



**Rabobank**

**Media Release  
September 11, 2012**

## ***Cotton remains 'king' – but profitability challenged***

The outlook for the Australian cotton industry remains bright, however the decline in global cotton prices and the high Australian dollar are placing pressure on gross margins, leading some producers to question the role of cotton in their crop rotations, according to a recently-released report by Rabobank.

The report, '***Cotton's superior profitability to be challenged***', says that the cotton market is now trading at historically average price levels, while many cereal and vegetable oil crop prices are skyrocketing, which has led many to analyse cotton's comparative profitability.

Report author, Rabobank cotton analyst Tracey Allen says that while the average international price outlook will challenge growers' planting decisions, further price easing/reductions would need to occur before there was a widespread shift out of cotton in Australia.

"While we expect to see some pressure on the dryland cotton area, particularly from sorghum, we don't expect too much competition from alternative irrigated summer crops due to near record water availability and a favourable seasonal outlook," Ms Allen says.

### **Is cotton still 'king'?**

Australian cotton area has trebled to nearly 600,000 hectares since 2009/10, due to the upward trajectory in global cotton prices combined with the availability of water, according to the Rabobank report.

Ms Allen says the 2011/12 crop is shaping up to be the largest on record, however the weaker prices will place pressure on operating profits, with profits to be further squeezed in 2012/13.

"If cotton prices remain at average levels next season, dryland cotton gross margins could contract by up to 20 per cent (year-on-year), while irrigated growers could see their margins fall by up to 40 per cent," she says.

"While price impacts the cotton growers' gross margin, yield has a bigger influence – downside production is perceived as a greater threat than price risk, which may drive some dryland producers to look at sorghum or maize if they are worried about a dry summer."

As a result, Ms Allen says Rabobank expects to see a 30 per cent fall in the area planted to dryland cotton in 2012/13.

Conversely, irrigated cotton margins are expected to withstand the price pressure.



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“Good water availability is set to support strong yields, which is underpinning cotton’s position as the highest margin broadacre cropping option across all irrigated growing regions,” Ms Allen says.

### **Australia’s cotton industry’s revival**

The Rabobank report says that despite the anticipated marginal pullback in area planted to cotton this coming season, production is set to increase and reach a new record.

“While we expect a decline in the area planted to dryland cotton, irrigated production is expected to rise on the back of maximum water availability,” Ms Allen says.

“The good rainfall events over the past two years has given most irrigated growers water security for the next two to three seasons.”

Water use efficiency will continue to be a priority for the industry, Ms Allen says, and further initiatives will need to be taken to reduce the water required per bale.

“Another key priority for growers will also be the quality of their crop, with discounting commonplace in export markets if contracted specifications are not met,” she says.

“We have recently seen China become our biggest market, purchasing over 60 per cent of the 2011/12 crop, so supplying cotton that exceeds their quality expectations will help us capitalise on the opportunities of supplying this Asian cotton milling hub.”

### **The international outlook**

Rabobank’s report shows the elevated cotton price over the previous two seasons has swung the international cotton market from a production deficit to surplus supply, with the 2012/13 stocks-to-use ratio expected to increase to a record 66 per cent.

Ms Allen says a common saying is that “high prices cure high prices”, and this is exactly what has happened in the cotton industry recently.

“The current price environment will now see the global cotton area decline in 2012/13, in favour of soy and corn crops, which have rallied on tight fundamentals and weather,” she says.

“This paints a promising outlook for Australian cotton growers in the medium term, as cotton prices will need to rise from their average levels to compete with alternate crops for acreage both locally and internationally.”

On the international stage, Rabobank expects the battle for acres to begin in earnest and this will bode well for the price outlook and our domestic industry.

The outlook, Ms Allen says, will be particularly bright for those Australian producers who can maximise their yields and fibre quality.



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**Media contacts:**

Denise Shaw  
Media Relations  
Rabobank Australia & New Zealand  
Phone: 02 8115 2744 or 0439 603 525  
Email: [denise.shaw@rabobank.com](mailto:denise.shaw@rabobank.com)

Jess Martin  
Media Relations  
Rabobank Australia & New Zealand  
Phone: 02 8115 4861 or 0418 216 103  
Email: [jess.martin@rabobank.com](mailto:jess.martin@rabobank.com)