Media Release

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Wool growers urged to forward sell now to manage risk ahead of likely slowing demand

With wool prices still at record highs despite last week's drop, agricultural commodities risk management specialist Southern Aurora Markets is urging growers to consider hedging by forward selling a portion of their clip as a buffer against a likely price downturn driven by declining demand.

Southern Aurora Markets Partner – Wool Mike Avery said that the Australian wool market was in uncharted territory. Even with supply forecast to decline another 1.7% in 2018/19, the record prices currently being enjoyed by the industry are unlikely to last.

"Generally, when prices rise at the rate they have this year, which are 35% up on last year, we see some degree of demand destruction," said Mr Avery. "21-micron prices alone have risen 53% during the year.

"These price rises have led to cash flow difficulties along the pipeline from exporter to processors. Funding pressures and fluctuating currency movements have increased the "just in time" mentality of the market and are likely to lead to more of the volatility that came into play last week.

"Processors have exhausted any moderately priced stock and are unable to pass the full extent of price rises down the chain. This will lead to changes in blend ratios and substitution. The extent of the changes will be dictated by the nature of the yarn or garment and its end use. Against this negative impact are the facts that in China, the major wool import country, there remains low greasy stock and an over capacity of combing space."

Mr Avery said adopting a hedging strategy based on forward selling a portion of their wool clip at the current high prices would assist growers in providing insurance against likely price volatility in the future.

"Last week's price drop has not been felt as severely on the forward markets and highlights the value of considering hedging to manage volatility.

"Hedging is a price risk management strategy designed to minimise exposure to market risk associated with changes in supply, demand and price. It should be considered as a long-term margin management tool and is about valuing certainty over the fear of lost opportunity.

"By locking in a percentage of your clip now at the current spot prices and available forward prices - 2000 to 2200 cents a kilogram for 21 micron wool in spring and summer and over 1900c/kg into the New Year - is a compelling argument for managing cost of production and to ensure margins.

"In terms of what percentage of your clip to hedge, a conservative figure would be between 20 to 30% to cover the risk of a significant retraction in price.

"De-risking the business also has a positive impact on the cost and ability to obtain funding."

Southern Aurora Markets offers the Riemann Wool cash settled 'over the counter' (OTC) forward contract, which is based against the Australian Wool Exchange (AWEX) nominated
Micron Price Guides (MPG) mid-point price of the North and South MPGs.

Example of how a wool forward contract works, assuming the contract is placed in July 2018

A wool grower is expecting to shear around 300 bales (36,000 clean kg) of average 21 micron wool in December 2018. His strategy is to hedge a third of his total exposure.

An exporter/processor is looking to lock in a forward price to provide margin cover for a 21 micron export order he has sold in December at 2050c/kg.

Wool grower offers the Riemann 21.0 AWEX MPG Contract for 12 December at 2050c/kg for 12 tonnes	Exporter bids the Riemann 21.0 AWEX MPG Contract for 12 December at 2050c/kg for 4t

The grower and export execute the forward hedge with each other at 2050c/kg. **The contracts are cash settled against the AWEX Auction MPG to mature on 12 December.**

On 12 December, the physical market has fallen to 1990c/kg.

The grower sells his wool for 1990c/kg at auction. His hedge settles at 1990c/kg. He receives a cash adjustment of 2050c/kg – 1990c/kg = 60c/kg. His nett return is 2050c/kg – 1990c/kg via his auction sale plus 60c/kg on his hedge.

The exporter goes to the auction and buys the wool required to fulfil his contracted export sale at 2050c/kg (the wool purchased is not necessarily from the wool grower with whom he has executed the forward contract). The wool he buys costs 1990c/kg. His cash settled adjustment is 1990c/kg – 2050c/kg = minus 60c/kg. The exporter's nett cost for the wool to fulfil his contract is 2050c/kg (1990c/kg plus 60c/kg), which he pays the grower via the hedge.

Both parties achieved their strategic aims. The wool grower locked in a forward price and was not exposed to market fluctuations. The exporter was able to lock in his

margin on his forward export sale without buying stock incurring interest and storage.

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About Southern Aurora Markets
Southern Aurora Markets is a solutions provider to the agricultural commodities market, providing effective risk management tools, liquidity and strategic advice to sellers, buyers, banks and investors.