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G Schneider Australia submission to the AWI Wool Selling Review – February 2015

The Schneider Group's primary interest is in the first stage processing of wool and other precious natural fibres, delivering wool tops to exact customer requirements. We guarantee the quality of our deliveries and pay cash to the grower within 10 days maximum of the purchase and finance the purchase for at least six months.

The reliability of the test results and the integrity of the sample we inspect are the basis of our operation.

We own and operate four wool combing mills across Italy, China, Argentina and Egypt and 2 wool carbonising plants in China and Egypt with a total annual capacity in excess 200,000 farm bales. Each mill processes wool sourced from fully owned purchasing organisations in the country of origin. We communicate between origins constantly, and with our processing mills, to ensure consistency and reliability of our deliveries in an extremely competitive market environment. The processing performance of the raw materials we buy and guarantee is the focus of our Australian operation. We have trading activities in all the main textile centres of the world.

We operate in Australia principally at auction but regularly support other methods including private buying, forward sale contracts and electronic sales.

We strongly support the AWI initiative in this review to ensure the best possible platform for the exchange of ownership is in place for the wool industry. It is our firm belief that the buyer and grower welfare are very closely linked. A strong market is a clear indication of demand, and rising prices are the result of strong market conditions. Clearly in both the buyer and grower interest.

In our opinion the oversupply of average quality fine and superfine wool over the past four to five years has been the greatest single factor determining the poor performance in this sector of the industry. A factor unfortunately exaggerated by the result of severe drought conditions over large parts of Australia during this period. Transparency within the logistic handling sector should be examined as well as the reliability of the test and the integrity of the display sample.

GST on greasy wool should also be examined. The process and flow of the GST through the system should be examined to understand if the government(s) actually see a positive revenue from it. As prompt exporters of wool, we are claiming the GST refund through our monthly BAS. The funding cost of the GST is a real cost to the exporter.

We have recently developed our own sophisticated invoicing, export, logistic and processing software that takes the wool from the broker invoice through to post production and invoicing wool tops to our customer. We are extremely proud of this software which is maintained by minimal staff based in Europe. We also keep a detailed archive of auction data dating back more than a decade. With the use of report generators we are able use the data to make professional and commercial decisions that benefit our daily activities.

WOOL PREPARATION

We believe there is insufficient focus on the positives rather there is too much focus on the negatives and 'cost savings' in the industry. We'd like the industry to consider a 'Gold Export Status' (or similar) for growers who have consistently provided a reliable product that's met best industry practice with regards to clip preparation. Perhaps a system that awarded a grower with 'Gold Export Status' following a set period in which they have maintained that best practice. It should be endorsed by the Australian Council of Wool Exporters and Processors, AWEX, AWI and AWTA. These growers could display their 'Gold Export Status' to promote their clip for sale. Quality assurance schemes have been used before but traditionally for individual marketing purposes. This should be an industry scheme for the sole purpose of promoting quality. G Schneider Australia would happily consider being a part of a system that improved meaningful communication between the grower and their

customer (us) for mutual benefit. Any system would need to be simple and cost effective. Growers should follow the AWEX “Code of Practice” as a minimum. The code of practice is reviewed regularly with buyer and processor input. It is in our opinion dangerous and of little benefit for a grower to regularly chase vague and often misleading market signals. Growers are producing longer and finer wool despite clear market indications that there is little market demand for such types. To dictate to the customer (weaver / retailer) that they should buy what is produced is ill informed. We believe at times there is too much emphasis on test results. In our commercial opinion, the traditional classing standards of ‘consistent type’ are being compromised in classing standards as classers / owners have been influenced by producing finer microns.

The increased percentage of the clip <17.5 micron is the primary reason for suppressed superfine prices. Not necessarily a failure of the auction system.

AWTA annual figures for micron production (source AWTA Ltd web site / key test data / annual figures) – source www.awta.com.au

- Season 11/12 17.5 finer = 23.6M kg (6.9% of clip 342M kg)
- Season 12/13 17.5 finer = 26.8M kg (7.7% of clip 350M kg)
- Season 13/14 17.5 finer = 35.2M kg (10.1% of clip 345M kg)

Since the 2011 / 2012 season we’ve seen an increase in production of 49% of wool 17.5 micron and finer to June 2014. This must affect grower returns and the ability of the wool textile sector to consume the increased volume.

The effect of SRS type wool must also be considered as growers push for finer microns (due to historical price premiums) while maintaining or increasing the cut of wool per head. Increased productivity, clearly a strong incentive to the grower (we are not critical of this) but we are seeing an increased production of fine wool. This leads to over-supply.

The New Zealand Merino Company (NZM) sell a large volume of fine wool in Melbourne and this must influence the result of the Australian auction prices. Supply of fine and ultrafine wool has also increased dramatically in New Zealand.

- Offered ex NZM catalogue (New Zealand) in Melbourne, excluding withdrawn bales. All types.

	2012 season`	2013 season	% increase YOY
15.5 mic and finer	2,118 bales	4,934 bales	+133% (bales)
16.5 / 17.5 mic	10,272 bales	14,620 bales	+42.3%

Source G Schneider Australia

With regards to preparation, we believe some growers are cutting costs in the wrong areas. The Schneider Group’s purchasing habits are being influenced by better performing wools from South Africa. This is detrimental to Australian growers. Australia is a high cost country and the cost of production must be significant when compared to South Africa. Maintaining quality standards in preparation is important to us and should not be compromised.

More wool is now being offered with a “D” certificate. This means that the wool has not been prepared to the industry code of practice standards. In the season 2010/2011 only 5% of the first hand grower merino wool was sold with a D certificate. This season to date it’s 7.2%. For the non merino section in the season 2010/2011 28.6% of first hand grower lots were “D” certificates. This season to date 48.4% of all non merino wools have been offered not prepared to the industry code of practice standards. The trend towards “D” certificates must be reversed and the system revised. We all want to see better prices but surely reducing quality standards that impacts on the reputation of the whole Australian clip is not the answer. Buyers buy “D” certificate wool but under the clear understanding that they are taking a risk. We are seeing the sample. Who will guarantee the description of wool that does not meet the industry code of practice standards? Currently the buyer will do this on the basis of seeing the sample. It’s a simple case of buyer beware.

The concept of “D” certificates should be reviewed as we believe the industry is not using this test certificate as it was initially intended. Unskirted clips should be better identified, perhaps in their own section of the catalogue, and at least still classed by a registered classer. Care must still be taken to prepare the wool for sale. If they are clearly identified, market signals could be monitored more easily, and growers could make more informed decisions before taking the decision to prepare their clip in this manner.

We inspect every sample pre sale and again after purchase before inspecting again at the mill prior to processing. We have never exported a bale from Australia without inspection of a sample. However, the sample is not always a true representative of the bales. The system of extracting the grab sample is not 100% accurate for all bales and the system can be compromised by an extreme minority of sellers. We find in our mills, individual cases where the sample has not been representative of the bales. The last bale may be incorrectly lotted or a small amount of non consistent wool has been placed on top of a bale and therefore avoiding the grab. These cases are fortunately the exception, but a reality. A cost to the Australian exporter and processor and a strong negative to the reputation of the Australian clip. We scour wool locally and in those cases, these bales have been returned to the broker and grower for a full reimbursement. We have 4 other combing mills where such a system of accountability is not possible. How would sale by an industry description without a sample benefit our company, the growers customer? What if these bales are located in our mill in Egypt, Italy, China or Argentina?

DELIVERY AND TESTING

Note the number of core holes and grab cuts in small lines (<3 bales) and in particular light weight bales.



We believe this system should be improved to limit the damage to the high quality fibres. The bale on the left was nominated (by the grower) as an industry 1PP, the ‘best of the best’. This bale is hardly in the ‘best of the best’ condition. The number of core holes in the bale on the right, also an ultrafine bale, must have an impact on the quality of the wool, the fibres must be cut all the way through the bale(s). Another unnecessary cost on these precious fibres. Processing performance is extremely important in this field.

The exporters and private treaty wool merchants recently promoted an increase in the minimum bale weight for a bale and provided an enormous amount of data supporting the reasons. Simply put, we are promoting a more productive bale for buying and selling. We made it clear that standards of classing should not be compromised. Using historical bale weight data provided by the AWTA, we felt we provided a strong, simple and effective case to reduce grower costs and improve their return.

Resistance from the brokers saw the original AWEX decision overturned and a more conservative increase of just 10kg/bale introduced from 2016.

Larger growers should consider requesting their selling broker to keep their own samples for inclusion in later wool clips for sale. In a small lot size of 1 or 2 bales or a light weight bale, the loss in the sample as a percentage of the total weight is even greater.

WOOL APPRAISAL

Any compromise with the sample is unlikely to benefit the grower. The sample creates competition. It combines the AWTA full range of tests with a human element. Buyers are always looking for a commercial edge over the others. Ways that any lot will give them something better than their competitor. If we rely solely on one industry description, the competitive human nature of the buyer would be lost and we'd move closer to 'fair average' for price and quality. We've attempted to buy on industry description with the option to inspect the sample if purchased. We find the industry description leads us to be too conservative and we buy less.

The AWTA response to the review sums up the position quite well (source AWTA response to the AWI Wool Selling Systems Review). The processing performance that we look for, is not guaranteed by the test or any industry description.

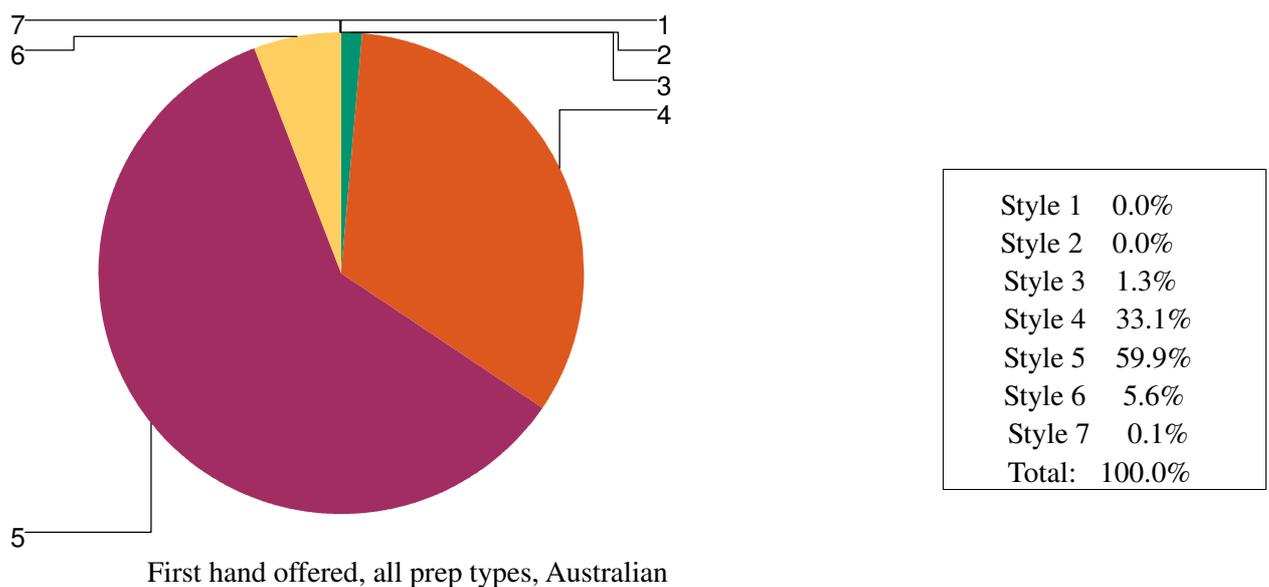
“AWTA Ltd will provide a guarantee, based on an assessment of the display sample taken in accordance with IWTO Standards, that the AWEX-id determined is a fair and adequate description of the non-measured wool characteristics as applied by a qualified AWEX-Id Appraiser. This guarantee does not extend to processing quality or performance.” (Source - AWTA response the the review.)

It's the sample and the buyer interpretation of it that creates competition.

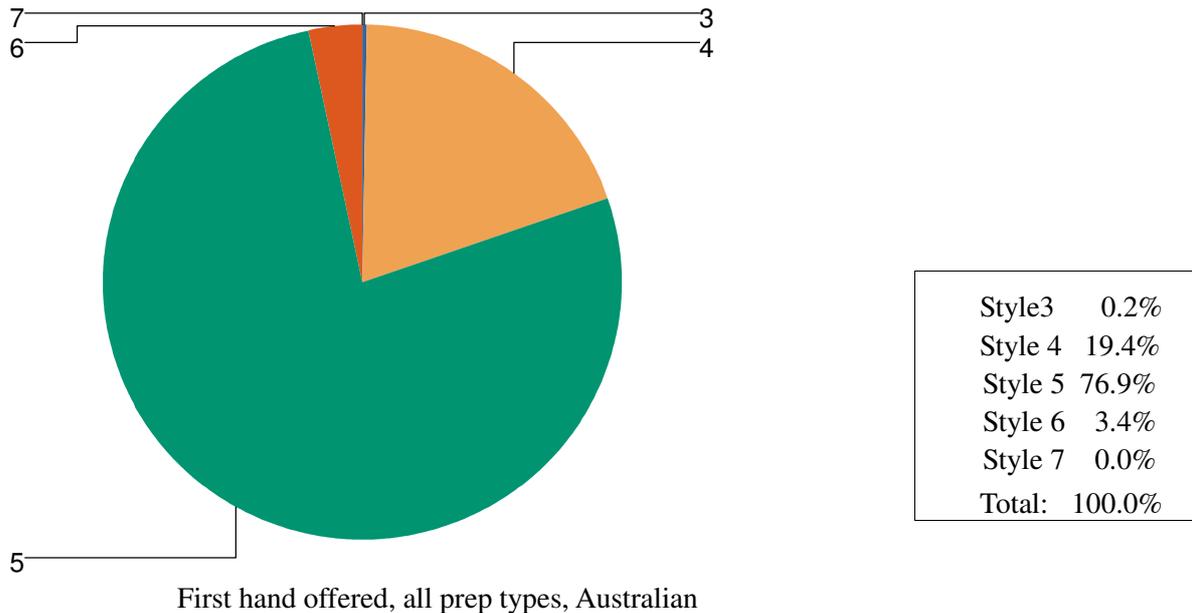
AWEX description tends to be used too conservatively in our opinion. The majority of the clip is typed within just a few style descriptions. The problem is that the description tends not to be commercial, rather an appraisal to assist with a conservative market valuation. The buyers look for processing characteristics in a lot that are not tested. All clients and mills are different and the buyer is buying within specific customer and mill requirements.

See below the AWEX description allocated by style code (source AWEX). The percentage of Merino wool offered by Style - Season 2013/14

Merino Adult and Weaner (Combing) Fleece



Merino Pieces and Bellies



It seems inefficient to use such a narrow range of the style descriptors that are currently available. For the fleece we think style 2 and 3 along with styles 6 and 7 should be used more often to help differentiate quality more effectively. This should happen regardless of the market indications for the various types.

As guarantor of our deliveries, we insist on seeing the sample. The integrity and accuracy of the sample representing the bale(s) is important. If the AWTA were responsible for applying AWEX id at the core line (probably the most effective way to save costs related to the sample), we see potential for enormous variability in type descriptions. There are approximately 88 individual core lines registered nationally in 35 centres. In our opinion if AWTA were to appraise the wool it would be less commercial (with the potential for more focus on the test result) and inconsistent due to the number of workers involved across multiple centres and core lines.

At auction we find risk wools, those with potential black and medullated fibres, are not always identified correctly. Any move to sell these wools by description would be to the detriment of the customer.

Alternative selling methods including computerised selling systems and multiple systems should be explored and their success will depend on the benefits achieved. Current electronic platforms have been found inadequate by buyers. The auction determines the true market value. The value that is the basis for the alternative selling systems that are available.

Sample box sizes (not sample sizes) have become too small making it difficult to adequately value and inspect the wool sample. This is detrimental to the grower. They've taken 12 months to grow it, a sample is drawn, yet the buyer is not given adequate space to inspect their product. Brokers claim to be saving space but in our observation they rarely, if ever, use the space and sample boxes available to them. An industry agreed minimum standard display box size should be established.

PRICE REALISATION

Electronic sales, private and tender sales as well as direct farm to mill contracts are available at the moment but the level of price is related to the auction system which determines the market value. Regardless of the method of sale, the exchange of ownership must pass through the broker and we would estimate little if any cost savings to the industry under this structure. All current alternative sale methods should be examined and their success should depend on the benefits to the buyer and seller. They will determine which method of sale they prefer and which best suits their needs. Wooltrade is the only electronic platform at the moment.

Computer selling (not sale by description) could be possible if the current exchange of ownership standards could be maintained without any increase in cost to the buyer or seller. It's difficult to understand the focus on the phrase 'competitive tension' being promoted in this review. Simple supply and demand principles determine the level of competition. Growers in consultation with their broker can decide when to sell and they have the option to pass their wool in should it not reach their target or reserve price.

Current (as at 6th February 2015) AWEX micron price guides (MPG) from southern markets shown as a percentile ranking for the past 5 years (source AWEX)

17	MPG	51%
19		53%
21		57%
23		64%
28		100%
MC (carding)		100%

A percentile of 64% means the MPG has been lower 64% of the time (or higher 36% of the time). Clearly the auction system is very effective when positive supply and demand factors are in place. Over supply of fine wool has meant prices 17.5 and finer are historically low. It's not the auction being non-competitive, simply oversupply.

Exporters would need to evaluate if 'online' or electronic selling actually save money or increased costs. At this stage it seems unknown. Any increase cost to the exporter would ultimately be included in the cost of the wool purchased. It's a cost of doing business.

The Schneider group operate with our own buying company in Australia. We buy for our own processing requirements to deliver guaranteed wool tops to clients worldwide. Before delivery of our wool top to our customer, a sample is sent for verification. Importantly, the sample along with the test result of the wool top are essential also to our spinner or weaver client.

The strength of the payment structure (cash) associated with the auction system in this country is something that the buyers and exporters are extremely proud of. We pay cash for the goods within 10 days of the fall of the hammer and operate at weekly auctions. The integrity of the system is extremely high. All buyers operate within strong local competition laws. These systems are extremely well managed by the auction system. Any 'outside' or downstream interests permitted to act at auction electronically, or otherwise, would need to guarantee the same. Payment and competition laws would seem logical areas that would need close examination if the system was changed.

Commission buyers survive in the process of reducing exporter costs. Increased exporter and processor costs would result in lower prices to the grower. Exporters chose a commission bidder (if required) with the view of minimal (if any) conflict. The commission buyers act within Australian laws at auction. Instructions are issued daily and commission bidders are expected to follow them as an employee would. G Schneider Australia has our own staff and office in each of the 3 selling centres.

The most significant requirement to participate at auction is the ability to pay cash for the goods. The auction system is a cost efficient method for the exporter to buy wool and the grower to sell.

INVOICING AND PAYMENT

PSC is a real cost on the wool. Essentially the cost is taken from the price bid at auction and forms part of the full cost of the wool purchased. Our customers buy on a 'delivered' basis and the PSC is a part of the value of the wool. We presume not all growers are aware of the PSC.

We believe there is potential for a more detailed breakdown of the individual selling and buying costs of wool to be made available to woolgrowers to facilitate more informed commercial decisions regarding the sale of their wool and an industry standard invoice or account sale format should be considered. Competition in this area should result in reduced costs to the grower, but we feel it

unlikely to deliver any substantial saving.

The current auction terms, effectively cash, must at some point effect all buyers in their ability to act to their maximum potential. Again this is normal business conditions, but still extremely strict terms of trade. However it must be seen as a strong point of strength to the buyers and exporters. With cash terms, rarely do they miss a prompt, most never have. The buyers finance the whole of the Australian wool clip with cash. The prompt period should be examined to see if it would improve grower returns through better competition from more buyers.

The buyer is responsible for storage costs before the prompt payment date and often pay for the wool early in order to meet delivery requirements. In the majority of cases there is no incentive to pay early but a significant penalty should any buyer be late with payment. The storage is a cost we can't avoid and as a cost of the delivery process, will effect the price that we pay for the wool.

The selling broker pays the grower only after receipt of funds from the buyer. Perhaps a clearing house system could be considered using the pool of buyer / exporter payments held in a trust account until payment to the grower. If possible, any revenue raised could be used to the industry advantage to minimise costs in other areas.

EXPORT PROCESS

The exporter and processor companies are generally large volume stand-alone exporters and as such can negotiate competitive rates from shipping companies in an already competitive field. Major buyers are unlikely to agree to the use of their volume to assist smaller competitors. Freight and logistics strengths within a company can often be the only difference in margin in a competitive greasy trading market.

All exporters having different funding requirements. We are of the opinion that in general the Australian banks are not so pro export for the rural sector when compared to the New Zealand banks. Note New Zealand dairy and wine industries as an individual cases.

GENERAL – Wool Industry Institutions

The service provided by the AWTA seems very much as a test house only. We would support some amalgamation with AWEX only if it brought the AWTA closer to the market place. We believe competition in testing would be an improvement only if competition was focused on the reliability of tests and the assurance from global clients to accept the alternative test methods and certificates. This would be important.

Buyers are often critical of individual and selected test results but AWTA staff are rarely available for consultation. The integrity of the drawn sample and the reliability of the test result are the major factors influencing price yet the AWTA are infrequently challenged on individual test results.

The Talman software system is old. To a user it seems difficult and expensive to maintain. Changes requested are often not possible due to cost and level of service to the buyer is minimal and expensive. There should be the potential for competition in this area.

GENERAL - AWEX Market Reporting

We have at times been critical of AWEX reporting on the market. Some argue too much information is provided by AWEX which is the most widely read document (daily report) in the wool industry, world wide. The AWEX EMI seems to have a strong following but often doesn't reflect the whole market. It's just an average of a pool of types. It's used as a bench mark and an easy reference for the industry to establish the direction of the market however is not always a true indication of the whole market and can be misleading.

There is no separation between the best and the average in the general reporting, other than commentary. Real logistic costs are not well reflected such as the Tasmanian stored offering.

GENERAL – Centralisation

The Mick Keogh report of April 2009 determined the savings provided by centralisation of wool sales was in the order of \$2 per bale (two selling centre model). This would be 1 to 2 cents per kg saving. This small saving would unlikely be passed to the grower.

We are not convinced there would be a saving to our company. We employ few staff who would all be required regardless of any move to centralisation. The logistic storage locations and costs far outway centralisation savings in our opinion. We are finding more storage locations nationally with presumably greater expense to the buyer to have bales delivered to a local scour or main centre dump.

The loss of identity for the grower and reduced interaction between grower and buyer would further widen the gap between the two. We could also find reduced competition in the broking sector with small local companies facing greater expense and more difficulties attending a centralised selling centre. The larger national based companies could take advantage of this.

Buyers use prices relative to the storage location costs of the wool not the sale location. Buyers prices reflect the full cost to deliver the wool to our customer, or in our case, our own mill. Centralisation of wool storage would assist the buyer but presumably at a greater first cost to the grower. Unfortunately logistic issues dominate the industry.

GENERAL - Digitalisation

The Schneider Group is of the strong opinion that our staff or representatives must have the possibility to inspect the greasy wool samples. The sample creates the competition in the market. We don't believe the consistency or reliability of the full range of tests alone to be satisfactory for our processing requirements. We believe conservative industry appraisal would be detrimental to our business, and therefore the grower. Daily we challenge the test results and appraise wool for the processing characteristics that are not easily tested nor described. This is drawn from our experience with our own combing mills, which all perform differently, and our diverse range of clients requirements. We compete strongly on the best types from the best cardings, best brokens and best spinner style fleece wools, often well above the auctioneer calling price. A clear indication industry description standards are conservative. AWEX id is not commercial in our opinion. Rather it's useful to establish fair average price and market reports and average market quotations. AWEX id relies heavily on the AWTA test result.

It would appear to us the sample is cheap insurance for the grower (although they should retain the sample). With the sample, the buyer guarantees quality to our client or mill and payment (with cash) to the grower. Without the sample, who guarantees this?

Price realisation between the seller and the buyer could be achieved via an online platform.

Maintaining a comparable or improved level of competition for woolgrower's wool with a suitable system is yet to be discovered. Price realisation should be maintained in some way. Previous attempts have given no advantage to the buyer. They've tended to be slower than the auction and the 'screen time' associated with the system was a strong point of concern for the users. At that time the auction market was still determining the level of price. We would expect little cost saving to the buyer, most operate with only a few staff.

Managing the buyers via any proposed online platform would be critical. Any foreign interests would need to operate within Australian competition laws that we would expect. The potential for more risk to the buyer is related to less transparency

GENERAL - Transparency

Growers should be aware of all costs and charges imposed on the exchange of ownership. This would ensure good competition and service through the whole sector. We suspect growers have limited knowledge of broker post-sale charges (BSC) and freight to dump costs.

GENERAL - Selling Alternatives

The auction system currently provides the basis of price internationally.

Representative samples and test results must still be the basis of price regardless of the method of sale. Regardless of the selling method chosen, the logistic handler should still provide the sample for inspection, invoicing, warehousing and delivery to the customer. In our experience the cost of these services 'non auction' is similar to that of auction purchases. Although the time and effort to negotiate individual direct contracts with single or a group of growers must result in higher costs to the buyer. It's difficult to imagine if a processing group like ours was to negotiate a multiple of private arrangements, how this would lead to greater prices to the grower. We would expect these negotiations to be more time consuming than a traditional exchange of ownership through the transparent auction system.

Our experience to date with forward contract would indicate the same principle, price is everything. Growers are typically looking for forward contracts either when the current price is in the high percentile range and they wish to take this price long term (buyers perhaps less willing) or when the price is in the low percentile range and they look for distant months for a premium, again buyers less likely.

We are willing participants in this review and would welcome any correspondence with the panel if any questions arise from our submission.

G. Schneider Australia Pty Limited