

Moving along the chain: Ginning and classing

By Gillian Turco, Rabobank

Our previous article examined the competitive position of Australian cotton at the farm level. In this issue, Rabobank aims to move further along the chain, examining the ginning and classing segments of the market.

In doing so, it is important to realise that cotton is produced by over 90 countries around the world, with approximately 75 of these nations still classified as developing countries. The nature of trade for these countries is based strongly around the ability to generate a foreign cash income.

For example, this year in Brazil some cotton production areas have been put to soybean as the opportunity income level was more attractive for this crop at planting time. In contrast, Australian cotton is produced as a function of availability of water and land resources and on the



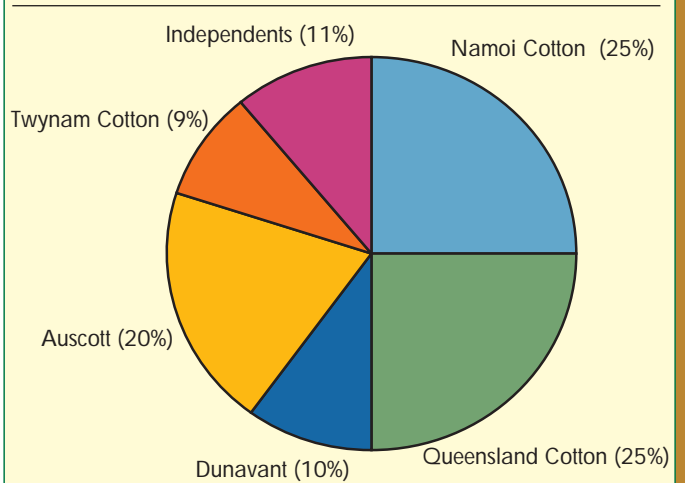
assumption that there will be a market for the high quality lint produced.

But before cotton can be marketed it must be ginned. The ginning sector of the chain is dominated by a relatively small number of Australian and offshore compa-

nies. While to date there have been many efficiency gains in ginning operations, companies continue to work with organisations like the CSIRO to optimise sectoral efficiency. And the focus is not just on improving turnout rates — other gains can be made by ensuring fibre quality through the ginning process so that the final product remains attractive to offshore buyers. In addition, the type of ginning operation may vary with the type of cotton involved — for example, ginning pima versus upland cotton.

The ginning sector in Australia is well serviced. Some market analysts believe that there are too many gins for the productive capacity of the industry. The majors — Namoi Cotton, Queensland Cotton, Twynam Cotton, Dunavant and Auscott — are a mix of local and US com-

FIGURE 1: Ginning market share



Source: Company reports, broker research, Rabobank analysis, 2003

TABLE 1: Cotton lint assessment

Current testing	Future testing likely to include
USDA grade	Uniformity
Staple length	Short fibre content
Staple strength	Impurity
Micronaire	Neps content
Colour	Stickiness
	Contamination

Source: Rabobank, 2003

panies. In addition, the sector is serviced by smaller regional focussed operations — for example, North West Ginning and Carrington Ginning. The presence of the smaller independent gins, while not a risk free proposition in a potentially over supplied market, does provide another dimension of competition and generates a need for ongoing research and technological innovation for the sector (Figure 1).

The Australian industry is cost competitive when placed against international producers (Figure 2). This data collected annually by the ICAC shows that ginning costs vary considerably across countries. At the extremes are Syria at USD0.23/kg and China at USD0.05/kg.

The highs and lows are interesting. Positioning Australia against its potential competition provides an opportunity to see where weaknesses exist for the industry in the future. For example, it is well disclosed that there is significant potential to expand Brazilian cotton production, an opportunity made more attractive by the highly competitive ginning cost at USD0.07/kg. To sustain this price competitiveness, there will need to be an ongoing investment into the technology and development of the Brazilian ginning sector.

Generally speaking, globally custom ginning is not popular and in some markets not available, depending upon the local industry structure. In Uzbekistan, cotton ginning is largely done by government organisations, similar to the situation in China. In the Chinese market, the government is slowly retreating from full ownership of such activities, but their current position remains substantial.

In Uzbekistan, the government is opening up the marketing channels for cotton faster than it is opening access to the ginning of raw cotton. In the US, ginning is completed by private and public companies as well as grower-controlled cooperatives, which is similar to India and Pakistan. In Brazil, there is a drive towards private company ownership of gins, which may be a factor in ongoing price competitiveness of this part of the Brazilian industry.

Ginning costs will also vary as a function of seedcotton produced and the selling arrangements that relate to that seedcotton. Lastly, the ginning process has a direct influence on the quality of lint available for trade, which is why the sector is particularly important for export based countries like Australia. Inefficient or inappropriate ginning of cotton can damage the lint, leading to a price/quality discount for the cotton once it becomes available for trade.

The importance of maintaining the qual-

ity profile of Australian cotton should not be underestimated. One of the strengths of the industry is that instead of competing with bulk grade suppliers (like the US or Uzbekistan) for the majority of the cotton market, Australia competes for a smaller market of high quality cotton.

Simply, Australian cotton will be used in 100 per cent cotton clothing products versus blended or lower quality end products. A profile of production is provided by a post-ginning assessment that includes visual inspection in conjunction with High Volume Instrument (HVI) testing. Spinners continue to push for more non-visual assessments of cotton and the use of HVI machines in some countries has enabled marketers to service this demand.

Not all producing nations use HVI to describe their cotton for export. In fact, most countries still rely solely on visual inspection, so their quality descriptions tend to be less precise.

This is another factor behind the success of Australian cotton exports — they are well described, consistent and effectively matched to demand. In trying to protect the market for Australian cotton, the role of non-visual testing and assessment is likely to expand to include a number of new variables (Table 1).

The efficiency of HVI testing has been a factor in reducing the rejection rate or buyer default of internationally traded cotton. It is widely accepted that eventually

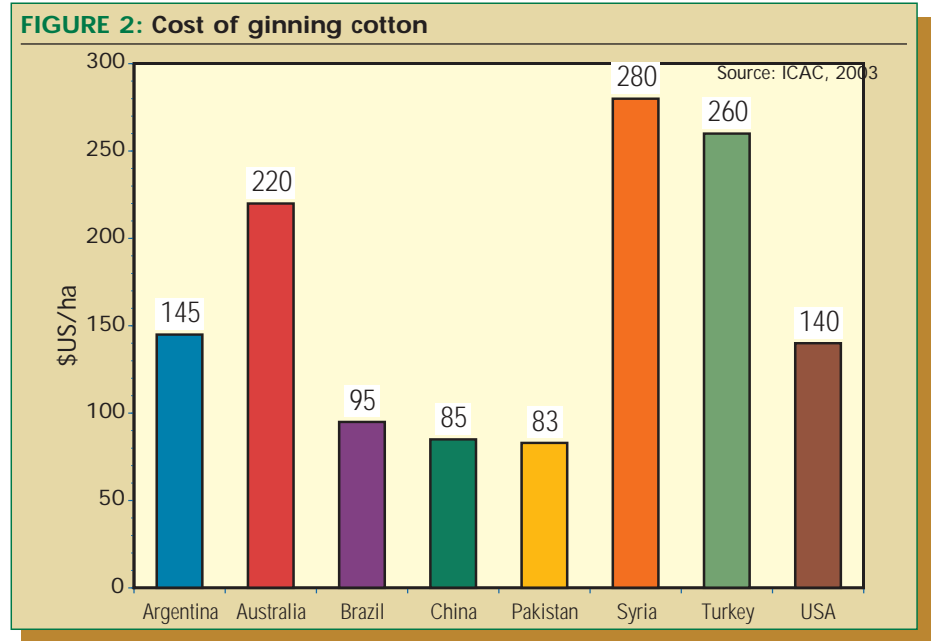
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HVI testing will become the norm for the cotton industry and being familiar with the process and its benefits/drawbacks can only be considered a positive.

HVI reports define the ability to trade cotton, but the characteristics measured using this technology reflect the intra-seasonal impact of untimely rain, general levels of water availability, heat units during boll development, damage from pest or weeds and variety planted. To some degree, HVI machines are one side of the market, while ongoing research into the agronomy of cotton has enabled producers to control some of the risk associated with fibre performance.

So while planting decisions in countries like Brazil or China are driven by potential cash income for arable land use the options are somewhat limited in Australia. As a result, industry has focussed heavily on variety performance, efficiency and fibre quality sustenance through the ginning process. Australia, while not as specific in its lint profile as Egypt or Syria, has maintained its position in the market based on fibre performance and reliability.

In part, this has been aided by the lumpy supply and fibre inconsistency of potential



competitors. With an efficient ginning and classing infrastructure and timely access to key markets for cotton imports, Australia is well positioned to service an ongoing demand for high quality cotton.

Competition already exists and can only be expected to increase over the longer term, yet localised constraints will continue to provide Australia with a window of

opportunity for success in the international market.

In the next step of the value chain analysis, Rabobank will provide an examination of the global trade of cotton — the competitors, destinations and issues to consider for the future.

Contact: Gillian Turco; Phone: +61 2 8233 8446. Email: gillian.turco@rabobank.com