Summer 2013

StaplReview



Advisory Board **Meetings**

President's Message: **Two Worlds**

Two Worlds



Meredith Allen
President & CEO

Today's global cotton fundamentals are puzzling. On one hand, we have the cotton world inside of China and, on the other hand, we have the cotton world outside of China. If one looks at China alone and ignores its central government's influence, the fundamentals are extremely bearish for cotton prices. If one looks at the world outside of China, the fundamentals are supportive of prices. So, which world are we living in today? I think, with cotton futures trading in the mid-80s, it is obvious we are trading in the world outside of China.

Traditionally, cotton traders have traded cotton fundamentals based on total world supply and demand. With China projected to end this coming season with 59 million bales of cotton, or 62% of world stocks, the traditional focus changes. While China is the largest single cotton consuming country, nearly 70% of the world's cotton consumption is located outside of China and collectively stocks in those countries are not burdensome. The Chinese central government holds a huge portion of China's oversupply and will have the final say on when and how those bales are released into the marketplace. For the past two years, China has supported cotton prices domestically and around the world by allowing for massive imports and by purchasing the vast majority of their domestically produced crop at prices above world cotton prices. As long as China continues to be a cotton importer and not an exporter, their stocks will continue to grow under the current policy. Chinese officials have acknowledged that their policy, which causes these increases in cotton stocks, is not sustainable; and, they have indicated they are likely to modify their price support system starting with the 2014 crop.

China

	Carryout	Stocks to Use
2004	18,388	47.72%
2005	22,536	50.04%
2006	20,536	41.00%
2007	20,504	40.16%
2008	21,366	48.47%
2009	14,246	28.48%
2010	10,603	22.99%
2011	31,081	81.67%
2012	50,006	138.62%
2013	58,931	163.36%

Rest of the World

	Carryout	Stocks to Use
2004	42,233	54.90%
2005	39,197	43.02%
2006	42,321	49.98%
2007	41,391	49.20%
2008	40,176	54.94%
2009	32,409	40.59%
2010	38,841	48.35%
2011	40,138	44.68%
2012	35,569	38.93%
2013	35,405	41.75%

So how will China alter its cotton policy? There are many schools of thought about this coming change. The majority of us believe that China will gradually encourage their farmers to reduce cotton acres and increase food production. They will have to change the current structure of their price supports to accomplish this reduction in cotton acreage. Most of us also believe they need to gradually increase cotton consumption. China's consumption has been badly damaged by the slow world economic recovery as well as the high domestic price of cotton in China versus much cheaper man-made fiber prices. Few believe the Chinese government will dump their excess cotton supplies on the world market as this would certainly cause a significant price decline and cost them (the government) the most money. Hopefully, the Chinese government will make policy changes over the next few years and avoid any abrupt change that could devastate cotton prices.

Regardless of how and when the Chinese government moves to address the excess supply, there will likely be some pain for all cotton producers in the world. Hopefully, the pain will be bearable and not erode the U.S. cotton infrastructure any further. These two cotton worlds that we currently live in can merge with much less price disruption if done slowly and methodically.

My hope is that the Chinese government will encourage more food production, less cotton production, and more cotton consumption. It seems that any country would prefer to be dependent on cotton imports rather than food imports; particularly when they find themselves sitting on multiple years' worth of reserves. If this turns out to be the direction of future Chinese agricultural policy, then the U.S. would have a bright future in cotton production as China

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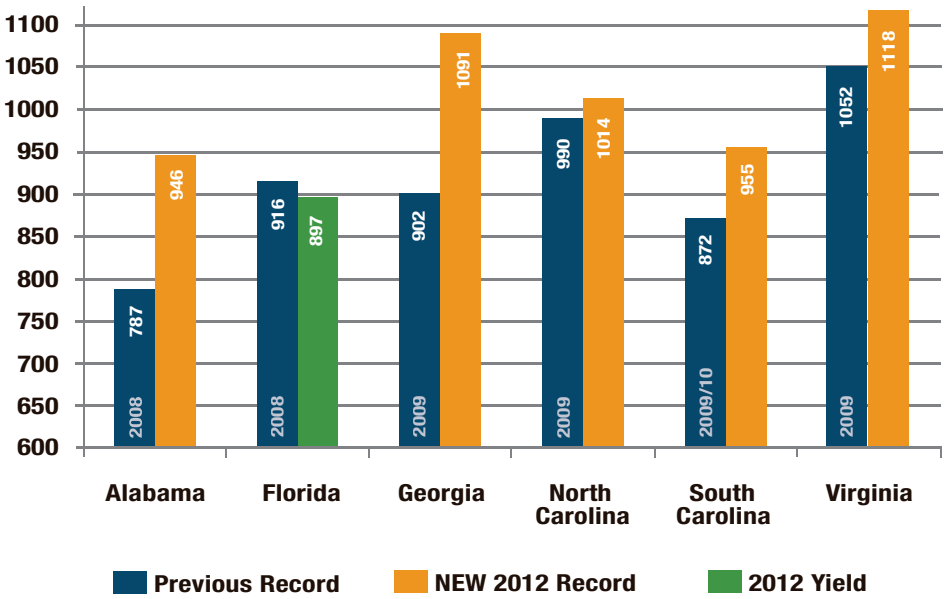
Advisory Board Meetings 2013

During the month of July, Staplcotn held its annual advisory board meetings in Albany, Georgia; Memphis, Tennessee; and at the main office in Greenwood, Mississippi. "We had a great turnout by both advisors and board members. It's always good to have face to face meetings with them, and it was a valuable exchange of information," said Shane Stephens, VP of Cotton Services and Warehousing.

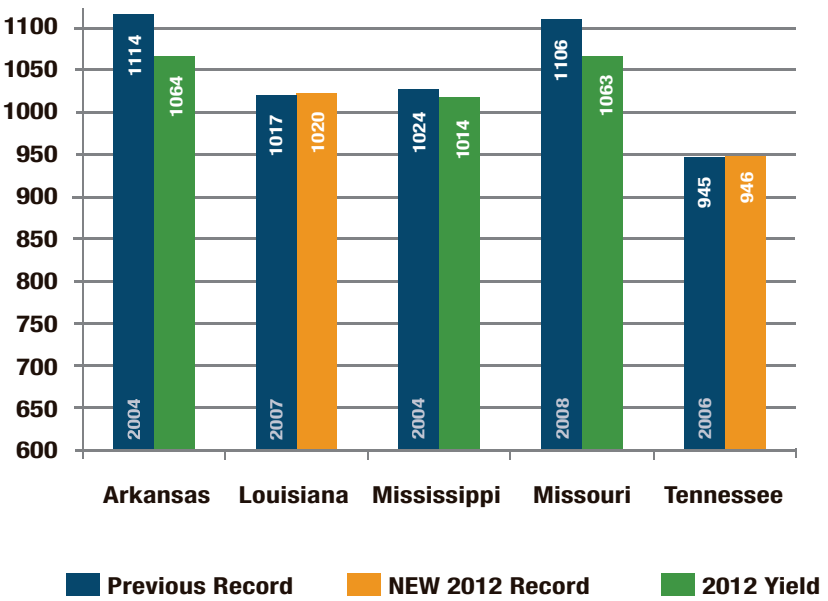
Staplcotn's advisory board consists of a good cross-section of members from all areas that Staplcotn serves. They are considered representatives of their area and are encouraged to give feedback, ask questions, and offer suggestions to management and staff on Staplcotn's performance. "It's very important to us that we keep good communication going between our membership and our staff. The members are our 'bosses' and we want to make sure that we are meeting their expectations," remarked Stephens.

This year's advisory board meetings included remarks by Woods Eastland, Board Chairman, and presentations by Meredith Allen, President and CEO; Frederick Barrier, VP of North American Sales; and Hank Reichle, VP of Export Sales and Market Administration. Allen's presentation reviewed the status of the three divisions (Cotton Marketing, Warehousing, and Stapldiscount). He explained the current world supply and demand status and how Staplcotn is monitoring the situation. Allen also discussed China's position in the cotton industry and how it affects the rest of the world (see Allen's article on left). Additionally, he illustrated the record yields that Midsouth and Southeast regions enjoyed with their 2012 crop. Particularly, Georgia enjoyed an increase of nearly 200 pounds per acre!

Southeast Yields for 2012



Mid-South Yields for 2012



Barrier's report to the advisory board included highlights regarding sales in the North American and Central American markets. He highlighted many factors, including import demand and the qualities our members produce, that have an impact

on where Staplcotn sells its cotton. "As a marketing team it is our responsibility to maximize the returns to our members based on the quality of cotton they harvest. Therefore, when we receive higher grade cotton from our members, we sell it to those customers who demand that quality and are willing to pay premiums for it. We are very pleased with the relationships that we have built in these markets and continue to serve them the best we can," he said.

Barrier also explained the current status of the Trans-Pacific Partnership (TPP) negotiations. Currently, the U.S. and Vietnam are in a "deadlock" over textiles. The main issue of contention is the "yard forward rule of origin." The U.S. supports the "yard forward rule of origin," which has been the standard textile rule in Free Trade Agreements (FTA) for the past 25 years. The "yard forward rule of origin" requires that yarn, fabrics, and the final garment (triple transformation) be produced within the FTA countries in order to get the benefits under the agreement. Vietnam is insisting on new rules of "single transformation" that would allow them to source textile fabrics and yarns from other countries, which are outside of the TPP agreement, and export them into the U.S. duty free. Independent studies (The O'Rourke Group) estimate a loss of over 500,000 jobs in a 10-year period in the U.S. apparel and textile platform if we allow Vietnam to circumvent the "yarn forward rule." They also estimate that the entire western hemisphere could lose up to two million jobs and that U.S. textile exports could drop by $6.7 billion. This could result in a possible two million bale reduction in U.S. consumption. The U.S. government opposes this proposal but is receiving a great deal of pressure to reach an agreement by October. Barrier encouraged all members to get informed about the TPP and contact

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Shane Stephens, VP of Cotton Services and Warehousing, welcomes Advisory Board Members to the Greenwood main office and introduces Staplcotn's staff and board members who were present at the meeting.

Two Worlds continued

and the rest of the world demand more imports from the U.S. Farmers are by nature optimists or they would not farm. Growing up on a farm and having worked most of my career for farmers, I am also an optimist. I believe we may have a few more challenging years in the cotton world, but I also believe the light at the end of the tunnel will grow brighter as our two cotton worlds complete the transition and become one cotton world again.

Meredith Allen

Sturdivant Named as Chairman-elect



During the June 2013 quarterly meeting of Staplcotn's Board of Directors, Woods E. Eastland, Board Chairman, announced that he would be retiring in 2014. It is Staplcotn's policy that the board then nominates a current board member to serve as Board Chairman upon the current Chairman's retirement.

Mike P. Sturdivant, Jr. from Glendora, Mississippi, was nominated by the 2012-2013 board to be Staplcotn's Chairman-elect. He has served on Staplcotn's board since 1992. The 2013-2014 Board of Directors will vote to approve the nomination in the September meeting.

Advisory Board Meetings continued

their legislators and provide input.

Reichle's presentation discussed Staplcotn's export market. Staplcotn sells cotton to more than 20 active countries worldwide. The three largest recipients of Staplcotn's cotton are China, Turkey and Mexico. Pakistan and Bangladesh are two other significant markets. In fact, Staplcotn ranked 48 in the Journal of Commerce's top 100 exporters of 2012. The world's largest retailer, Wal-Mart, ranked 47.

Reichle explained that foreign mills want U.S. cotton for several reasons. First, foreign production usually has a deficit and the U.S. production has a surplus. The U.S.'s ability to give volume offers and forward buying in addition to their reputation for being dependable are important to foreign mills. "The U.S. generally has reasonable transit times and is much quicker than Brazilian cotton, for example. Overall our logistics capabilities and favorable backhaul rates are advantageous. Additionally, HVI data is available on every bale of U.S. cotton, which benefits the mills. And, machine-harvested cotton from the U.S. generally has less contamination than hand-picked cotton in other countries," he said.

"We believe our approach to exports has worked really well for our membership," Reichle remarked. "We try to find the best home for your cotton by identifying reliable customers who want the qualities you've grown. We stick to our principles of fairness, honesty and integrity, and that is very important to them. They know they can trust us. Plus, we add value to your cotton through quality and logistics. We are able to offer volume to them, we ship them what we sell them, and ship it on time. Our sales people and Sales Operations, our in-house inventory management logistics team, work closely on this." Reichle also emphasized that Staplcotn's export sales and domestic sales complement each other. "Domestic mills' quality requirements rarely overlap with what the foreign mills require, and that helps tremendously with marketing to both and giving our membership the best return possible for their cotton."

Bylaws Votes Are In

In April of 2013, Staplcotn members began casting ballots approving or disapproving proposed changes to the Articles of Association and Bylaws of Staple Cotton Cooperative Association and to the Bylaws of Staple Cotton Discount Corporation. Approval of the proposed changes required the affirmative vote of more than 50% of the entire membership.

While the official vote is not final, we are pleased to announce that an overwhelming majority of the membership has cast their vote in favor of the proposed changes, and we very much appreciate the attentiveness of our members in this matter. The Board of Directors should formally adopt the changes at the September meeting.

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Allen Named to Federal Reserve Bank Industry Council

Meredith B. Allen, President & CEO, has been named to the Agribusiness Industry Council of the Federal Reserve Bank of St. Louis. The St. Louis Fed created four District Industry Councils in 2006, each designed to provide the Fed with important feedback regarding economic conditions within a key Eighth District industry sector. The members' observations—along with the economic data and information developed through the Federal Reserve's Beige Book, the St. Louis Fed's Burgundy Books and meetings of the Reserve Bank's boards of directors—help ensure that conditions of Main Street America are represented in monetary policy deliberations in Washington. Each council is based in one of four of the Reserve Bank's offices: Memphis (transportation), St. Louis (real estate), Little Rock (agribusiness) and Louisville (health care). The councils meet twice a year.

The St. Louis Fed is one of 12 regional Reserve banks that, along with the Board of Governors in Washington, D.C., comprise the Federal Reserve System. As the nation's central bank, the Federal Reserve System formulates U.S. monetary policy, regulates state-chartered member banks and bank holding companies, provides payment services to financial institutions and the U.S. government, and promotes community development and financial education.

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