Wool exporting and risk management

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Elders/BWK Ltd

1. Introduction

Selling and exporting wool from Australia is one of the nation's oldest and most prominent industries. While this country no longer 'rides on the sheep's back', the wool industry is still a very important part of the nation's economy. With the benefit of this time and experience, marketing Australian wool offshore is also one of the most competitive export industries in Australia. Whether they are selling one bale airfreighted to Europe or exporting 50,000MT to China, the participants in this market are constantly under pressure to manage the risks inherent in the business and maintaining any competitive advantage obtained.

Broader components of the role of and functions performed by the wool exporter are also covered in other segments of this course. This module will focus primarily on exporting risk management as well as the selling options and documentation involved in being a participant in the industry, highlighting the issues from an exporting and trading perspective in an ever-changing commercial environment. Examples of this change in the last 15 years include the abolishment of the Reserve Price Scheme; restructuring of the global processing (demand) base from USSR, Japan, Europe and Australia to India and Asia, especially China; the Asian financial crisis; liquidation of the wool stockpile and recent drought-induced supply shocks. This module discusses the risks associated with these changes and some of the processes for managing those risks.

While the intricacies of supply and demand fundamentals that drive wool prices are beyond the scope of this text, the subsequent changes to price and resource structures and their consideration are addressed.

Wool exporters that operate with any relevant capacity or scale need to employ considerable logistic and trading resources, combined with adequate balance sheet funding to viably function in this market.

2. Preparation for shipment, delivery certification and documentation

Two basic options exist for the exporter in accumulating and originating wool for export:

- sell a specified or type parcel from previously accumulated stock (sell from a 'long' stock position)
- accumulate to sales made from a starting position of no wool stock (sell, from a 'short' position).

Either way, once the wool is ready to be delivered and shipped at the pre-determined delivery/shipment time, a pre-shipment preparation and documentation process is initiated.

The difference between the first cost of the wool and export price transacted is the logistic or 'bareme' cost involved in exporting; this is covered in more detail in another module.

2.1 Batching and preparation to specification or type

Most exporters use a specifically developed computer system, (either in-house or externally provided) to 'batch' an export parcel, typically 90-140 bales (or a container), to the minimum specification and/or type set out by the contract of sale.

This can be done prior to moving to port/dump in up-country warehouses or at a port/dumping facility.

The subject of building consignments for export is covered in more detail elsewhere in the course.

2.2 Delivery to port

Once a vessel is assigned and booked for export the wool needs to be moved to the port and 'dumped' prior to the cut-off deadline for that vessel's departure.

The dumping facility will prepare the order to fit in the assigned container, typically in single bale or tri-packs (three bales compressed into one by hydraulic pressure). Mark the bales (countermarking) to identify the shipment. Then move the wool to the container terminal for loading onto the vessel.

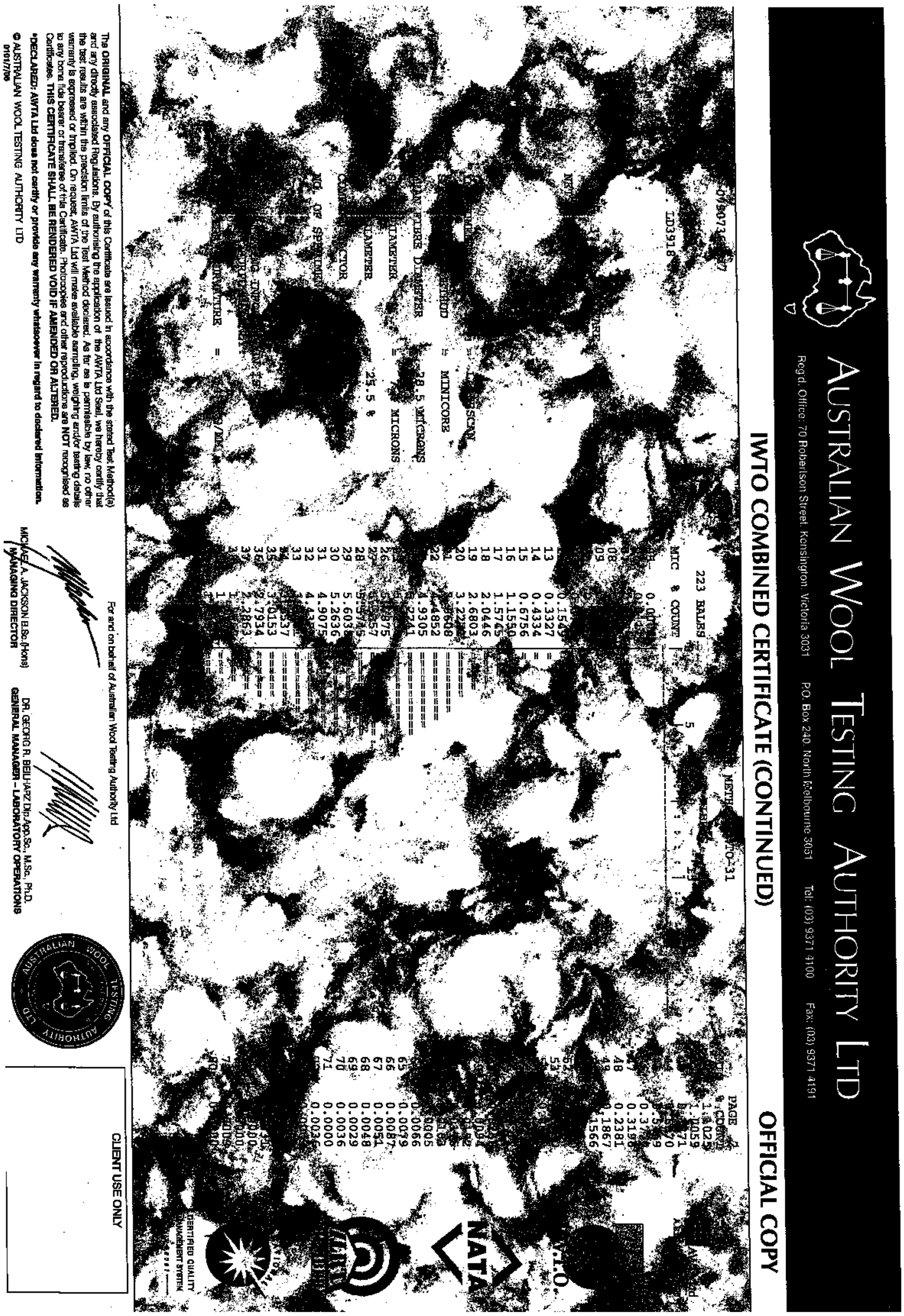
2.3 Pre-shipment documentation and certification

The majority of greasy wool sales/exports from Australia are made subject to IWTO terms and conditions, which predominately utilise Australian Wool Testing Authority (AWTA) results as the standard for the contract.

At this stage in the export process, certain documentation is gathered prior to shipment that will be used in finalising the export documentation. Examples of this documentation include:

- AWTA and AWEX certificates
- Invoice and Packing lists
- Shipping Advices, References, Re numbers and EDNs
- Insurance Certificates
- Health Certificate
- Certificate of Origin
- Beneficiary Certificate.

The following are some examples of these documents.



AUSTRALIAN WOOL TESTING AUTHORITY LTD

Regd. Office: 70 Robertson Street, Kensington, Victoria 3031 P.O. Box 240, North Melbourne 3051 Tel: (03) 9371 4100 Fax: (03) 9371 4191

IWTO COMBINED CERTIFICATE (CONTINUED)

OFFICIAL COPY

For and on behalf of Australian Wool Testing Authority Ltd

CLIENT USE ONLY

AWTA Certificate (partial)

Exporter		CERTIFICATE No.
AWTTC TEXTILE DR WARRNAMBOOL, VICTORIA 3280 AUSTRALIA		EXPORT REF LD3916
Consignee TO ORDER	Buyer(If no consignee)	

Certificate of Australian Origin

Victorian Employers' Chamber of Commerce and Industry
Agent for the Australian Chamber of Commerce and Industry
3rd Floor, 196 Flinders St
MELBOURNE VIC 3000
AUSTRALIA
Telephone: 61 3 8662 5333
Facsimile: 61 3 8662 5201
Email: icd@vecci.org.au

AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY
24 BRISBANE AVENUE
BARTON ACT 2600
AUSTRALIA
ACN 008 391 795
TELEPHONE 612 6273 2311
FAX 612 6273 3196
Authorised to issue Certificate of Origin by the Government of the Commonwealth of Australia

PORT LOADING	
MELBOURNE/FREMANTLE	
VESSEL	DATE OF DEPARTURE
MOL GOLDEN WATTLE 112	on or about 25/05/2006
Port of Discharge	Final Destination
SHANGHAI CHINA VIA SINGAPORE	SHANGHAI

Marks and Numbers	Number and Kind of Packages	Description of Goods	Export Statistical Code	Gross Weight
LD3916 T424FNF SHANGHAI SERIAL NO.	223	BALES OF AUSTRALIAN GREASY WOOL		37710 KGS

SAILING 22/5/06 MELBOURNE on/or about
SAILING 28/5/06 FREMANTLE on/or about

I, the undersigned, being authorised by the above exporter, and having made necessary enquiries HEREBY CERTIFY THAT based on the rules of the origin of the country of destination/printed on the reverse hereof all the goods listed above originate in AUSTRALIA. I declare that I will furnish to the Customs authorities of the importing country of their nominee, for inspection at any time such evidence as may be requested for the purpose of verifying this certificate.

The goods were produced/manufactured at

AUSTRALIA

SIGNATURE OF EXPORTER

I, the undersigned, being duly authorised by the Victorian Employer's Chamber of Commerce & Industry to sign documentary evidence of origin, hereby certify that on the basis of information supplied by the exporter and to the best of my knowledge and belief the country of the above-mentioned goods, based on the rules of origin by the exporter is AUSTRALIA.

SIGNATURE OF AUTHORISED OFFICER

Victorian Employers' Chamber of Commerce and Industry

DATE

23/05/2006

273205 MAY 24

Melbourne, Australia

Certificate of Origin

AWTTC
TEXTILE DR
WARRNAMBOOL, VICTORIA 3280
AUSTRALIA

BENEFICIARY'S CERTIFIED COPY (IES) OF FAX

TO

WE HEREBY CERTIFY THAT THE FOLLOWING DETAILS HAVE BEEN DISPATCHED TO APPLICANT WITHIN 72 WORKING HOURS AFTER SHIPMENT ADVISING

DATE	28/05/2006		
CONTRACT NO.	2006RMC-009AU(LD3918)		
OUR REF.	LD3918		
L/C NO.	LC0621300702133		
NAME OF VESSEL	MOL GOLDEN WATTLE	112	
B/L NO.	MEFRSHAP065769		
SHIPPING DATE	MELBOURNE FREMANTLE	21/05/2006 28/05/2006	
COMMODITY	AUSTRALIAN GREASY WOOL		
QUANTITY		223 BALES	
WEIGHT		37710 KG 37264 KG 27580 KG	GROSS NET CLEAN
VALUE OF SHIPMENT		95702.60 USD	
ETA FINAL DESTINATION	SHANGHAI	14/06/2006	

For and on Behalf of
LOUIS DREYFUS AUSTRALIA PTY LTD

Beneficiary Certificate

3. Payment methods and export documentation

In conjunction with preparing the wool consignment for export, the exporter must engage a process that facilitates the desired method for collecting payment from the buyer (importer) of the wool.

There are two basic categories, predominately defined by payment risk, that wool can be exported by: documentary credit and open account.

3.1 Documentary credit (letter of credit, L/C)

A letter of credit (L/C) is an authority issued by a bank (applied for by the importer of the wool) requiring the recipient bank (typically the wool exporter's bank) to pay a sum of money to the recipient upon fulfilment of stipulated terms and conditions. This may be for 'sight' (immediate payment) or 'term' (payment on due date and discounted by the bank).

This method has traditionally been the most common practice to enable payment for wool exports in Australia. Mainly due to the changing structure of the demand base for Australian wool in offshore markets, a decent trading history has not been established to mitigate the inherent payment risks in exporting wool. This is slowly changing, and there has been a recent trend towards open account terms being established between the exporter and importer.

3.2 Open account

- Clean remittance from buyer in prepayment for the wool, for example, TT transfer
- Documents against payment (D/P sight), for example, documents (ownership) to be released only against payment.
- Documents against acceptance (D/A term), for example, documents to be released against acceptance of the bill, with subsequent presentment from payment on the due date (for example, term of 30/60/90/180 days).
- Clean remittance from the buyer after the wool is received.

With the exception of direct and clean prepayment transfers, open account payments put the exporter at considerably greater credit risk than L/C. The exporter can negate this risk by employing export finance to protect on payment default or demand a percentage deposit prepayment as security over market and geographical risk (cost of reshipping to a different destination).

This counterparty (credit) risk is addressed later in this module.

3.3 Export documentation

There are three documents that are essential in wool exporting:

- invoice – ideally details the information in the sales contract and the shipping details
- insurance – typically, marine insurance that insures the goods during transport, which can include pre and post-ship storage periods

- bill of lading – the contract of affreightment and the document of title to the goods. Bills of lading are fully negotiable instruments. Transfer of the bill of lading transfers ownership of the goods from one party to another
- Depending on the payment category, additional documentation may include:
    - letter of credit
    - documentary sight bill of exchange – documents against payment (D/P)
    - documentary term bill of exchange – documents against acceptance (D/A).

For the exporter preparing, delivering and negotiating these documentation and payment processes is a very intensive, detailed and exacting procedure. Any breach of expiry dates on documentation, discrepancies in document details or problems with document delivery may result in payment problems, which can result in default, especially if the market has moved adversely against the buyer (for example, depreciated in price versus the contract).

This organisational resource risk is addressed later in this module.

The following are examples of export documentation:

AWTTC
TEXTILE DR
WARRNAMBOOL, VICTORIA 3280
AUSTRALIA

COMMERCIAL INVOICE FOR AUSTRALIAN GREASY WOOL

ORDER NO LD3918

INVOICE NO :LD3918
DATE :28/06/2006

INVOICE TO

COUNTERMARK
LD3918
T424FNF
SHANGHAI
SERIAL NO.

VESSEL	: MOL GOLDEN WATTLE 112
LOAD PORT	: MELBOURNE/FREMANTLE
FINAL DESTINATION	: SHANGHAI,CHINA
DISCHARGE PORT	: SHANGHAI, CHINA VIA SINGAPORE

TOTAL BALES 223

TOTAL GROSS KG 37710 TOTAL TARE KG 446 TOTAL NET KG 37264

37264	NET KG @ YIELD 74.00 % Scoured 16% regain yield 27580 CLEAN KG		
27580	CLEAN KG @ USD 3.470	USD	95,702.60
	TOTAL CHARGES		
	CIF SHANGHAI	USD	95,702.60

Description of Goods and/Or Services
27,580.00KGS CLEAN SCOURED WEIGHT ON IWTO SCOURED YIELD 16PCT
REGAIN AUSTRALIAN GREASY WOOL, T424FNF,28.8MIC MAX ANY LOT ,
100 PCT ALL FLEECE,0.8 PCT VM MAX AVE,1.8 PCT VM MAX ANY
LOT,SCOURED YIELD 73 PCT MIN AVE,4.5 INCHES UP,IWTO COMBINED
CERTIFICATE OR COMBINED CALCULATION OR COMBINATION REPORT
ISSUED BY AUSTRALIAN WOOL TESTING AUTHOUITY LTD.
UNIT PRICE: USD 3.47/KG CIF SHANGHAI, CHINA
TOTAL VALUE: USD95,702.60
2006RMC-009AU(LD3918)
COUTRY OF ORIGIN:AUSTRALIA
ALL OTHER TERMS AND CONDITIONS AS PER CHINATEX'S GENERAL TERMS
AND CONDITIONS COVERNING PURCHASES OF WOOL AND WOOLTOPS DATED
JULY 1, 1990
PACKING: BE PRESSED AND PACKED IN STANDARD EXPORT PACKING
PRICE TERMS:CIF SHANGHAI, CHINA
L/C NO. LC0621300702133
CONTRACT NO. 2006RMC-009AU(LD3918)

WPDOI101 V8.00

Commercial invoice

AWTTC
TEXTILE DR
WARRNAMBOOL, VICTORIA 3280
AUSTRALIA

Booking Ref: 0-811

Page No:

B/L No.: MEFRSHAP065769

PIL

PACIFIC INTERNATIONAL LINES (PTE) LTD
(Incorporated in Singapore)
CO. REG. NO. 196700080N

PORT-TO-PORT OR COMBINED TRANSPORT BILL OF LADINC

Received in apparent good order and condition except as otherwise noted the total numbe packages or units enumerated below for transportation from the Port of Loading (or the Plac Receipt if mentioned below) to the Port of Discharge (or the Place of Delivery if mentioned bel subject to all the terms and conditions hereof, including the terms and conditions on the reve hereof. One of the signed original Bills of Lading must be surrendered duly endorsed in excha for the Goods or delivery order. In accepting this Bill of Lading, the Merchant expressly acc and agrees to all the terms and conditions hereof, including the terms and conditions on reverse hereof, and the rights and liabilities arising in accordance with the terms and condit hereof shall (without prejudice to any rule of common law or statute rendering them bindin the Merchant) become binding in all respects between the Carrier and the Merchant as the the contract evidenced hereby had been made between them.

Consignee (not negotiable unless consigned "to order" or "to order of" a named Person or "to order of bearer")

TO ORDER

Notify Party

Vessel and Voyage Number	Port of Loading	Port of Discharge
MOL GOLDEN WATTLE 112	MELBOURNE/FREMANTLE AUSTRALIA	SHANGHAI CHINA VIA SINGAPORE
Place of Receipt*	**Place of Delivery***	**Number of Original Bs/L**
MELBOURNE/FREMANTLE AUSTRALIA	SHANGHAI CY, CHINA	

PARTICULARS AS DECLARED BY SHIPPER - BUT WITHOUT REPRESENTATION AND NOT ACKNOWLEDGED BY CARRIER

Container Nos. / Seal Nos. Marks / Numbers	No. of Containers / Packages / Description of Goods	Gross Weight (Kilos)	Measurement (cu-metres)
LD3918 T424FNF SHANGHAI SERIAL NO.	2 X 20GP CONTAINERS SAID TO CONTAIN 223 BALES OF AUSTRALIAN GREASY WOOL LINK BILL SHIPPED ON BOARD EX.MEL ON 21/05/2006 EX.FRE ON 28/05/2006		
PCIU3496656 Seal:A2373786 EX.MEL	112 BALES	19943.000	
PCIU3890485 Seal:F039040 EX.FRE	111 BALES FREIGHT PREPAID SHIPPED ON BOARD SHIPPERS LOAD AND COUNT FCL/FCL CY/CY	17767.000	

FREIGHT & CHARGES

Total number of containers or packages received by the Carrier (in words)

TWO (2)

Shipped on Board Date: 28 MAY 2006

Place and Date of Issue: MELBOURNE 28 MAY 2006

In Witness Whereof the number of Original Bills of Lading stated above have been iss of the same tenor and date, one of which being accomplished, the others to stan

Signed for the Carrier,
PACIFIC INTERNATIONAL LINES (PTE) LTD

* applicable only when this document is used as a Combined Transport Bill of Lading

COPY NON-NEGOTIABLE

Bill of lading

Lumley General Insurance Ltd

Lumley General Insurance Ltd, Victoria 99 King Street,
Melbourne 3000 Phone (03) 8627 4333 Fax (03) 8627 4234
ACN 000 036 279 ABN 24 000 036 279

Certificate of Marine Insurance

CERTIFICATE NO: [redacted]

ORDER NO: LD3918 **COPY**
(FULL SET CONSISTS OF 3 ORIGINALS, 1 COPY)

THIS IS TO CERTIFY that insurance has been effected in the following terms for goods as specified for the Account of: Louis Dreyfus Australia Pty. Ltd. As per open policy no. 7CP/2589060

For and on behalf of Lumley General Insurance Limited

Managing Director

Conveyance/Ship: MOL GOLDEN WATTLE 112 From: MELBOURNE/FREMANTLE To: SHANGHAI, CHINA

Via/To: SHANGHAI VIA SINGAPORE Sailing: 22/5/06 MELBOURNE on or about
28/5/06 FREMANTLE on or about

Insured Value: (In Words) ONE HUNDRED AND FIVE THOUSAND TWO HUNDRED AND SEVENTY TWO UNITED STATES DOLLARS AND EIGHTY SIX CENTS

(Figures) 105,272.86 Currency: USD

Marks and Numbers	Container Nos	Number and Kind of Packages	Description of Goods
LD3918	PCIU3498656	112 BALES OF	AUSTRALIAN GREASY WOOL
T424FNF	PCIU3690485	111 BALES OF	AUSTRALIAN GREASY WOOL
SHANGHAI			
SERIAL NO.			

CLAIMS PAYABLE IN CHINA IN US DOLLARS; COVERING OCEAN MARINE TRANSPORTATION ALL RISKS AND WAR RISKS.

CONDITIONS OF INSURANCE

SHIPMENTS BY SEA

Institute Cargo Clauses (A). Institute War Clauses (Cargo). Institute Strikes Clauses (Cargo). Institute Replacement Clause. Secondhand Replacement Clause. Institute Classification Clause. Institute Radioactive Contamination Exclusion Clause. Excluding Claims For: Mechanical and/or Electrical and/or Electronic Derangement; Scratching, Chipping, Bruising and/or Marring of Paint and/or Surfaces.

SHIPMENTS BY AIR

Institute Cargo Clauses (Air Cargo). Institute War Clauses (Air Cargo). Institute Strikes Clauses (Air Cargo). Institute Replacement Clause. Secondhand Replacement Clause. Institute Radioactive Contamination Exclusion Clause. Excluding Claims For: Mechanical and/or Electrical and/or Electronic Derangement; Scratching, Chipping, Bruising and/or Marring of Paint and/or Surfaces.

This Certificate is not valid until signed for and on behalf of Louis Dreyfus Australia Pty Ltd

Signed __________________ Dated at MELBOURNE 19/05/2006
For and on behalf of Louis Dreyfus Australia Pty Ltd

IN THE EVENT OF LOSS OR DAMAGE WHICH MAY RESULT IN A CLAIM UNDER THIS INSURANCE POLICY, IMMEDIATE NOTICE MUST BE GIVEN TO :-
McLarens Toplis
Room 2102, 21F The New Tower No. 1 Hua Hai Road Central 200021 Shanghai
Ph (86) 21 6386 6295 Fax : (86) 21 6373 5832
Or Nearest Lloyd Agent

Insurance certificate

DRAWN UNDER L/C NO. LC0621300702133 DATED 060517 ISSUED BY CHINA BANK

Number	**LD3918**	Exchange for USD	95,702.60
DOMICILE	SIGHT	Date	28/05/2006

of this FIRST of Exchange

1st

(second of the same tenor and date being unpaid)pay to the order of

BANKING GROUP LTD

The sum of NINETY FIVE THOUSAND SEVEN HUNDRED AND TWO UNITED STATES DOLLARS AND SIXTY CENTS

To [redacted]

CREDIT NO. L[redacted]

DATE. 060517[redacted]

LOUIS DREYFUS AUSTRALIA PTY LTD
ABN 57 004 098 000

DRAWN UNDER L/C NO. LC0621300702133 DATED 060517 ISSUED BY CHINA BANK

Number	**LD3918**	Exchange for USD	95,702.60
DOMICILE	SIGHT	Date	28/05/2006

of this **second** of Exchange

2nd

(first of the same tenor and date being unpaid)pay to the order of

BANKING GROUP LTD

The sum of NINETY FIVE THOUSAND SEVEN HUNDRED AND TWO UNITED STATES DOLLARS AND SIXTY CENTS

To [redacted]

CREDIT NO. L[redacted]

DATE. 060517[redacted]

LOUIS DREYFUS AUSTRALIA PTY LTD
ABN 57 004 098 000

Letter of credit advice

Banking Group Limited ABN

Documents Presentation Form

To Banking Group Limited International Trade Services	**From** AWTTC TEXTILE DR WARRNAMBOOL, VICTORIA 3280 AUSTRALIA

Date....29/5/06

.... Customer reference....LD3918................................ (*Bank use only* Acronym ....)

Please handle the attached documents **in accordance with instructions marked "X"** and subject to the International Chamber of Commerce current Uniform Rules for Collections, current Uniform Customs and Practice for Documentary Credits, and/or current Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits where applicable.

DOCUMENTARY CREDIT Credit No. LC0 300702133 **Issued by**............**CHINA BANK** **Reference LX1379803073**............. ☒ Negotiate and credit proceeds immediately to account/s stated below. (*Convert at TT Buying Rate. Interest will be paid in arrears.*) ☐ Negotiate and credit proceeds to account/s stated below when payment is received from Reimbursing Bank.	**COLLECTION** ☐ Negotiate by crediting account/s stated below immediately and forward for collection. (*Convert at TT Buying Rate. Interest will be paid in arrears.*) ☐ Forward for collection and credit proceeds to account/s stated below on receipt of payment from Collection Bank. ☐ Dispatch **Original** and **Duplicate** documents by Courier.
Credit proceeds to: ☐ AUD Account No: .... ☒ Foreign Currency Account (*Currency*) .... USD .... ☐ Bank .... Branch	☐ Apply proceeds against Forward Exchange Contract No .... Due .... No .... Due ....
Buyer BEIJING	**(Acronym** .... **)** Tenor...SIGHT Currency & Amount USD95,702.60

Documents Presented *(state number of copies)*

2 Bill of Exchange	6 Invoice	4 Packing List
3 AWTA CERT	4 Certificate of Origin	4 Health Certificate
STAPLE Certificate	1 Beneficiary's Certificate	4 Insurance Policy
2 Bill of Lading	3 Non-Negotiable Bill of Lading	1 Bene fax

1x Extra docs

Shipping Details

Shipping Date...... 28/5/06............ Via (*Name of vessel/flight no.*) MOL GOLDEN WATTLE 112................. To (*Port of Destination*) ...SHANGHAI CHINA ....

From (*Port of Loading*)......... MELBOURNE/FREMANTLE

(use only)

Description of Goods............ GREASY WOOL .... (*Commodity Code*

(Provided the documents are drawn in full compliance with the terms and conditions of the Documentary Credit, no further instructions need be given.)

Collection Instructions

☐ Present on arrival of bill.	☐ Surrender documents on **acceptance.**	☐ Surrender documents on **payment.**	☐ Note or protest for non-acceptance/non-payment.
☐ Presentation may be delayed until arrival of goods at port of destination without noting/protesting.	☐ Store and insure goods if documents have not been surrendered upon arrival of carrying vessel.	☐ Obtain advice of non-acceptance/non-payment by teletransmission.	☐ Obtain acceptance by airmail giving due date.
☐ Overseas bank's charges including commission, stamp duty, teletransmission cost and postage are for drawees account.	☐ Charges and/or interest on financed bills may be debited to above account if refused by drawee.	☐ Do not waive charges/ interest if refused.	☐ Collect interest @...%pa from .... to ***payment/acceptance** date.

☐ charges (*including interest if applicable*) are for the account of ***drawer/drawee.** (*If charges are for drawer, charges will be calculated at the exchange rate applicable on date of lodgement.*) Interest will be calculated on a 365 day basis for all Commonwealth countries currencies (except Canada) and on a 360 day basis for all other countries.

In case of need refer to .... ☐ who may assist in having draft honoured as drawn ☐ whose instructions may be accepted in every respect	Special Instructions ....

This application is subject to the terms and conditions set out in the ANZ International Trade Services Terms and Conditions booklet and we acknowledge that ANZ recommends that we read all relevant documentation that is provided by ANZ and seek clarification from ANZ about any issues of concern.
We acknowledge that ANZ has provided us with a copy of that booklet

Authorised signature(s) .... **Delete as applicable*
(*Print company Name/Customer Name above Authorised Signature(s) - if a Company include ABN*)
Signature(s) verified in accordance with Signing Authority Initial of verifying officer(s) ....

use only		Recorded in DPL Initials .... Checked ....
Date lodged	Reference no	Bills Finance Reference No. ....
Reimbursing Bank	Acronym	Collecting Bank .... Acronym ....

F:\User\WOOL\Shipping Dept\Docs\China\BEIJING LODGEMENT LD3918.DOc

Letter of credit presentation form

4. Selling/exporting options

Please note: Exporting is covered in more detail in another module of the course; the references made here are from a risk management perspective.

The sale of wool for the exporter or wool trader falls into two broad categories: fixed price selling (firm offer) or sales where the price is left unfixed or floating. While the majority of export sales are made via a firm offer basis, other selling options include:

- the currency for the wool to be sold in –
  - Australian cents/kg
  - US, euro, yen/kg etc
- delivered destination terms, common examples include –
  - EXW (ex works), which most commonly refers to selling delivered to a nominated storage warehouse, usually domestically within Australia
  - FOB (free on board), where the seller is responsible for all costs up to the point where the goods actually cross the ship's rail at the named port of loading
  - CFR (cost and freight), which includes all charges up to the arrival of the goods at the point of discharge from the vessel. It does not, however, include the cost of insuring the goods against loss or damage while in transit to that point
  - CIF (cost, insurance and freight), where the seller's price includes all charges up to the arrival of the goods at the point of discharge from the vessel including the cost of insuring them against loss or damage while in transit. This is the most widely used term in wool exporting
  - DDP (delivered duty paid), where the seller's obligation is fulfilled when the goods have been made available at a specified point in the buyer's country. In this case the seller is also responsible for payment of duties, taxes and other customs clearance charges.

4.1 Fixed price selling

Firm offer selling is one of the most common practises in wool exporting from Australia. The exporter agrees to deliver (or ship) a specific quantity and type of wool at a fixed price and delivery date.

Whether the exporter holds the stock at the time (long) at the time of the sale or does not have the wool in stock and will need to buy it (short), is a predetermined risk that is addressed later in the module.

- An example of a fixed price export trade would include:

  Quantity: 25MT (clean equ. 16% scd yld)

  Price: 550usc/kg

  Buyer: XYZ Mill, China, Address

  Type: T55 21.0um

Specifications: +/- .7um; 30nkt ave. (24nkt min AOL); 88mm min ave.(74mm min AOL); 1% VM ave (1.8% max AOL); 60% pobm max ave.; 70% min ave. Scd yield

Destination: Shanghai Port

Shipping date: by 30 December 2006.

It would be assumed that the wool exporter has a thorough knowledge of the type sold and the customer's requirements before transacting the sale.

4.2 Floating price selling

Floating price (or basis) selling is less common in Australian wool exporting than it is for other commodities, but in an effort to differentiate from the risks of firm offer exporting, selling wool on an indent basis is also very prevalent in the industry and can also be considered selling on a floating price risk basis that is not assumed by the exporter. Other (less common) floating price options are also highlighted below.

Indent

The buyer engages the exporter's services, usually on a fixed commission (bareme) basis, to accumulate and export the wool. While ACOF price ideas are fixed and changed by the buyer on a daily basis, the final export price for the desired consignment is only fixed when the average purchase cost is known. Therefore, the export price is floating until finalisation and, more importantly, the exporter does not inherit any price risk in this style of business. However, other risks are still prevalent; these are described later.

The main benefit to the exporter is in extracting a fixed margin from the business in the bareme, but, due to the competitive nature of indent business, these margins have been competed away in most cases. Indent is more prevalent in companies that have a vertically integrated processing structure offshore and the arrangement is absorbed internally into the company's balance sheet.

Basis contracts

This is uncommon, but made available by a few exporters where a contract is entered into for the exporter to supply wool to the buyer at a deferred date, but the final price is left floating and a fixed basis (difference) is agreed to be priced off at the designated maturity date.

Example:

- In June 2006, the same T55 detailed above is contracted to be delivered to Shanghai by End Dec 2006.
- Basis: 10usc over the 21um AWEX MPG (in USC) price calculated at close of business on 15 Dec 2006.
- In June 2006, the 21AWEX MPG was at 720auc/kg (@ .7500 AUD/USD) = 540usc/kg + 10usc/kg basis = 550usc/kg (current CIF price).
- On the 15 Dec, 2006: 21AWEX MPG is at 633auc/kg (@ .7900 AUD/USD) = 500usc/kg + 10usc/kg basis = 510usc/kg CIF or final firm offer price.

The buyer has been able to keep the price floating right up until before shipment to better manage resale strategies. The exporter has to manage the pricing from the November accumulation period to post-shipment, usually via derivatives.

Basis pricing relies on an unbiased indicator price being provided (for example, via AWEX) that both parties understand and have confidence in. Acceptance of contractual structure also needs to be mutual. The real negotiation is within the basis value agreed to (for example, 20, +5 or +25usc/kg).

Other variations may include maximum pricing structures to protect the buyer form adverse upside price movements, managed with option style derivative tools.

5. Risk management

The participants in the wool industry understand, to varying degrees, the risks associated with transacting in the market. These risks differ according from a producer's, trader's or consumer's perspective.

This module aims to address the main risks from an exporter's and wool trader's point of view, identifying the risks involved, especially price and basis risk, their measurement and management.

5.1 Risks identified

As soon as a wool trader 'puts up their hand' and buys or sells a bale of wool, certain risks are assumed; these include:

- price risk
- basis risk
- counterparty risk
- organisational risk.

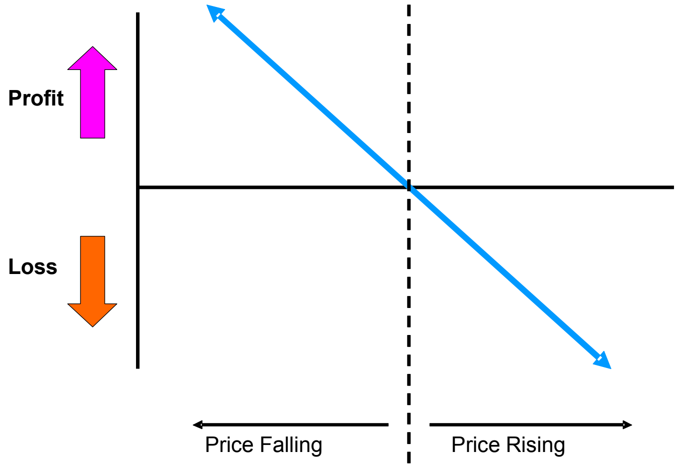
The predominant risk is from adverse price movements and, while the fundamentals of supply and demand are cited as drivers of this risk, the analysis and prediction of these catalysts are beyond the scope of this module.

5.2 Price and basis risk

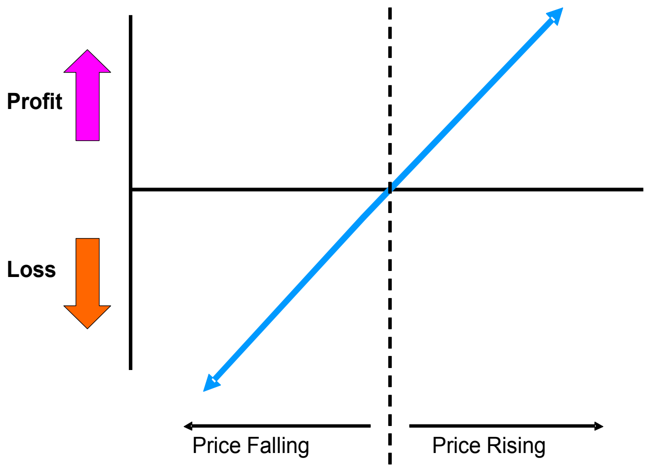
Price risk

Price risk is assumed in the wool market when the trader initiates a long (bought) position or a short (sold) position, with the adverse consequences resulting in a trading loss or, conversely, a profit. Refer to the diagrams below for further P&L implications of a long and a short position.

Profit/Loss Associated with a <u>Short Position</u>



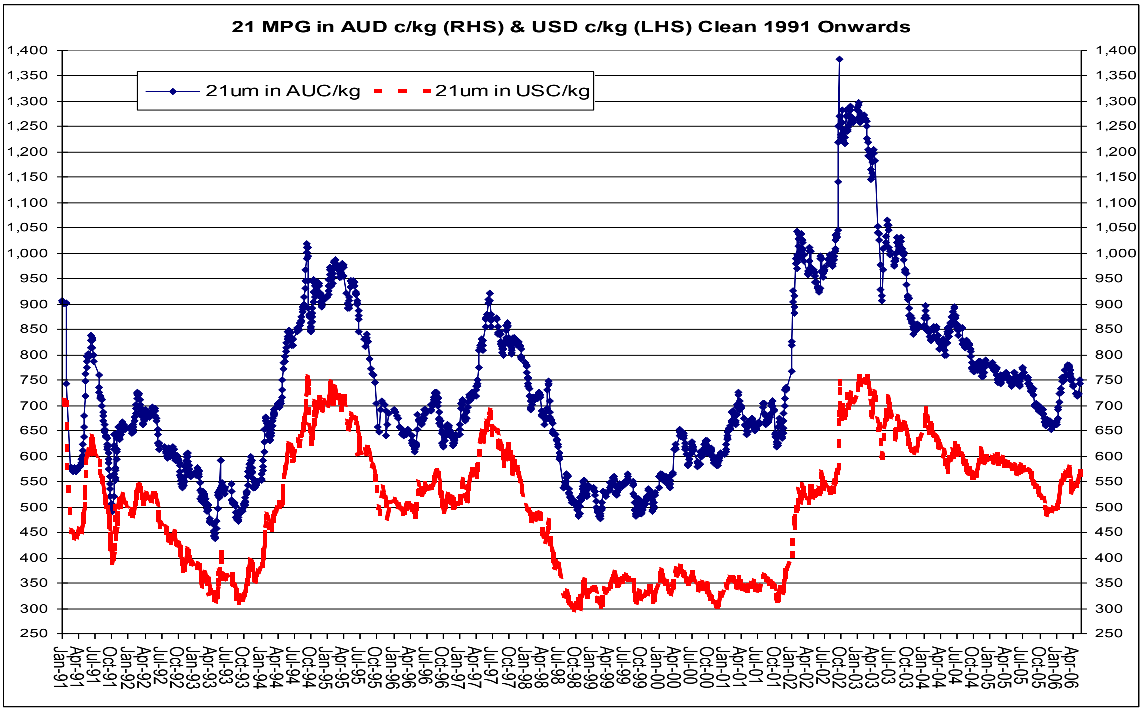
Profit/Loss Associated with a <u>Long Position</u>



Positional (or flat price) exposures in the wool market can be implemented by any of the various ways of trading wool, from buying physical in spot (cash) markets to selling forward delivery via firm offer exports or buying forward derivatives.

Price risk and variation are inherent to most commodity markets and wool is no different. Prices can move dramatically in both Australian cents and other currencies.

Refer to the chart below for a depiction of the wool price variation for the AWEX 21um MPG in both AUC/kg and USC/kg.



Volatility for wool exists in both currencies but AUC is generally higher (ranging from 10 to 25% HV 20day) than in USC (ranging from eight to 20% HV 20day)

Basis risk

Basis risk is the risk of having two different positions, a bought and a sold position, (even if the same quantity), that are not exactly matched by quality (type) and time. For wool, this risk is mainly defined by quality (same micron), quality (different micron) and time (same type/micron, different time exposure).

These risks are further defined below.

- Quality basis

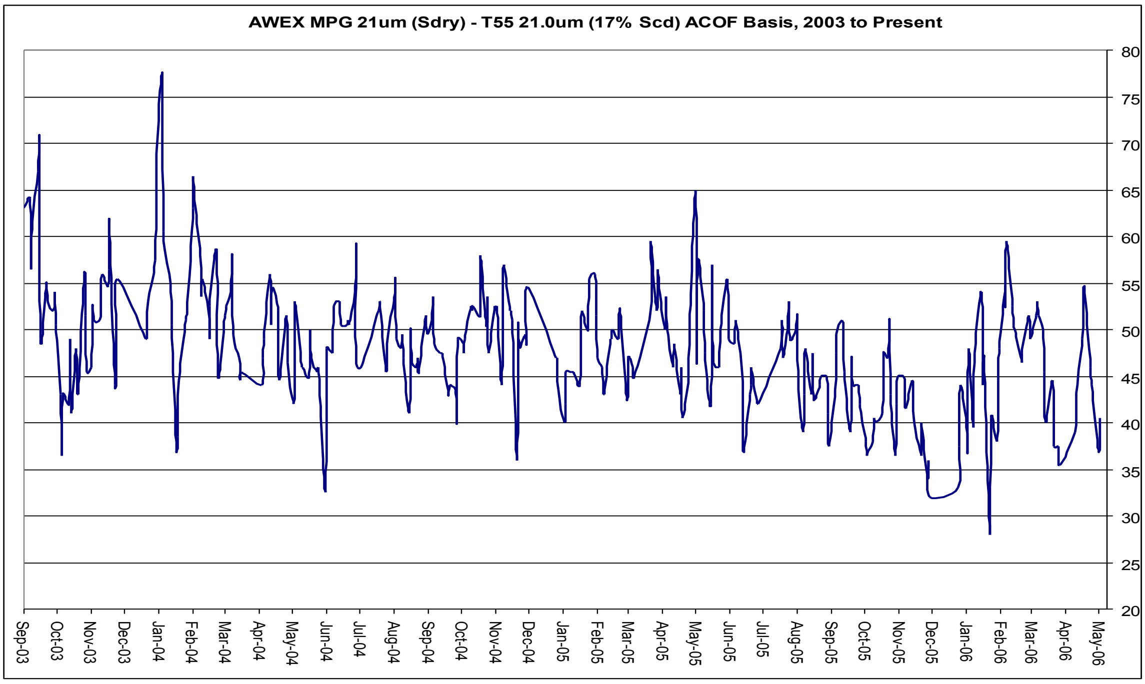
In wool trading, an exporter/trader can typically accumulate one type and then sell another, which is defined by different specifications, even if the two positions are for the same micron. This risk is often miscalculated by the exporter and can lead to considerable P&L fluctuations; for example, an exporter may have the following positions:

Long stock: 500MT of China Type 55 21.0

Sold Pos. 500MT to India and Europe of GTM 21.0 um (similar to AWEX MPG specification.)

The exporter may incorrectly assume that although the stock purchased cannot be shipped against the sales, there is little risk.

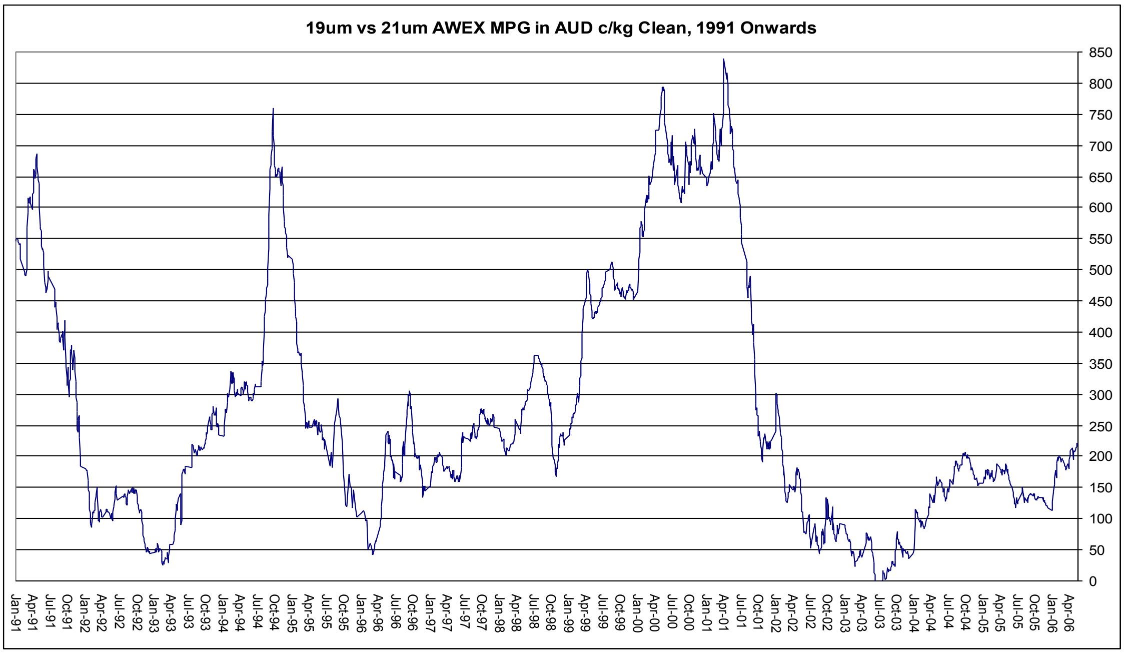
As depicted by the chart below (after taking into account yield differences of approximately 30c) to the basis for these two types fluctuates by 30c/kg on average (from 35c to 65c difference).



In an extreme and adverse case, this can represent up to $150k loss to the exporter's position.

Micron basis

As with type differences, in an exporter's position, micron differences may also represent an unaccounted for risk. The micron curve, differences between all microns, may fluctuate in price widely over time. Again, an exporter may be balanced in what quantity bought and sold, but any inherent difference in micron can lead to adverse movements in P&L. For example, in the chart below, we can see that the premium of 19 um wool over 21um wool can move by 100–200c on average, and more in extreme cases.



Time basis

This is the difference in the 'duration' of wool positions in the market, and is usually defined by the forward price structure of the time curve.

Forward prices do not always track or mirror the movements in the spot cash market (for example, auction). This can be illustrated by the difference in three-month forward prices compared to spot, or the three-month forward prices compared to the six-month forward prices. An example is in the following exporter's position.

In June the forward market is flat:

Bought (long) 100MT of T55 forward physical for August delivery @ 700c.

Sold (short) 100MT of T55 for December export @ 700c (carry adjusted).

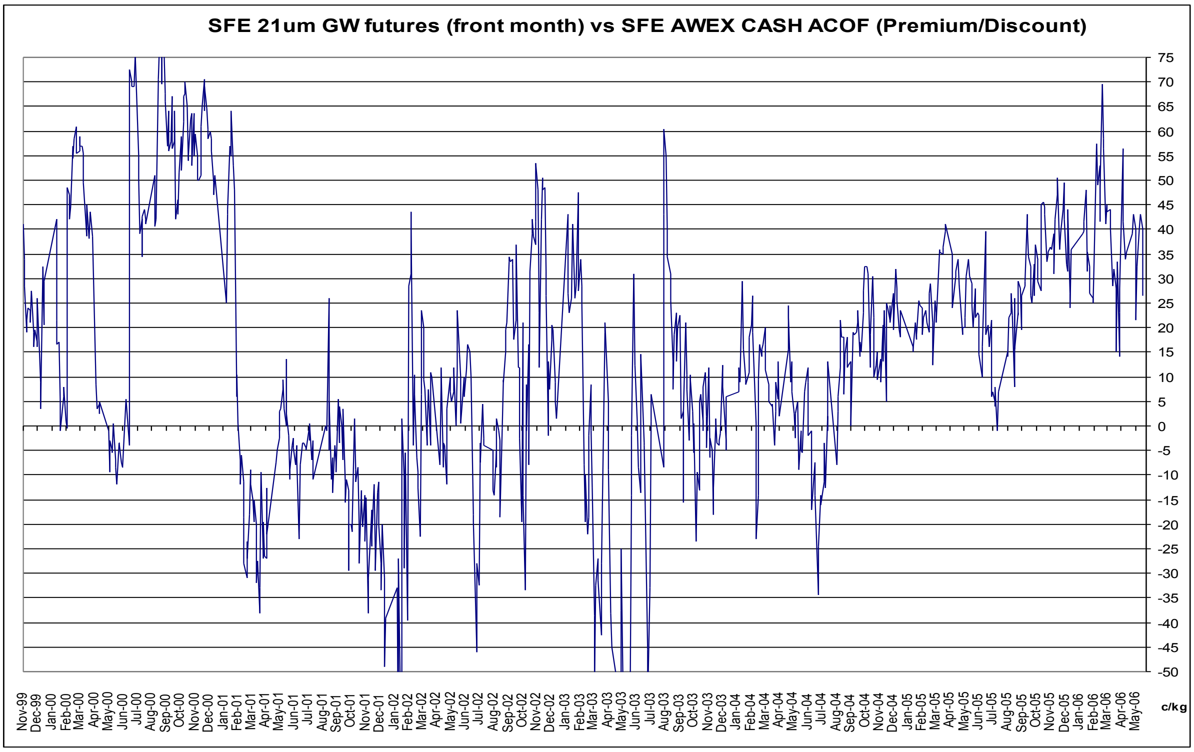
By July, the forward market is trading at a discount:

August T55 trading at 725c.

December T55 trading at 705c.

The exporter has had an unrealised adverse P&L move of 20c (x 100MT) or $20k.

This example can be applied to any trade position in the forward market, whether it is forward physicals or derivatives (which will be discussed later).



The chart below depicts another example; the difference between the auction price of SFE 21um wool versus the front (one to two-month) contract trading on the Sydney Futures Exchange (SFE). This is the time premium or discount difference of spot prices against one to two months of time value.

Again, this basis (difference) can vary greatly according to market conditions and, while this premium/discount above only represents the nearby value (spot versus two-month) for this type, it can also vary even more as forward time values increase for the same type (for example, six-month versus eight-month).

Measuring price risk

Sophisticated techniques are generally applied to other commodities to measure market price risk, a common example being the application of a Value at Risk (V@R) measure to a trading position, where underlying price volatility, time values and liquidity functions are applied to generate an aggregate measure for all positions combined.

For wool, however, most participants apply a simple $ risk measure to their trading position (if at all), that use best/worst case scenarios. For example:

Position: long 100MT of 21um

Expected mkt move: +50c/kg or –30c/kg

Expected P&L risk: +$50k to –$30k

Apply this to all positions to gauge aggregate $ risk of the overall position.

It is also important for the wool exporter/trader to be aware of their own 'risk propensity' (that is, the amount of risk is the exporter is comfortable with) and to stay within the parameters of this acceptable $ risk amount. For example, a large corporation may be prepared to make/lose $1million from the existing position, while a smaller private firm may be more comfortable with an exposure that implies a P&L of +/-$100k from the existing position.

Management techniques and tools (price and basis risk)

It is practically impossible to trade within the wool market and not assume any price/basis risk, and it is important to manage and specifically target the desired risks the trader wishes to adopt in the position versus inheriting risk by default from normal buying and selling activity, noting that the market has an uncanny ability to deliver extra and unwanted positions (long or short) at the highs (overbought) and lows (oversold), in the price and basis cycles.

Techniques

While trading success is the domain of the individual trader and is measured by profit, there is an underlying theme that entails structuring the overall wool position for the desired outcome, including all type, micron and time exposures. Again, profitability relies on the ability of the trader to correctly predict price and basis direction, but managing the desired outcome for positions is the foundation for this realisation.

Ongoing manipulation of the trading position needs to be employed.

The following is a basic example of an exporter's trade book:

Long stock 19um: 200MT

Long fwd futures 19um: 50MT 3 months deferred

Short sales 19um: 100MT nearby, and 50MT three months deferred

Price risk 19um = net long 19um: 100MT

Basis Risk 19um = 50MT sales versus futures

Long stock 21um: 50MT

Short export sales 21um: 250MT nearby

Price risk = net short 21um: 200MT

Overall:

Flat price risk = short 100MT (all microns)

Basis risk* = long 19um 100MT versus short 21um 100MT

*(plus smaller 50MT of 19um hedge basis risk)

If this is not the desired position of the trader, further positions need to be initiated to correct the exposure. For example, if the view was that price overall was going to appreciate and the trader wanted to be long 100MT, the short would have to be lifted and buy 200MT; if the trader thought that 19um versus 21um basis was going to narrow (that is, 21 appreciate more than 19um), more 21um would have to be bought than 19um.

There are several options to execute this strategy, for example:

Sell 200MT of 19um stock via nearby export sales.

Therefore, new net 19um price risk = short 100MT.

Buy 200MT of 21um stock.

Buy 200MT of 21um deferred futures.

Therefore, new net 21um price risk = long 200MT.

New position overall:

Flat price risk = long 100MT (all microns).

Basis risk* = short 19um 100MT versus long 21um 100MT.

The trader is at desired long exposure, coupled with a new basis position of short 19um and long 21um.

If we extrapolate this simple example outward to include a lot more micron, type and time positions, we can start to gauge the difficult task involved to manage a complex export/trading book.

Wool execution options

There a large number of ways the exporter/trader can assume risk in the wool market, and frequency of implementation is usually defined by liquidity, access and recognition of the 'pricing point'.

Physical trading

Spot market

Auction	Liquidity: Most liquid market for Australian wool, especially for exporters (buyers) with 2-4k MT being offered each auction day (two to three days per week, approx 44 weeks per year), covering the full spectrum of greasy wool produced in Australia; approximately 80–90% of all wool offered. Access: Open to broker/buyer (members) or on commission (indent) to third parties. Recognition: Most widely recognised and accepted way of buying and selling wool domestically.

Ex-auction	Liquidity: Approx. 10–15% the liquidity/volume of the auction system, but still important. Access: Typically limited to wool brokers and their subsequent supply relationships established, usually manual pricing, and increasingly via electronic platforms. Recognition: Less transparent than auction, but still actively utilised by exporters.

Forward (deferred) market

Domestic	Liquidity: Approx. 5% of overall supply is bought and sold on a forward physical basis, usually sold via brokers offloading grower selling, with some inter-trade activity. Access: Usually via broker/exporter networks. Recognition: Not actively priced in the market, also subject to grower hedging activity.
Export	Liquidity: Best source of sell side activity for the Australian exporter*, currently averaging 10k MT per week (firm offer + indent). Note: As export sales involve some time value before delivery, they are considered as deferred sales. (*Notwithstanding re-offering through auction, usually unviable for volume trading due to timing and cost.) Access: Available to participants who employ the required resource structures need to facilitate exporting. Recognition: Widely recognised.

Derivative (paper) trading

SFE	Description: Sydney Futures Exchange 19um: cash settled trading out 18 months (contract months – Feb., April, June, Aug., Oct., Dec.) 21um: physical delivery, trading out 18 months (contract months – Feb., April, June, Aug., Oct., Dec.) 23um: cash settled trading out 18 months (contract months – Feb., April, June, Aug., Oct., Dec.) 21um Options: physical delivery trading out 18 months (contract months – Feb., April, June, Aug., Oct., Dec.) 25c/kg strike increments Liquidity: Best derivative pricing point in the market Volumes vary, but average approximately 50–150MT a day

	Access: Via SFE brokers e.g. Elders Risk Management, after account established and margin paid
	Recognition: Widely recognised pricing point, but acceptance is limited
ASX	Description: Australian Stock Exchange Wool Futures
	Based on generic China type specifications
	19.5um (T54): physical delivery, trading out 18 months (contract months – Feb., April, June, Aug., Oct., Dec.)
	21um (T55): physical delivery, trading out 18 months (Contract months – Feb., April, June, Aug., Oct., Dec.)
	22.6um (T56): physical delivery, trading out 18 months (Contract months – Feb., April, June, Aug., Oct., Dec.)
	Liquidity: Not liquid in 2005/06
	Access: Via ASX brokers, after account established and margin paid
	Recognition: Not accepted by market after launch in 2003
OTC	Description: Over-the-counter products
	Predominately cash settled 'swaps' offered by financial institutions (for example, NAB, CBA) and corporates that acquire ASIC licensing. Noting variations incorporating physical delivery are also traded in the market
	Priced off independent price indicators, usually AWEX MPGs, and maturity can be set for any day of the week (typically an auction day)
	Cash settled options on these swaps are also offered in the market
	Liquidity: Banks and corporates will usually make a two-way market for 10–15MT, with a 10–100c/kg bid/offer spread (depending on volatility and time risk). Accurate volumes traded are not available, but would typically be 5–50MT a day. (Cyclical, and dependant on the price maker's marketing and risk profile.)
	Access: After margin/security paid to bank or via broker commercial relationship
	Recognition: Widely advertised but not well accepted, especially by grower hedge market, which limits the liquidity available to the trade market

While auctions and exports dominate the main incidence of trading within the wool market, it can be noted that utilising the other options can augment and assist positional management. For example, it is not unrealistic to accumulate 500MT of forward deferred length over a couple of days.

5.3 Counterparty risk

Counterparty or credit risk is another major risk assumed by the Australian wool exporter. The risk of default by the buyer (offshore importer) is still very prevalent in today's market.

The main examples of incidence involve contractual default by the buyer either before or after shipment due to adverse market movements (price falls); insolvency of buyer and disagreement or breakdown of relationship between exporter and buyer.

IWTO and CIETAC arbitration processes are usually employed to resolve these problems. These are covered in a different module of the course.

Management

Credit risk can still be alleviated by employing several processes to limit adverse P&L impacts on the exporter:

- Gather financial information and incrementally build a 'trade history' with buyers.
- Apply exposure limits and credit ratings to the customer base, with the aim of diversifying risk across a broader base.
- Limit time exposure from contract date to payment date, with the aim of minimising market risk.
- Ensure maximum legal sanctity in contractual terms.
- Engage export insurance for open account terms.

5.4 Organisational and other risks

Other risks to be considered in wool exporting are summarised below:

- not having access to the following resources:
    - human resources – inadequate/inexperienced logistics staff to handle supply chain requirements, or inadequate trading experience
    - financial resources – mainly typified by inadequate funding resources to operate effectively in the carry cumbersome wool market.
- delivery/supply risk – failure to have access to or to deliver the appropriate quality and quantity as per the contractual requirement
- global demand shocks, and economic, political or country risks.