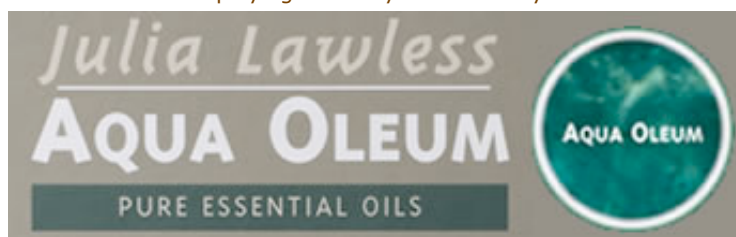


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## Market Update, Spring 2010

Extreme weather conditions, increased global demand and exchange rate fluctuations continue to be the main factors affecting production volumes and prices of essential oils.

Upward pressure on prices always makes it more difficult to maintain quality, especially through retail distribution channels. Producers of aromatic raw materials can adjust their prices immediately in relation to yields and other factors which influence their production costs. However, for companies like us and our competitors it can take several months to pass price increases down the distribution chain due to wholesaler/distributor catalogue printing schedules and market sensitivity. In the interim period essential oil companies can either absorb price increases or reduce quality.

Contractual obligations are most frequently attached to existing stocks i.e. a primary producer has enough stock of a certain quality oil to service a manufacturers needs for the next twelve months. The price is fixed in relation to the quantity required, the exchange rate at the time that the deal is struck and the call off rate. The accuracy or fairness of the deal can be adjusted in the context of long term collaborative relationships by applying the criteria of most recent vintage to the current obligation.

All long term relationships require collaboration so this is very different from trading currency, futures and derivatives, or spread betting. We have been dealing with some producers for over twenty years so mutual benefit matters. Suppose we have committed to taking 200kg per month of certain oil for a twelve month period. After seven months into that contract it becomes clear that there will be a major price correction. We then have a conversation with our producer and agree to a new price based on an average of what we have been paying and the ensuing price for the following twelve months. This becomes our new contract price that overrides the existing contract price and continues for twelve months from the date of the new agreement. This arrangement has evolved out of long term relationships with our suppliers and involves trust from both sides. Suits are not involved; so there are no legal or administrative costs factored in to our prices. I will stick my neck out on this one and say that this kind of long term mutuality is the best possible way of ensuring the purity of our oils.

### China

China has had severe droughts in several oil producing areas – notably those of eucalyptus and geranium. The Chinese authorities have forbidden all production of eucalyptus oil temporarily due to fear of the kind flash fires recently seen in Australia. Significant heat is involved in distillation and also naked flames. The yield of eucalyptus oil will not, in the short term be affected by seasonal drought. However, geranium is cropped twice a year for oil production and the weather impacts dramatically on oil yields. Historically, China has been a net exporter of geranium oil which serviced the huge demand from the cosmetic industry. In more recent times the expanding Chinese domestic market has absorbed most of the native geranium oil. Increased domestic demand and lower production volumes due

to drought have pushed up prices of Egyptian geranium oil. It remains to be seen if sustained price increases will persuade more farmers to grow geranium for the oil industry.

There is also some evidence that the Chinese authorities are tackling environmental pollution. Some oil producers have been prevented from operating until they become more eco friendly. Obviously this is a good thing but in the short term it will add more upward pressure on prices.

## Exchange Rates and New UK Government

Exchange rates of the US\$ and the Euro in relation to sterling will also have an impact. The problems with sovereign debt are very serious and after Greece we can worry about Spain, Portugal and Italy. Some financiers have predicted that the Euro could slide to £0.70 by the end of the year – it is currently £0.86. The US\$ remains the main trading currency for oils coming out of the Orient and it has firmed up against sterling. It is too early to see the effect on sterling of the hung parliament and debatable to what extent such a single factor can be isolated as causal from the interconnectedness of global economic forces.

We at Aqua Oleum and our families are grateful for your continued support and in return for that we pledge that we will do all we can to maintain the quality and purity of our oils.

With best wishes from  
Alec Lawless

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