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MARKETPLACE INSIGHTS

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Before discussing my U.S. and world numbers and reflecting on prices for the next 12 months I would like to again share my thoughts on the U.S. cotton industry both producing and consuming segments for the next 3 years.

Just to refresh our memory I have been speaking to this group for 17 years, and it continues to be an exciting and rewarding experience for me, as I share my thoughts with my biggest customer the U. S. cotton producer. We have witnessed during this time very high prices in cotton at nearly 114.00 cents in May 1995 and last season December traded at 28.20 on Oct. 26, 2001. When I spoke last season March cotton was trading at 37.40 and today March cotton is trading at 51.17 but you as producers probably received a higher return from price with March at 37.40 versus March today at 51.17. The loan deficiency payment created by the farm program is the name of the game not necessarily the futures price or the cash price.

Remember, over the last two years I have shared that it is hard for me to grasp completely a farm program that can return more when prices are low rather than when prices are high.

Let me also say we must, must have a U.S. farm program that allows American agriculture to survive and hopefully survive well. Even though you know I do not always agree with the economics I am supportive because I fear that without a farm program the same thing will happen to the U. S. cotton producer that has happened to your number one customer the U.S. textile industry.

You and I have witnessed the rapid deterioration of a great industry. It was just 5 years ago that we consumed 11.3 million bales, and this season; we will be fortunate to consume 7.5 million bales.

Just recently a U.S. textile executive whom I respect said that domestic consumption within five years would be a maximum of six million bales. I agree that is a distinct possibility but today I would question whether we would go much lower than 5.5 million bales. That would mean a loss of an additional 2 million bales from today's consumption level.

I have thought for about a year that other developed countries would continue to lose more of their textile industry than the U.S. In the next three years we will move to 2005 with complete elimination of world trade organization quotas.

We in the industry all know that it will be a battle to maintain the existing farm bill in its present form thru 2005. It can and must be done for our industry.

We know the South American countries and African countries are going to continue to attack us on the farm bill because they say we are attempting to destroy with low prices their potential for developing their own agricultural future. We must be on our toes and the National Cotton Council is our main stay for the future.

The other subject of vast importance is the U.S. textile industry, which we must try to maintain. The only government assistance they are receiving is through the step 2 marketing certificates, which today is 588 points. These payments are allowing them to modestly compete with Chinese and other countries that create exports of textiles to the U.S. The merchants, and cooperatives, receive like payment to make U.S. cotton competitive abroad. I think one thing that the government can do to help the U.S. textile industry improve is to better regulate textile imports. There are definitely illegal textile imports coming into our country.

My theme, as I live out my years in the cotton industry, is to support the U.S. cotton producer, and work to make the U.S. textile industry competitive with textile imports. These are my priorities.

I would like to share a few comments about Gaylon Booker's service to the National Cotton Council, and the cotton industry. As we know Gaylon will be retiring at the annual meeting in February.

Gaylon has been a servant, and a friend, to all seven segments during his tenure with the National Cotton Council. He has served us all well through out the years, as have his predecessors. I wish him a happy retirement and know he will always be on call to our industry. God has given us a special person for our industry, and I sincerely appreciate his life.

Now, let me turn the page and try to look at the U.S. and world cotton situation as I see it today. The numbers have certainly changed from my comments a year ago and so have prices, and all to the positive.

The final U.S. crop we see at 17.175 million bales versus USDA at 17.375 million bales so we have a few discrepancies in production. USDA projected domestic consumption at 7.5 million in their last report, and I think that is a good number. It could eventually wind up slightly lower by maybe 50 to 100 thousand bales. First and second quarter 2003 demand will determine that.

USDA is carrying exports at 10.8 million bales and our Dunavant number is 10.7 million bales. We have already registered for export 7.3 million bales and this time last season we had registered 9.363 million bales. As you can see by comparison we are running about 2 million bales behind in registering new export sales.

To meet my 10.7 million bales export number we must ship 250 thousand bales per week, and that is going to be a tall order but I think we can do it. When I discuss China I will comment on their importance.

When you put our U.S. production consumption and exports together we end up with a carryover of 6.4 million versus last years number of 7.4 million bales. USDA has a carryover number of 6.5 million so we are on target.

I would caution that, even though we are moving strongly in a bullish direction with supply, if we had had a favorable harvest in the Mid-South and Southeast, we probably would have produced a crop of nearly 19 million bales versus our 17.175 million bales. Rather than friendly, that number would have been very bearish.

Now let's review our world numbers versus USDA for the marketing year.

We think world production will be 87.5 million versus USDA of 87.4 million and final world consumption of 95.5 million versus USDA's number of 96.4 million. We definitely do not think we will meet USDA's expectations of world consumption. When you put all our numbers together the world carryover on Dunavant numbers will be 38.8 million the same as USDA's 38.8 million. However, this is a major draw down of world stocks from last season. We will reduce world carryover by 8.1 million bales - certainly friendly to prices versus a year ago. Our projected numbers, for 2003-2004 season, look even more friendly, and I will address those in my closing comments.

Now, let me be more specific on some producing and consuming countries that make up our numbers for the marketing year.

As always, China is number one. We think China will end up producing 21.5 million bales versus 24.4 million bales a year ago. I think the Chinese statistical bureau will release a higher production number than our 21.5 million bales, but I will stick with our number of 21.5 million bales. We think Chinese consumption will be 27.0 million bales a huge number and could be even higher as they take markets from other cotton consuming countries.

The Chinese carryover will drastically drop this season to 9.4 million bales versus 13.6 million bales last season. Yes, China will continue to be an importer of all growths in 2003.

We originally thought China would buy in the world 2.0 million bales and 1.2 million bales from the U.S. Through last week China has already bought from the U.S. 700,000 bales and we now project their U.S. Purchases will be 1.6 million bales for this marketing year. They have been more aggressive on the coarse count styles of cotton because the U.S. Price in december was cheaper than their domestic Chinese price, and so they bought a volume of U.S. Description slm 1-1/32 and 1-1/16 micronaire 3.5 and higher.

China has announced their import quota for 2003 of 3.9 million bales. They will not import the full quota and they will monitor their quotas with regulations. They will, in my opinion, place some road blocks to purchases, and they have always done this until they really need the cotton.

China will continue to be the major player in the U.S. and the world in purchasing cotton.

I would caution other cotton consuming countries to be aware that China is going to try and take their customers. China will continue to put pressure on Korea, Taiwan, Japan, Thailand, Indonesia and other developed countries. They will also exert pressure on developing countries such as Vietnam, Bangladesh, India, and Pakistan.

I think overall China today has better technology than other developing countries. I think over the next three years chinese cotton consumption can go from this years number of 27 million to 29.0 million. We project a 2-½ percent increase in consumption each year through 2005-2006 crop year. The numbers speak for themselves.

Mexico and Turkey will be the other two major importers of U.S. cotton this season and Mexico will import 1.95 million bales of cotton and 1.93 million will come from U.S. Because of NAFTA and price. They have already purchased 1.96 million from the U.S., which is the bulk of what they will buy. Their purchases will exceed my projected number but it will not all be shipped during this marketing year.

Turkey is another major importer of U.S. cotton. Up until recently they had been concentrating on buying Turkish cotton but have recently started buying other growths especially U.S. Turkey imported 1.53 million bales from the U.S. Last season and we project they will import 1.3 million this season of which they have already contracted 496,000 bales of U.S. cotton. They need to become more aggressive in the weeks ahead to meet our number.

We project India and Pakistan will buy U.S. cotton in the weeks ahead but they also have been focused on buying local Indian and Pakistan cotton because it is cheaper.

Just recently we have been getting more inquiries from both countries. Pakistan has already bought a nice volume of pima cotton from California but very little upland.

India will produce 11.2 million bales this season. They would have had a disaster except for the late monsoon rains. Our numbers indicate that India will consume 13.5 million bales and buy 1.8 million bales in the world markets. Their high grade cotton will come mostly from Uzbekistan, West Africa, and Australia, and maybe some California SJV variety.

When one takes a look at Australia it is a disaster. They are experiencing a 100-year drought and it will certainly affect their cotton production. Last season they produced a crop of 3.25 million bales and of excellent quality comparable with California Acala. This season we see production at 1.6 million bales. They have no surplus water for irrigation and must depend on rain to finish out their crop. Australia has a very small textile industry so basically all their cotton goes export and is desired all over the world because their cotton is of high quality, long staple, and free from contamination. I cannot say that all foreign production is contamination free.

Just a few comments about manmade fiber. World manmade fiber consumption we project to be 158 to 161 million bale-equivalents this season versus 139 million bale-equivalents 5 years ago.

Prices for manmade fiber vary from country to country. In the U.S. The price for premium manmade polyester fiber is 58 cents per pound. In China the price is 48 cents per pound, and China has capacity to produce a tremendous volume. The price for manmade polyester fiber in Korea is approximately 44 cents per pound. Our projections show manmade fiber consumption will continue to grow and it is the major competitor for cotton. Fortunately cheap cotton prices have put pressure on manmade fiber during the last two seasons.

I sincerely hope the U.S. cotton industry is happy with the new farm bill. As I commented earlier, there will be repeated attempts to change and challenge the bill but I feel it will survive. The National Cotton Council has done a tremendous job in working for the industry and certainly deserves full recognition.

Now for the most difficult job in my speech projecting prices for the balance of this season and then taking a look at new crop projections.

We certainly have seen a dramatic change in cotton prices from a year ago. We have seen a move to the upside of about 14 cents for March cotton versus when I spoke to the Beltwide last year. There are a number of factors affecting price. First, we do have a substantial draw down in U.S. stocks of about 1 million bales this season. As stated earlier, the world carryover is going to drop to 38.8 million bales versus 46.9 million bales last season. Second, the availability of high grade cotton is quite limited as we can judge by what has happened to world price over the last 4 months.

Over the last 4 months world price based on the five cheapest growths has gone from 49.15 to 56.50 which reflects a shortage of 31 and better qualities in world markets. It will even get tighter in the spring of 2003.

You as producers want to know when will you receive a 10 cents a pound equity for your cotton this season. During the last 30 days equity prices have ranged from no equity to five cents. The lower the quality, and the higher the micronaire the greater the equity. Today a 31-3-34 in West Texas will bring no equity but a 41-4-33 will bring a $5 equity. In the world market it is all a game of price. West Texas high quality brings minimal equity while West Texas low quality brings a higher equity.

You will ask the question why no equity on high grade West Texas cotton when there is a world shortage. The answer is a West Texas stripper bale 31-3-34 will not produce the yarn counts that Uzbekistan, West African or Australian cotton does. That is one of the reasons the certificated stock is so large. The bulk of the stock is Texas cotton or lower strength Memphis eastern cotton.

This situation may change in March – april as we address the shortage of world price 31-3-35. Maybe and only maybe will U.S. West Texas cotton in 31 and better grades, and 34 and better staples, bring a premium in the spring.

The big issue in my mind is what will happen to the certificated stock of which the quality is generally good when the futures contract goes from march to may where there are 70,000 bales of below tenderable strength which must find a home in the cash market. Even though it is currently certificated stock it will not be tenderable on may because of the change in the strength requirements for the may contract. Cotton below 25 grams per tex will not be tenderable against the may contract. Maybe the differences between march and may solve the problem. The low strength cotton has value but at a discount and once that discount is realized then differences take care of the 70,000 bales of non-tenderable cotton.

This should definitely encourage cotton producers for the future to produce a fiber that has 25 grams per tex or better or they risk quality discounts that will be prohibitive. Quality has always been a problem but very low strength could carry a discount of 10 cents per pound. That’s a strong discount but it could happen.

In Memphis territory, and the southeast, loan options are worth zero to seven cents. If the quality is good-grade, staple, micronaire, and strength it will bring a commanding premium, which is more incentive if yields are comparable to pressure Delta and Pine Land, and Stoneville to give you better quality seed. I understand clearly that yield is very important but if the seed breeders don’t hear the producers and mills the future for U.S. cotton is very bleak if you want a premium.

What do I see for March and may futures as it relates to price? March futures in my opinion will range between 49 and 54 cents per pound once the difference between March – May spreads out to an appropriate level. When that occurs it may solve the level problem and the downward pressure may be over. If the holders of the certificated cotton find a buyer for the cotton that will also solve the difference and level situations.

We still cannot forget that commodity funds are 45% long and can always be a threat to lower price if they decide to liquidate. I believe the trade will be there to absorb their liquidation.

When the may futures contract rolls around and the May futures contract is stronger from a grams per tex perspective then may should trade 53-59 cents.

As we enter the spring the pressure on prices to the upside is weather in the U.S. and around the world for the 2003-2004 crop.

Now let’s look at our projected numbers for 2003-2004 crop in the U.S. and around the world. We project today we will plant 14.0 million acres in the U.S. and produce a crop of 17.5 million bales. Domestic consumption will take another hit going down to 7,350,000 but exports will remain firm at 10.9 million bales so the U.S. carryover stocks will be drawn down to 5.7 million.

However, we think world production next season will expand by about 8% going from 87.5 to 94.5 million bales, and world consumption will also expand, but not nearly as dramatically. World consumption will go from 95.5 million bales to 97.0 million bales a 1.6 % increase.

If these projections are met then the world carryover drops again from this season’s 38.8 million bales to a projected 36.3 million next season.

All these numbers are fairly constructive price wise.

At this point in time I do not think new December has the potential to drop below 52 cents and could have an upside of 65 cents.

Remember any problem with world production in 2003-04 could drive U.S. and world prices higher to well over 60 cents. However, this is January, and may is a long ways off, and we have a number of issues to deal with as I have shared today.

I would continue to recommend to U.S. growers to sell equities during this crop year at levels of 2 to 6 cents depending on quality. You don’t want your cotton to die in the loan because that can be expensive. Our U.S. carry over will be 6.4 million bales so some one is going to have cotton stocks on august 1, 2003. If you are friendly to the market you can buy call options, which is an excellent move for upside protection.

For 2003-2004 crop year I think it is too early to plan for marketing your crop.

I think it is interesting that we project nearly an 8% increase in world production but U.S. Production rises only slightly. It tells me that the world is certainly more price sensitive and responsive than the U.S. cotton producer. I think the nature of our farm program definitely creates this situation as I have shared earlier. Cotton futures prices for December need to rise to nearly 70 cents a pound to make cash prices better than the farm program protection.

If you are going to do anything for new crop I would sell equities not fix price. There are just too many questions marks for the future both up and down.

As always, I still believe China will be the key in 2003-2004.

Again, thank you for allowing me to share my thoughts for the next 12 months. In my sincere opinion, the National Cotton Council is by far our best ally for the future.