USDA Agricultural Outlook Forum 2013

Risk Management for the US Cotton Farmer: Strategies for Today's Market

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Risk Management for the US Cotton Farmer: Strategies for Today's Market

- ✓Events that rocked our world
- ✓Farmers reacted with fight or flight
- ✓Merchants hammered on both sides of the trade
- ✓Mills went from elation to despair
- ✓Entire industry changed forever
- ✓What happens now

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DECEMBER 09 COTTON CHART

✓2008

- ✓First Wave of Chaos
- ✓ICE futures moves to electronic trading
- ✓Cotton swings 56 cents in 8 ½ months
- ✓Specs ran the market past any reasonable fundamental price
- ✓In the midst, ICE changed margin requirements to synthetic futures prices with no warning
- ✓Futures and cash divorced
- ✓Less than two years later, cotton back into 70 cent range

DECEMBER '11 COTTON CHART

✓2010

✓Second Wave of Chaos

✓Fundamentally/panic driven market over $2

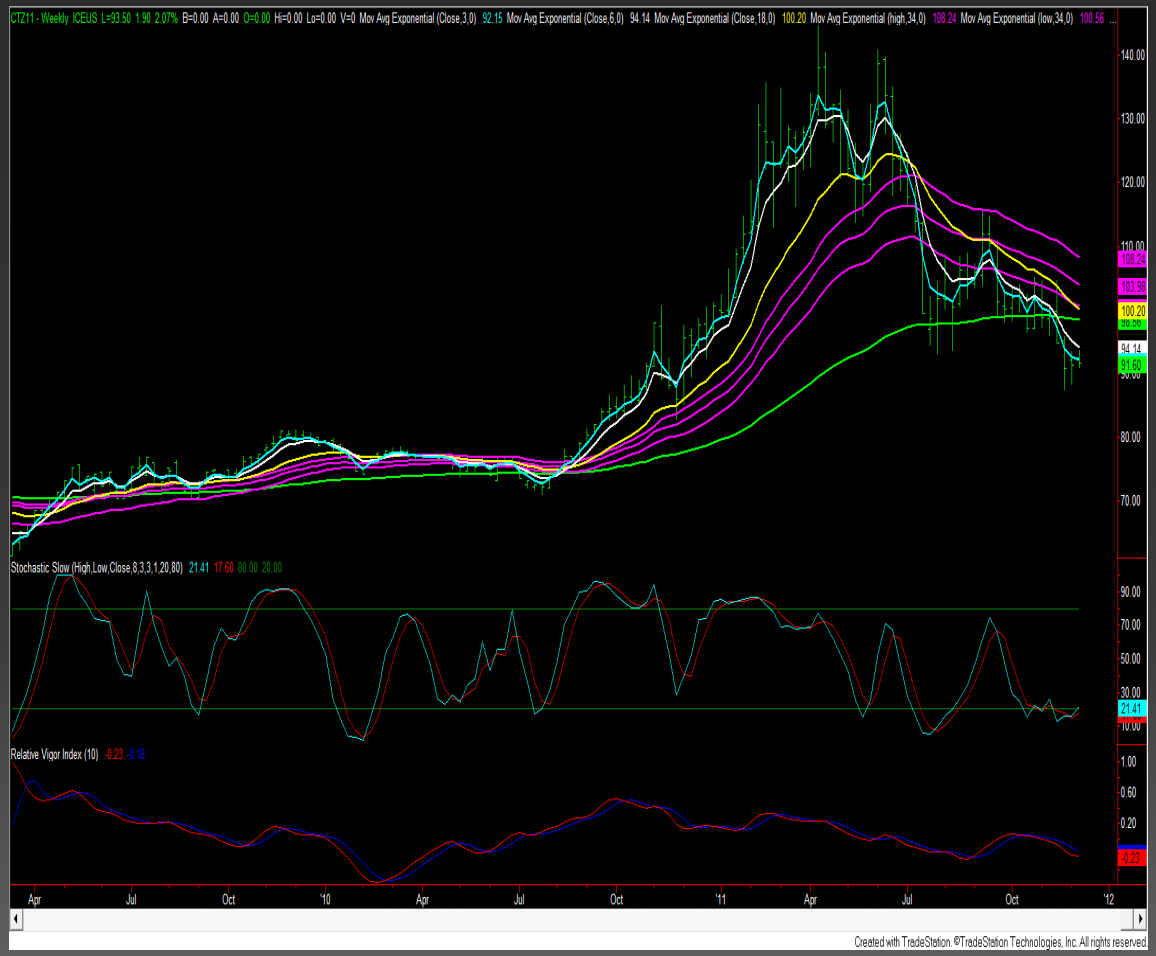
✓85% of the cotton crop was contracted when this rally began

✓Farmers felt betrayed

✓Mills jubilant because great demand at any price

✓Merchants squeezed

✓Cotton was under $1 by the summer of 2011



FARMERS

DISBELIEF, DISMAY, DISDAIN

MERCHANTS

SQUEEZED FROM BOTH SIDES

MILLS

HEADLINES

Defaults send chilling signal to cotton shippers

Cotton-Contract Crackdown

RPT-INSIGHT-Cotton market trust crumbles on defaults, lawyers pounce

US Cotton Seeks Action on Contract Defaults

Record cotton defaults show no signs of slowing in Q1 - ICA

ATTORNEY PLAYGROUND

- Over $2 billion in default contracts, including mill and farmer defaults
- Legal battles on both sides are still underway and will continue for years
- Arbitration provisions heavily scrutinized

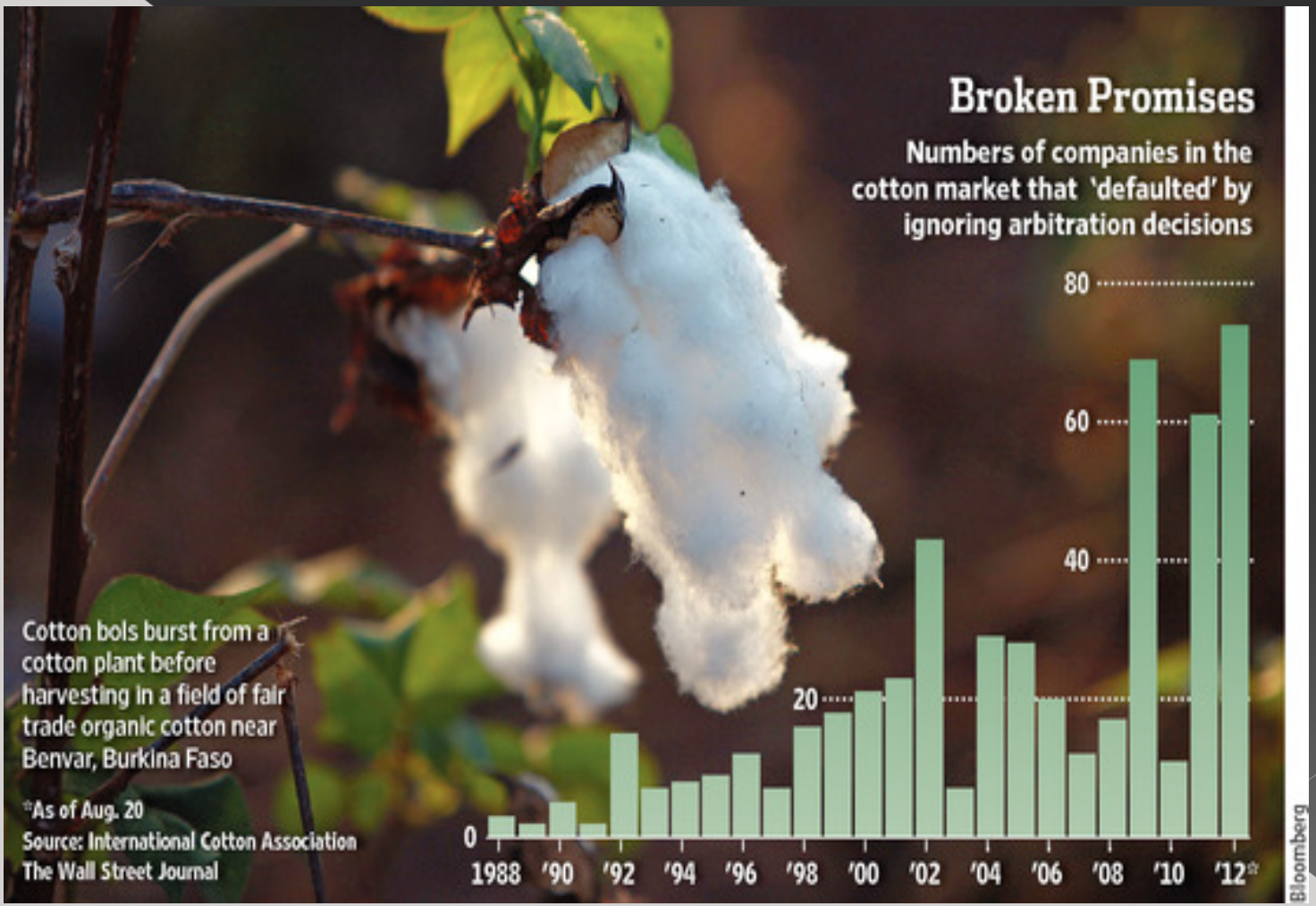
COTTON SUPPLY CHAIN ASKEW

"Arbitrations should be the last resort, not the first," said Paul Ruh, a cotton consultant. "The cotton market is built on honesty, integrity and mutual trust—long-lasting relationships. This has gone away."

CONFIDENCE SMASHED

"It destroys people's confidence in these markets," says Neal Gillen, former executive vice president of American Cotton Shippers Association. The industry has been shaken, he says, by "the sheer amount of the losses, the audacity of the buyers, their feeling they can just walk away."

Broken Promises



Risk Management Keys For Farmers

- No acres contracts
  - Pools are an option
  - Banks are hesitant to finalize loans
- Hedge price in futures market
  - Futures volatility only for experienced
  - Options are almost cost-prohibitive
  - Education needed-this arena remains a mystery to most farmers with only 5% actively hedging
- Insurance covers up to 65% of Actual Production History
  - Percentage is determined by level of coverage a farmer purchases
  - Price paid is determined by the average December futures price in February of same year

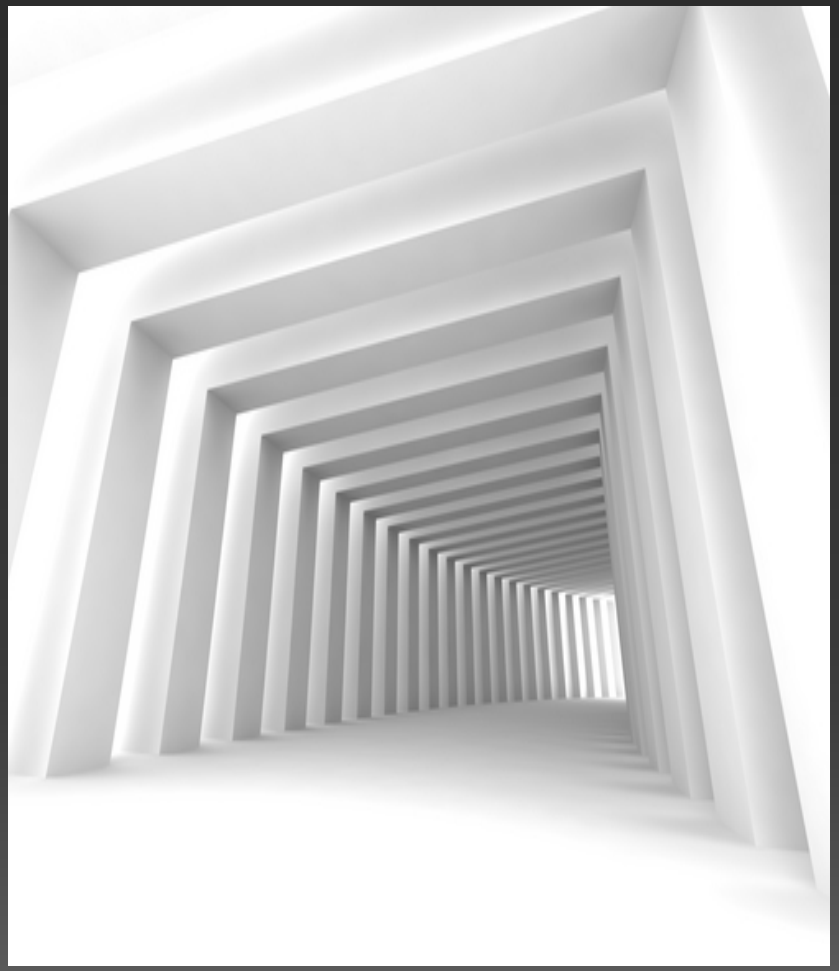
Risk Management Keys For Merchants

- Some merchants are requiring 5 to 10% in advance from mills
- No acres contracts for farmers
- No forward contracts result in cotton purchased and shipped hand-to-mouth
  - Warehouses are 2 to 2 ½ months behind
  - Mills unable to receive timely shipments

Now For Our Future…

- Delivery point in Dallas
- Speculators follow same rules as Trade
- Loan chart updated with more premiums
- Some way for foreign growths to be delivered to board

AND BEYOND



- ICE rules offer no surprises in the midst of chaos
- Some form of world contract
- Develop niche markets
- Entire supply chain working together to help return our price discovery tool

A NEW PARADIGM HAS ARRIVED

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Thank You

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