How U.S. Producers Market Cotton

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Overview

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

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 August 1, Crop Years 2007-2013

Region	2007	2008	2009	2010	2011	2012	2013
				Percent			
Southeast	3	12	7	27	31	13	33
Delta	9	16	2	73	64	30	15
Southwest	2	8	2	15	14	4	2
West	0	3	0	0	3	4	3
United States	4	10	3	16	26	10	12

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 <u>only</u> average price.
  - Difficult to evaluate comparative performance.

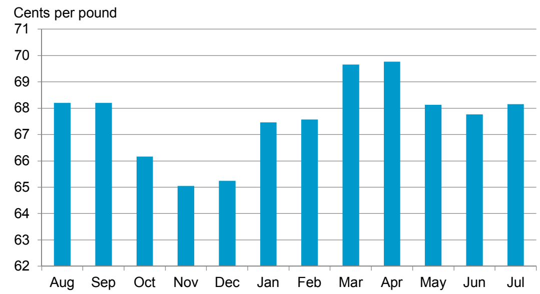
Cash Sale at Harvest

- 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.

Average Monthly U.S. Spot Market Price, 2007/08-2012/13 (2010/11 excluded)



Source: USDA, AMS *Cotton Price Statistics*.

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.