

CONFIDENTIAL

P&A is often contacted by foreign clients seeking information about the Brazilian coffee business. Inquiries become more intense at times of turbulence, e.g, when a frost or a change in government regulation happens.

In spite of the flood of on-line information about Brazil available today in the coffee news services, we gather from clients' inquiries that what they demand is the view of an insider who understands not only the Brazilian coffee business but also how it may affect their own business. This is what we propose to do with our Confidential newsletter.

Confidential will be sent to you at the beginning of each month with the following sessions: a summary of the relevant news published by the Brazilian press the previous month, prices prevailing in Brazil at the end of the month, an article the Outlook with our opinion about a variety of subjects, and a short piece about coffee processing the Machine of the Month. We hope you like it!

We look forward to receiving your comments. Would you prefer fewer pieces of news in greater detail? Should we include prices for other coffee producing regions? Would you like to have other sessions? Or else? Please let us know, including if you would not like to receive Confidential. Thanks.

RIO DE JANEIRO: SPORTS AND COFFEE CAPITAL

Coffee drinking was intensely promoted during the 2007 Pan American Games that took place in Rio de Janeiro in July. The Coffee and Health Team, composed of 30 physical education students nicknamed Coffee Athletes, used a bus decorated for the occasion to visit game sites, beaches and shopping malls and to distribute leaflets about coffee, sports and health. The mascot of the campaign was a coffee bean called "Carioca" which means both a person born in Rio and a coffee beverage popular in the city.

Source: ABIC



Bus that carried the Coffee Athletes

Carioca, the mascot of the campaign

BRAZILIAN CONSUMPTION GROWS FASTER THAN PROJECTED

The Brazilian Coffee Roasters' Association (ABIC) announced that Brazilian consumption surpassed 17 million bags in the last 12 months, thus anticipating its own target by a couple of months. Coffee consumption in Brazil has been growing 4 times faster than in the world, as shown by the rates of 5.8% vs. 1.5% per year respectively. Low Brazilian stocks coupled with a small crop may not be sufficient to meet domestic and export demands.

Source: Jornal do Comércio RJ

CAFÉS DO BRAZIL NETWORK ATTRACTS 50,000 VISITS

The social networking platform Peabirus (www.peabirus.com.br), created in Brazil 18 months ago, hosts the Cafés do Brazil Virtual Network that comprises "communities" of growers, researchers, cooperatives and companies, under the leadership of the Brazilian Coffee Council (CNC) and EMBRAPA, the agency of the Ministry of Agriculture in charge of research. The most active communities are marketing, husbandry and baristas. Peabirus; a type of Orkut or MySpace directed at business networking; earned the 2007 World Summit Award (WSA) for best business e-content in Brazil.

Source: O Estado de São Paulo



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ICO LAUNCHES VIRTUAL NETWORK TO PROMOTE COFFEE CONSUMPTION

The Brazilian experience with the Cafés do Brazil Network in the internet will be replicated at world scale with the aim of promoting the consumption of coffee. The ICO has commissioned the Brazilian companies P&A International Marketing and Radiumsystems to conceive and implement the network that will start operating late in the year with different communities covering producing countries, traditional consumers and emerging markets.

Source: O Estado de São Paulo / Peabirus

CONILON IS MORE PROFITABLE THAN ARABICA

Jorge Queiroz, a CONAB analyst, estimated that to produce conilon, the Brazilian robusta, is 5 to 6 times more profitable than to produce arabica. Queiroz arrived at this conclusion comparing average prices and costs prevailing in Espírito Santo, for conilon, and South Minas, for arabica, in the current crop. CONAB is the agency of the Ministry of Agriculture in charge of crop estimates.

Source: Gazeta Mercantil

PEPRO AUCTIONS SELL 5 MILLION BAGS

In spite of the controversy after the PEPRO Program was launched, its auctions went on smoothly and sold 5 million bags. PEPRO, which means, "price equalization premium paid to the producer" is a mechanism whereas instead of buying the coffee, the grower receives from government a premium meant to guarantee the price of R\$300.00 per bag of 60kg. The program was well received by growers and their cooperatives but criticized by exporters and roasters.

Source: several / Peabirus

GROWERS ARE RETAINING COFFEE

With 70% of the arabica crop already harvested, growers are holding their coffees supported by the PEPRO and other Coffee Fund (FUNCAFÉ) programs that have released in excess of US\$700 million so far this year. Based on the premium obtained from the PEPRO auctions, growers seem to have a target price of R\$260.00 per bag to be compared with the price of R\$225.00 to R\$230.00 prevailing in the last week of July.

Source: Gazeta Mercantil

GROWERS CONCENTRATE SALES ON LOWER QUALITY COFFEES

Growers are choosing to sell their lower quality coffees (e.g., unripe ones, harvested early in the season) in expectation of higher prices for their better products. Volumes traded have been small lately, with growers' sources claiming that prices should go up between now and the end of the year. Exporters and cooperatives are processing only enough higher quality coffee to meet their commitments.

Source: Agrolink

ADVERSE WEATHER MAY REDUCE NEXT BRAZILIAN CROP

Flower buds are being replaced by leaves, which may cause yields to drop in some areas. Plantations that look better than usual at this time of the year may produce less than expected due to physiological changes caused by atypical weather that goes back to 2006 and includes unusual temperature and rainfall patterns.

Source: EMBRAPA Café / Peabirus



Leaves instead of flowers

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BRAZILIAN STOCKS FALL 56% IN 6 YEARS

The ICO stated in its July monthly report that Brazilian stocks fell 56% between the end of the 2000/01 coffee year and March 31, 2007. The conclusion was based on official figures released by CONAB that carried out a detailed survey of stocks held in private hands. Source: Coffee Break

Brazilian prices

July 31, 2007 

Main Producing Regions / Farm Gate

Arabica Naturals (R\$/ 60 kg bag)	
Cerrado-MG fair average quality T.6	240,00
Mogiana-SP fair average quality T.6	230,50
South Minas fair average quality T.6	237,67
Arabica Pulped Naturals (R\$/ 60 kg bag)	
Cerrado-MG	250,00
South Minas	257,50

Conilon/ Robusta (R\$/ 60 kg bag)	
Vitória-ES fair average quality	200,00

BM&F (US\$/ 60 kg)	
Sep 2007	140,20
Dec 2007	144,40
Mar 2008	147,05

Dolar US\$/ Real R\$	
July 31, 2007	1,88

Outlook Carlos H. J. Brando



Crop Estimates and Hulling Losses

There has always been a heated debate about estimates of the Brazilian coffee crop. Even though the official forecasts by CONAB, an agency of the Brazilian Ministry of Agriculture, are gaining wider acceptance, discrepancies between different sources still remain for reasons that range from different forecasting approaches and techniques to market motivations.

There is a technical factor that has been mostly ignored in the debate: hulling losses. Some forecasting techniques take into account that nutrition, climate, etc. may affect out-turns, i.e., the relationship between the weights of cherries harvested, on the one hand, and green marketable coffee, on the other hand. However this effect is seldomly quantified in a proper way due to a series of factors.

In spite of the recent advances of pulped natural and washed coffees in Brazil, 85 to 90% of the coffee produced in the country is still processed by the dry system that produces natural coffees. The average hulling yields for natural coffees. i.e., the ratio of green coffee to dry cherries, may vary by 10% from one year to the other. This variation around the estimated crop figure introduces a range of fluctuations that may go up to 20% of the estimated value.

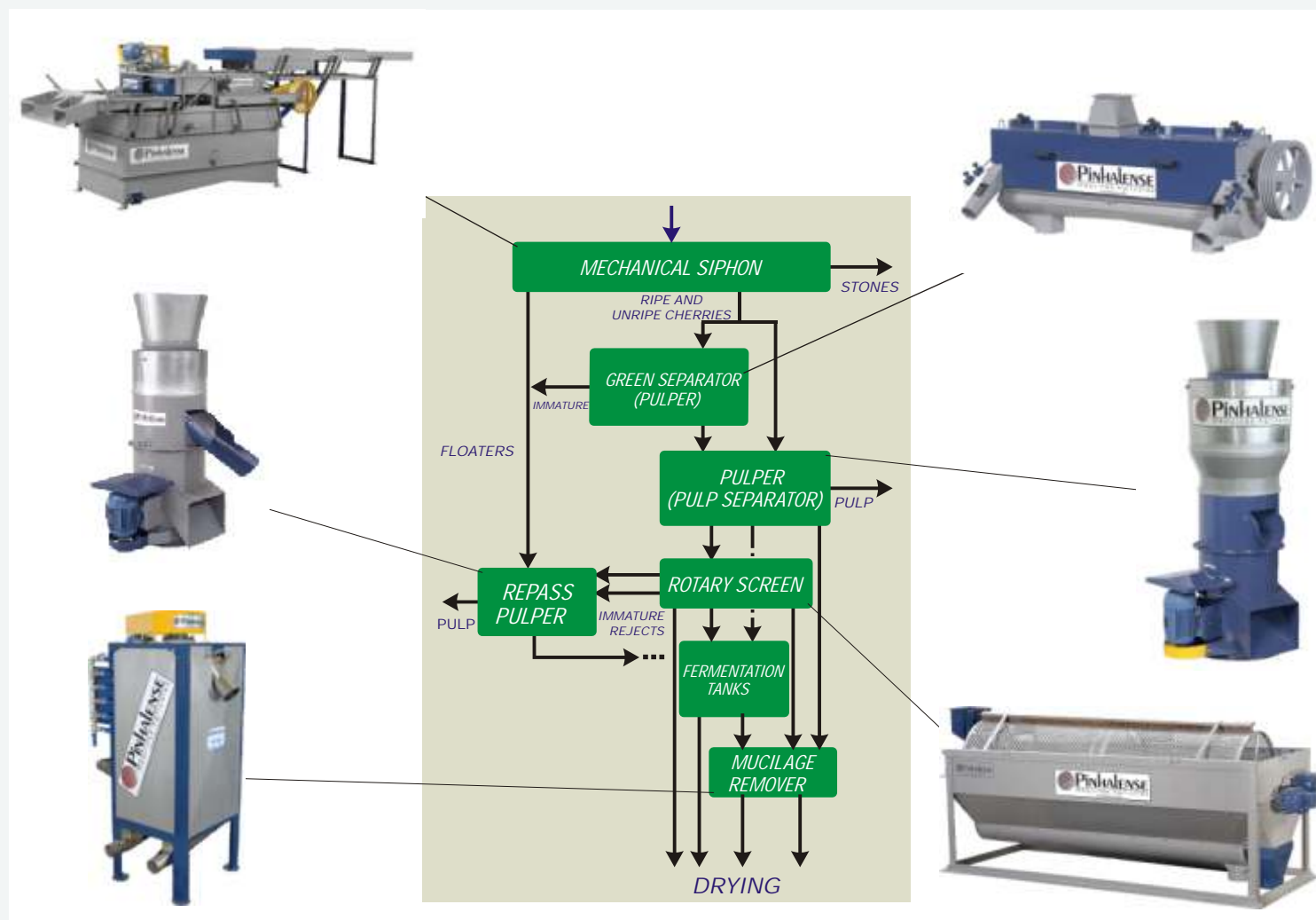
Assuming an average Brazilian crop of 35 million bags, 30 to 32 of which will be naturals, hulling losses alone may cause discrepancies in the range of 6 million bags. In other words, an estimate of 35 million bags based on an average hulling loss could turn out to be either 32 or 38 million bags for the lowest and highest hulling yields!

The calculations above may be theoretical and based on the extreme cases of minimum and maximum yields. Anyhow, they show that when natural coffees are involved and the crop is sizable, which is indeed the case of Brazil, discrepancies of a couple of million bags may be explained by hulling losses that are difficult to predict beforehand.

As a rule-of-thumb, hulling yields are higher in wet years and lower in dry years, among other reasons because coffee husk tends to grow thicker when moisture levels are lower. However there is a lot more to be considered, ranging from harvesting systems to nutrition, as mentioned before, not to mention the percentages of Arabica and Robusta in a given crop year. The point is that depending on the hulling yield assumptions built into the crop forecasting approaches used to estimate the Brazilian crop, discrepancies of 4 or even 6 million bags can happen and should not surprise anyone.

The grower / wet miller is today being squeezed between two different sets of demands. On one side, there is labor scarcity, rising wages and environmental pressures, not to mention the need to be competitive. On the other side, clients require less adstringency, more body and a sweeter cup. Some of these demands are obviously conflicting: labor problems imply less selectivity which causes unripe and partially ripe cherries to be harvested which in turn causes adstringency and a harsh cup. Other demands go in the same direction: adjustable mechanical removal of mucilage is both environmentally friendly and may produce a sweeter cup with a stronger body.

Pinhalense's response to this wide set of demands is the **ecoflex** line of ecological flexible wet milling equipment. This new approach offers damage free pulping; the ability to set apart fully ripe, partially ripe and unripe cherries that may be pulped separately; a system to pulp under-ripe and over-ripe cherries to maximize their value; and a unique approach to gradual removal of mucilage to control body and sweetness.



The **ecoflex** concept allows clients to put together their wet processing line according to their own specific needs. The **ecoflex** system can be adapted to every client requirement by allowing users to create complete mills or to add pieces of equipment such as mechanical siphons, pulpers with green cherry separators and/or mucilage removers to their existing lines whenever such need arises. It is evident that the more complete the line is the better the possibilities are to obtain a higher quality final product. **ecoflex** is a new option in wet milling that can help users to retain coffee quality despite difficulties such as lack of labor and water and/or poor harvesting; likewise **ecoflex** can help millers to meet clients' needs, including those of demanding espresso roasters.

For further information about the **ecoflex** system, please contact
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