

# Wool exporting and risk management

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# 1. Introduction

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## Exporting, Documentation and Risk Management

- ❑ Risks in 'exporting wool' are carried by the *exporter*
  - ❖ Financial capacity
  - ❖ Specifications
  - ❖ Logistics
  - ❖ Risk
- ❑ Wool preparation for shipment
- ❑ Documentation and logistics
- ❑ Risk management

## 2. Preparation for shipment – certification and documentation

- Initiate sale – ‘liquidate long’ or ‘go short’
- Prepare wool for shipment
- Delivery to port
- Pre-shipment documents and certification

### 3. Methods of payment – export documents

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- Letters of credit (L/Cs)
- Open account – TT, DP sight DA term
- Export documents – invoice, insurance, bill of lading
- Negotiation

## 4. Exporting options

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- ‘Fixed’ or ‘floating’ ? – Fixed
- AUD, USD, Euro, Yen? – AUD and USD
- EXW, FOB, CIF, DPP – CIF

# 5. Risk management

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- Always undertaking risk when trading wool
- Identify the risks
  - price risk
  - basis risk
  - counter-party risk
  - organisational risk

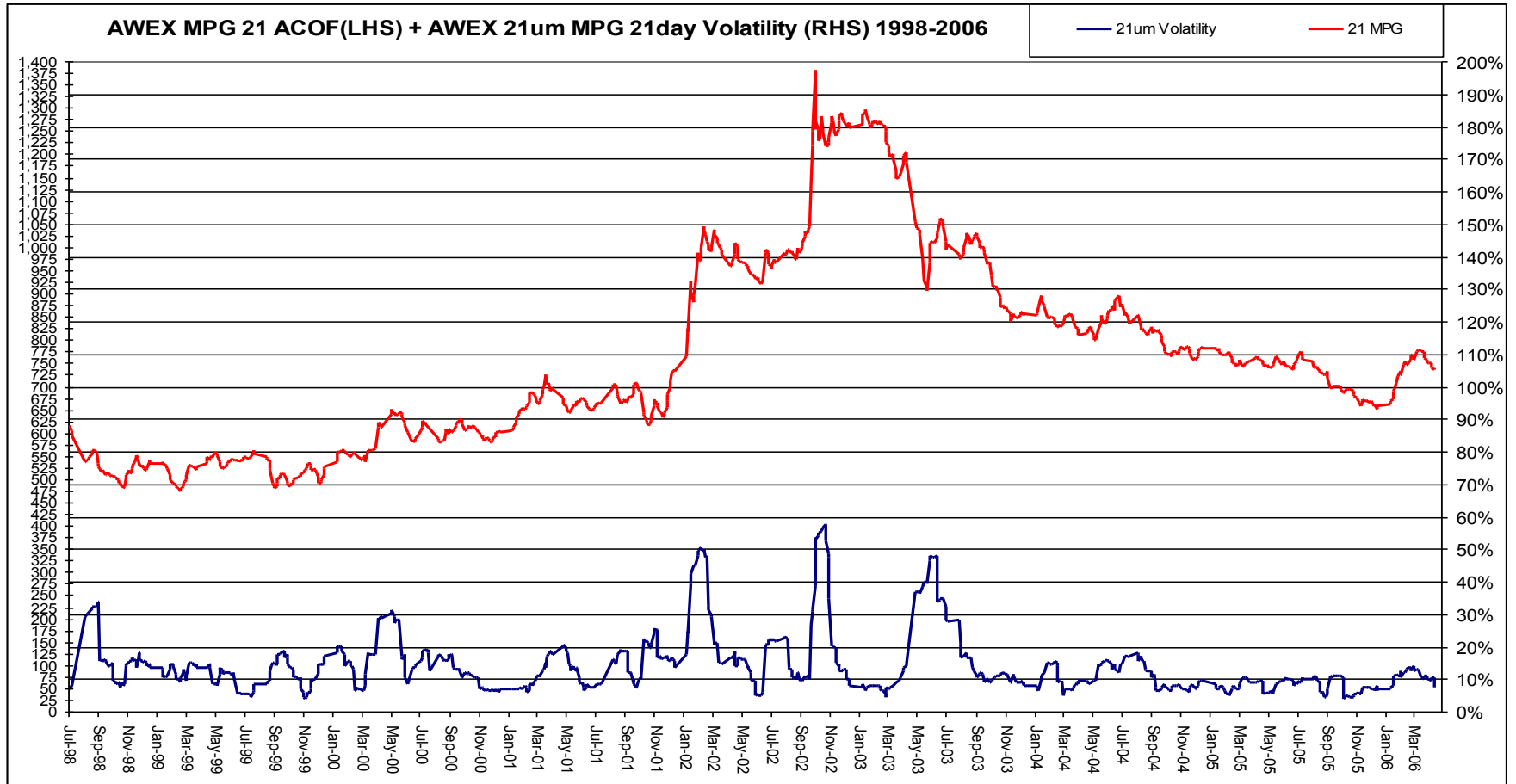
## 5.2 Price risk

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- Positional situation in the market
- Long = bought position, rising prices are favourable
- Short = sold position, falling prices are favourable
- Desired price risk needs to be targeted

# 5.2 Price Risk

- 21um price variation & volatility





## 5.2 Basis risk

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- Bought and sold positions that are not matching.
- Positions differ by:
  - Quality, micron and/or type
  - Time

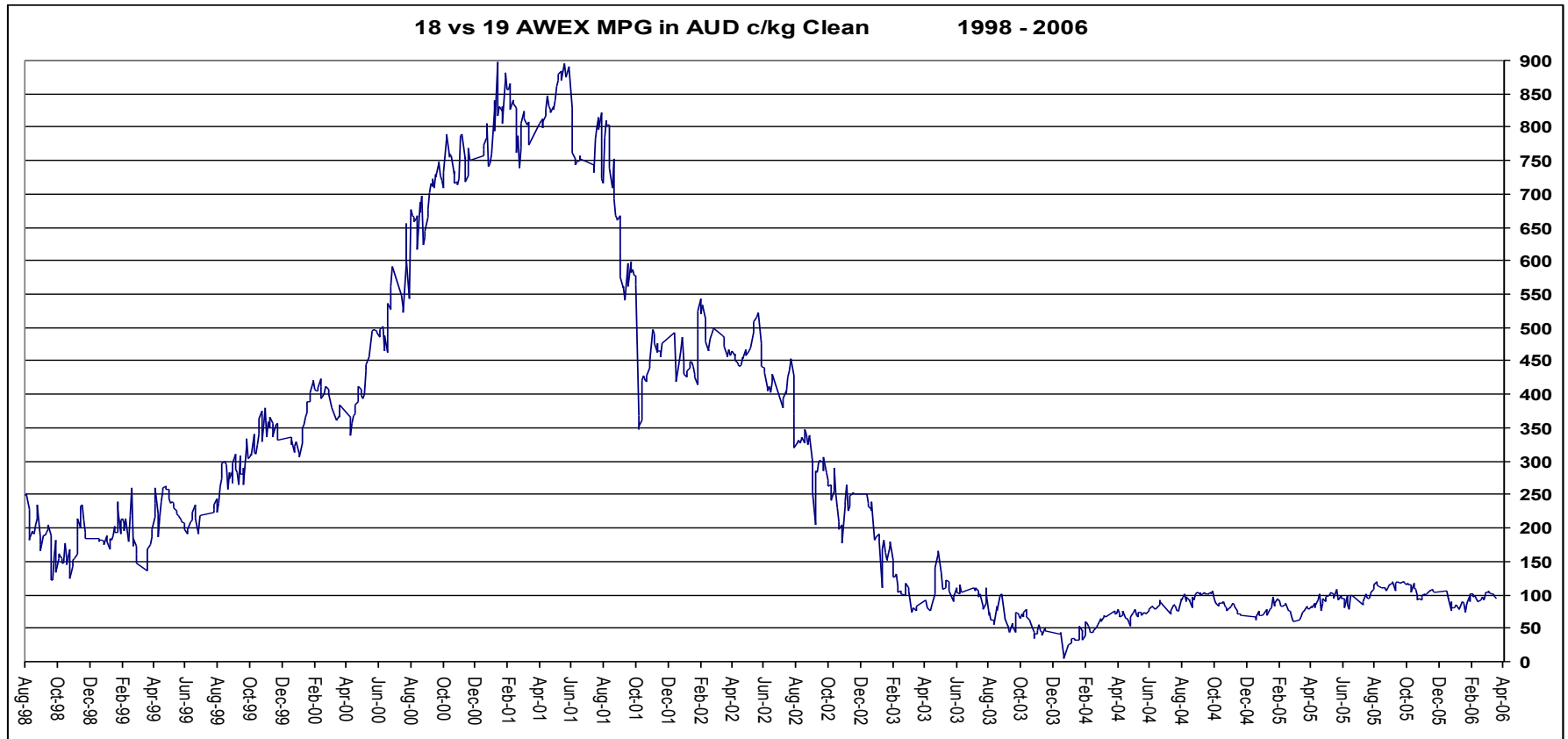
## 5.2 Basis risk: type

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- Bought and sold the same micron, but the quality, or 'type' differs
- 21um example:
  - China type 30 nkt 70% Scd yld
  - vs
  - Indian/Euro type 3537nkt 70% SchD yld
- Difference after yield

## 5.2 Basis risk: micron

- Bought and sold the same type, but the micron differs: 19 vs 21 and 18 vs 19 eg.s



## 5.2 Basis risk: time

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- Bought and sold the same type, but – the time value differs:
  - bought (long) stock in the spot cash market
  - or long/short physical or cash settlement in the forward market
- Structure of forward price ‘curve’ affects position and profitability

## 5.2 Measuring price risk

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- What amount of \$ risk exposure does the trader want?
- The \$ risk needs to be measured:
  - scenario testing, best/worst – risk/reward etc.
  - VAR: Volatility, time and liquidity values are ‘stress’ tested
- \$ Risk needs to be matched to trader’s ‘propensity’

## 5.2 Managing price and basis risk

- Target ‘desired’ price and basis positions
- Avoid inadvertently inherited ‘overbought and ‘oversold’ positions
- Effectively structure trades within the position (book)
- Efficiently and accurately report the position

Wool Position		Time													
Micron	Type	Spot	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	
19um	MF4 India	200	-100												100
	MF5 China				-50										-50
	Futures				50										50
		200	-100	0	0	0	0	0	0	0	0	0	0	0	100
21um	MF4 India	50	-250												-200
	MF5 China														0
	Futures														0
		50	-250	0	0	0	0	0	0	0	0	0	0	0	-200
<b>Total (ALL)</b>		<b>250</b>	<b>-350</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-100</b>

## 5.2 Pricing points (execution options) in the wool market

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- Spot (cash) markets:
  - Physical buying/selling in auction or ex-auction markets
- Forward markets
  - Forward physical buying or selling on a domestic or (usually) export basis
  - Derivatives:
    - SFE – 19, 21, 23 futures and options
    - ASX – 19.5, 21, 22.6 futures (China types)
    - over-the-counter (OTC) products, swaps and basis products

## 5.3 Counterparty risk

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- Client credit risk:
  - risk of non-payment by the buyer
- Major risk for the Australian exporter
- Manage via:
  - information
  - limit application and diversification
  - minimise 'time' exposure
  - maximise confidence in contract and export terms



## 5.4 Other risks

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- Organisational:
  - inadequate human resource
  - inadequate financial resources
- Supply and demand risks:
  - inability to delivery contracted quantity or quality
  - global demand shocks
    - conveyed by price and liquidity
    - Asian crisis, SARS, bird flu

**THE END**

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