the current market, makes for a worried merchant. As such they were prepared to "pay up" to secure physical bales to ship against these contracts. A tendered bale is available to the merchant straight away, hence it becomes very desirable. Tendered bales also provide the merchant with known quality and for this year anyway, such knowledge is very desirable.

This brings me to next factor, quality. Or perhaps more importantly the introduction this year of HVI to test for colour and leaf by Australia's predominant classing office, ProClass. This is not a new idea. The USDA first classed the US crop using HVI colour grade as the official grade for Upland cotton in 2000, some 24 years ago. The reasoning for moving toward full instrument testing lies predominately with repeatability, and as such inferred accuracy. Speaking from experience having started my time in the cotton industry as a classer some 35 years ago, a manual class is purely an informed opinion made by the individual at a specific time. It is safe to say my opinion on a Saturday morning, as a young guy in his mid-20s, may not have been as considered as it should have been, or would be, given an adequate prior night's sleep and no hangover.

HVI testing for colour breaks each colour grade into four segments (except for light spot which is broken into two only). This enables merchants to reduce the cliff face pricing that plagued past

P&Ds by using these segments to increase the discount increments as we work down the colour and leaf scale. I believe this is a positive thing for the industry however in doing so, it does produce a significantly more complicated P&D sheet. And it is this added complexity, and resulting uncertainty, that further compounded the forward selling hesitancy of this year's crop.

Tendering recaps, or selling cotton based on actual classing results, is nothing new. It is by far the most common method employed by US growers to sell their crop. Market participants in the US have access to electronic platforms, for example the Seam, upon which they can utilise to trade their classed cotton. In the US, cotton after ginning is moved into warehouse mostly prior to it being classed where it is then sold or placed into the USDA loan program. Compared to the Australian system it is significantly less efficient in both time and cost.

Limited space on Australian gin bale pads is a significant issue with waiting until the bale is classed prior to selling it. Our classing system is efficient however and depending on gin location, it will take 3 to 5 days for a bale to be classed then another day for it to be tendered or sold. Gins usually provide owners of cotton on their gin pads, 7 days in which to remove the bales. Adding another 4 to 6 days onto this while waiting for the bale to be classed will (and is), causing pressure on ginners' space and resources. Our established logistical system will have to change if the recap selling system continues to gain momentum.

I think it fair to say that selling known quality is advantageous to the seller if and when the quality they are selling is noticeably either side of the average of the crop. The seller will likely achieve a significantly higher return when selling known high grades in a year of wet harvest. They will also potentially achieve a higher net return when selling very low qualities, by selling their bales with the class already established, over the more traditional forward selling protocol based off a P&D sheet. This is especially true when cotton attracts more than one discount, ie discounts for both grade and micronaire. Buying a recap removes buyer uncertainty in two very important aspects - quality and availability. There will likely be very limited, if no benefit, in selling by recap if the quality is similar to the majority available on the market at the time. That is unless, as we have found this year, buyers need cotton that is immediately available and are prepared to "pay up" to secure it.

It is hard to argue against the success of tendering recaps this season and the volumes offered by growers support this. Is it likely that it will garnish similar popularity next year? Possibly not. I feel it is important to be mindful that a forward selling market provides a key pricing ingredient, and that is time. For the most part, selling after classing while bales sit on a gin pad narrows down the market opportunity to one or two days only. On the day it could well produce a superior price but when compared to prices achieved over the entire selling season the result may well be significantly different.

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