

How U.S. Producers Market Cotton



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Overview

- Cash Sales at Harvest
- Forward Contracts
- Marketing Pools
- Futures Contracts
- Options Contracts



Cash Sale at Harvest

■ What Is It?

- Producer sells cotton after it is harvested; sells to gin, broker, or larger merchant.
- Simple marketing alternative.



Cash Sale at Harvest

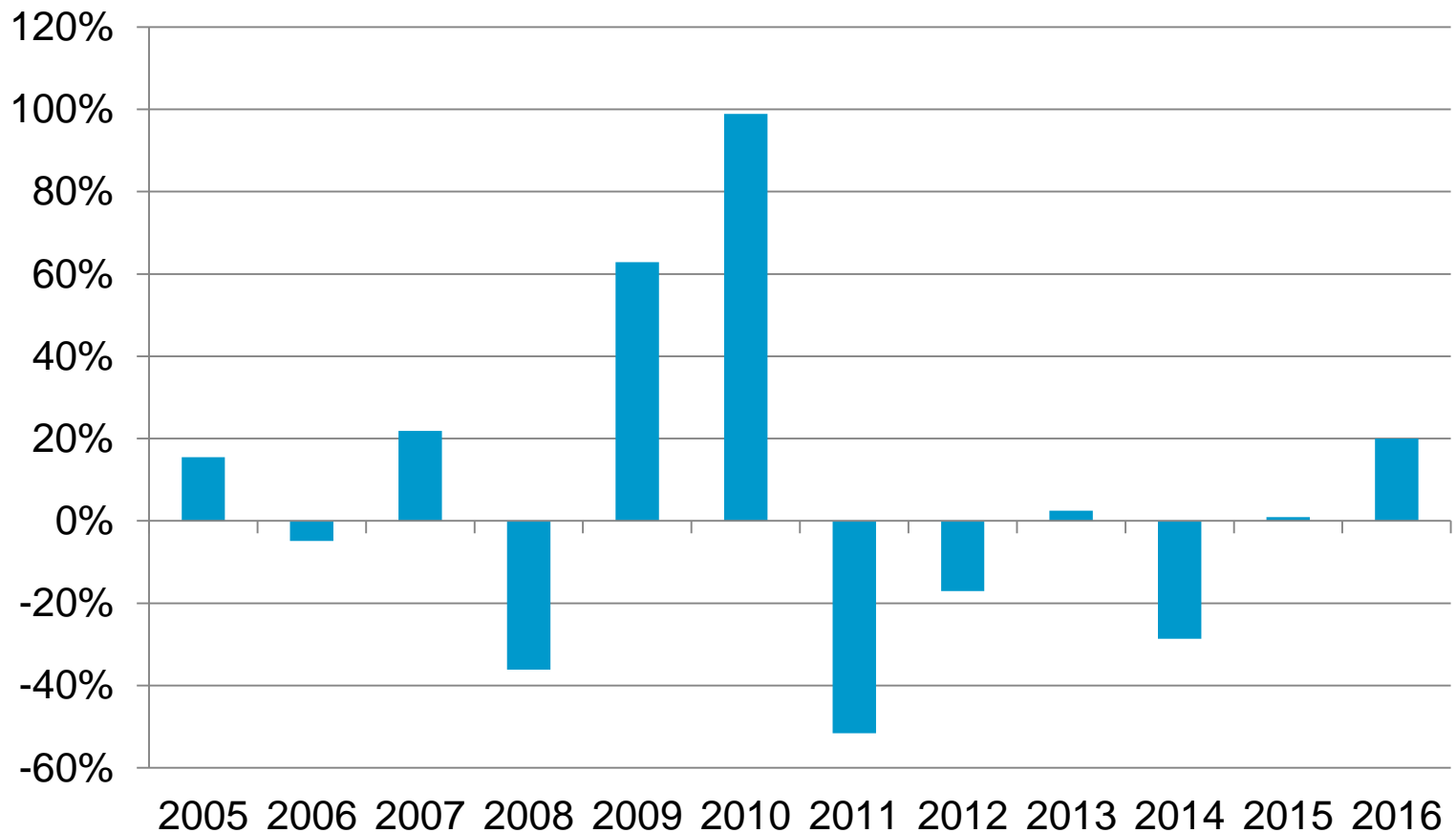
■ Advantages

- Simple approach with no risk of not fulfilling a contract.
- Enables producers to limit marketing costs.

■ Disadvantages

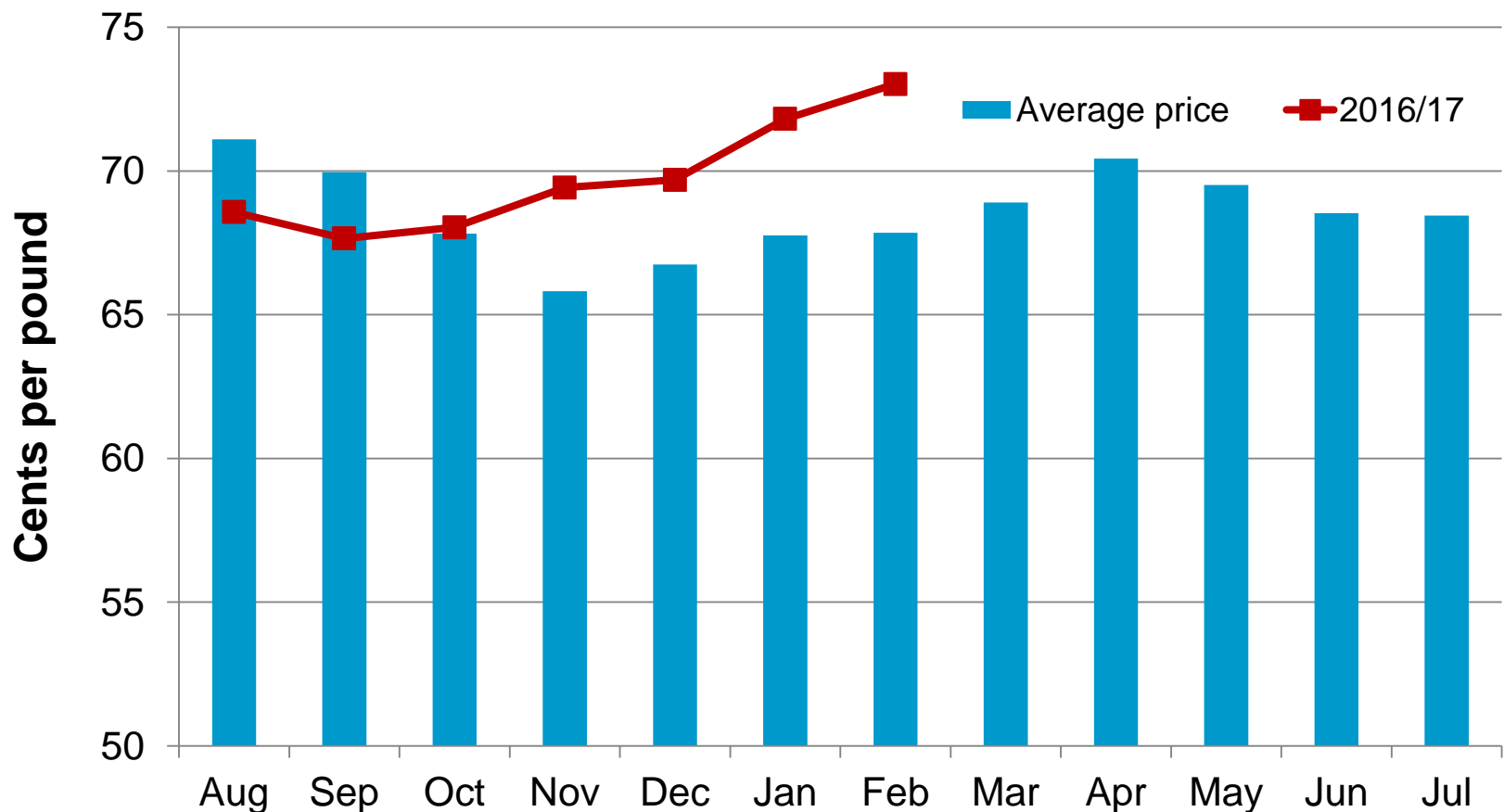
- Producer is fully exposed to price risk.
- Harvest-time prices tend to be lower.

Price risk from Planting to Harvest, Change in



Source: USDA, AMS *Cotton Price Statistics*.

Average Monthly U.S. Spot Market Price, 2008/09-2015/16 (2010/11 excluded)



Source: USDA, AMS *Cotton Price Statistics*.



Forward Contract

■ What Is It?

- Legal agreement between producer & merchant.
- Specifies a price (or basis) for a certain quantity and quality of cotton delivered at a future date.
- Used by merchants to make sale commitments to mills.



Forward Contract

■ Advantages

- Reduces price (or basis) risk when market opportunity presents itself.
- Enables producers to secure operating loans.

■ Disadvantages

- Contract may not be offered when market opportunity exists.
- Difficult to evaluate alternative contract terms.

Forward Contracting of Upland Cotton Area as of September 1, Crop Years 2009-2016

Region	2009	2010	2011	2012	2013	2014	2015	2016
Percent								
Southeast	7	23	32	17	34	21	6	11
Delta	2	6	66	31	16	9	5	11
Southwest	2	20	30	5	4	3	1	*
West	-	9	3	5	3	*	6	5
United States	3	18	38	13	16	8	3	5

Source: Agricultural Marketing Service, USDA.



Marketing Pool

■ What Is It?

- Farmer cooperatives that provide cotton marketing services for its members.
- Major regional marketing pools (Calcot, Plains Cotton Cooperative, & Staplcotn) as well as smaller local groups.
- Popular marketing alternative.



Marketing Pool

■ Advantages

- Strong bargaining position with large volumes relative to an individual.
- Guarantees market access; provides season average price.
- Provides competition with other pools/merchants.

■ Disadvantages

- Marketing services come with a cost—fees, limits on pricing, and receive only average price.
- Difficult to evaluate comparative performance.



Futures Contract

■ What Is It?

- A legal agreement to buy or sell a commodity at some future date.
- Offsetting market position is usually taken before the future delivery date arrives.
- Cotton contract months vary. Each contract represents 50,000 pounds (≈ 23 MT) of cotton.



Futures Contract

■ Advantages

- Ability to shift price risk to other willing market participants.
- Enables producers to secure a given price.

■ Disadvantages

- Commission or transaction fees.
- Producer's basis risk exists with futures contract.
- Margin deposits to participate with potential for additional margin calls.



Options Contract

■ What Is It?

- A contract that gives the buyer the right—but not the obligation—to purchase or sell an underlying futures contract during a specific time at a specific price.
- Put Options used to establish a floor price.
- Call Options used to establish a ceiling price.



Options Contract

■ Advantages

- Provides price protection with the ability to take advantage of favorable prices.
- Ability to choose level of price protection.
- Costs are known and fixed—no margin requirements or margin calls.

■ Disadvantages

- Greatest price not realized if favorable prices occur.
- Premium cost may offset gains.
- Eroding asset—time value decreases as expiration approaches.



Summary

- Several alternatives for U.S. producers to market cotton.
- Advantages and Disadvantages to each alternative.
- Alternative chosen may depend on a number of factors—including location, size of operation, market knowledge, prices, and risk tolerance.