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# COFFIDENTIAL

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## FULL MECHANIZATION ON THE RISE IN BRAZILIAN COFFEE PLANTATIONS

In order to fight labor scarcity, many growers in Brazil are favoring full mechanization of their plantations, from soil preparation for planting to harvesting. Many estates already use mechanical systems to apply fertilizers and lime, to spray pesticides, and for weeding; to introduce mechanical harvesting is the present challenge to complete the process. Mechanical harvesting helps to lower coffee production costs as much as 40%. On farms where the topography limits the use of large harvesters, the grower can choose partly mechanized systems that blend human labor with lower cost machines, such as portable hand-held harvesters. Besides lowering costs and increasing efficiency, full mechanization may have positive coffee quality impacts if integrated with adequate post-harvest processing.

Sources: O Estado de São Paulo, CaféPoint and P&A

## PULPING OF IMMATURE (GREEN) CHERRIES INCREASES PROFITS

Many growers in São Paulo and Minas Gerais are now pulping lots composed solely of green (immature) coffee cherries. Treated before as a defect among ripe beans, the green cherries are currently seen as a source of profit. Green cherries, that have been separated when the ripe ones are pulped, return to the same machines later, to be pulped in the same way mature cherries are, but with different adjustments in the pulper. Lots composed of 100% washed green cherries are being graded and sold as good commercial coffee, adding value to a product that was neglected by most growers before.

Source: O Estado de São Paulo

## FENICAFÉ SHOWS THE IMPORTANCE OF IRRIGATION IN COFFEE

During the XII Fenicafé Conference and Trade Fair, in Araguari, Cerrado of Minas Gerais, growers had the opportunity to attend presentations and debates about the Brazilian coffee sector. Fenicafé hosts the annual Conference on Coffee Irrigation that features scientific papers developed by the Brazilian Coffee Research Consortium (CBP&D-Café). One of the main topics discussed was the advantages of irrigation. The current average national yield of about 17 bags/hectare (1 ton/acre) may reach up to 60 bags/hectare (3.6 tons/acre) if irrigation is employed. Only 3% of the Brazilian area under coffee is presently irrigated, although irrigation covers full 100% of Arabica producers in Western Bahia, about 40% of Conilon production in Espírito Santo and Southern Bahia, and substancial percentages of the Arabica coffee grown in the Western and Eastern Cerrado of Minas Gerais.

Sources: Canal Rural, CaféPoint and P&A

## HIGH TECHNOLOGY INCREASES YIELDS IN WESTERN BAHIA

Thanks to investments in irrigation and technology, Western Bahia is now the state's fastest coffee growing area. Whereas yields in the Chapada Diamantina and Southwest regions of Bahia are roughly 18 bags per hectare (1.1 tons/acre), they reach an average of 55 bags (3.3 tons/acre) in the West, that uses advanced technoloy not only to increase yields but also to produce high quality Arabica coffees.

Source: Jornal da Tarde

## CONILON RESEARCH PROJECT LAUNCHED IN MINAS GERAIS

A pilot research project has been recently launched in the Pirapora eastern region of Minas Gerais to study the development of Conilon (Robusta) coffee plantations in conditions that are different from those found in neighboring Espírito Santo state. The partnership between Incaper (the institute in charge of research and rural extension in the state of Espírito Santo) and local growers planted 130,000 Conilon seedlings in an area of 44 hectares (108 acres) located at about 600m (2,000 feet) above sea level. Technicians will evaluate yields, quality and the incidence of plagues and diseases, among other factors. Preliminary results of Conilon behavior in Minas might be available over the next couple of years, after the first crops are due.

Sources: Incaper and CIC (Coffee Intelligence Center)

## BRAZILIAN TECHNOLOGY TO HELP ANGOLAN COFFEE SECTOR

In recent visit to Brazil, the Angolan Vice-minister for Agriculture, Mr. Zacarias Sambeny, showed interest in using Brazil's successful experience in coffee research to help restructure Angola's own coffee sector. Like in Brazil, the majority of coffee growers in Angola are small holders. Coffee areas in Angola were totally devastated by the war and now farmers look again for ways to profit from agriculture, coffee being one of the main targets. The general manager of Embrapa's Coffee Research Consortium and the dean of Viçosa Federal University both demonstrated intention to cooperate with human resources in order to support Angola's project for the establishment of a coffee research institute.

Source: Embrapa Café

## "SOS COFFEE MARCH" BRINGS THOUSANDS TOGETHER IN VARGINHA


More than 15,000 people – coffee growers, processors, workers, cooperative and association members and politicians – got together in Varginha, Minas Gerais, on Monday, March 16th for a walk in favor of coffee. The participants demanded a minimum price for coffee as well as the pegging of growers' debts to their product, i.e., bags of coffee, instead of money. Participants claimed that the coffee crisis may go beyond the coffee sector itself and impact the economies of all producing regions, with major social problems. The total coffee sector debt in Brazil is estimated at around R$ 4 billion (US$1.75 billion).

Sources: Jornal Hoje em Dia, O Estado de São Paulo and CaféPoint

## FEDERAL GOVERNMENT TO BUY COFFEE FOR NATIONAL STOCKS

The Brazilian government may buy as many as 3 million bags of coffee at prices higher than the current market, informed the Production and Agroenergy Secretary of the Ministry of Agriculture, Livestock and Food Supply (MAPA). The measure intends to increase official stocks and to reduce product availability in the market. The Brazilian government has not bought coffee for stocks since 1999. Since then government stocks have fallen to around 500,000 bags compared to 8 million bags a decade ago.

Sources: Bloomberg News and Gazeta Mercantil

## GROWTH OF CONSUMPTION DISAPPOINTS INDUSTRY BUT REMAINS FIRM FOR GOURMET COFFEE

Brazil's total domestic consumption of coffee reached 17.66 million bags in 2008, a 3.2% growth over the previous year, but still below ABIC's expectations of 18 million bags. For 2009, consumption should not fall, but the association forecasts a reduction in consumption growth due to the economic crisis. The industry target of 21 million bags by 2010 has now been rescheduled for 2011-12. Meanwhile Brazilian consumption of gourmet coffees has been growing 15% per year on average. While gourmet coffee represents only 4% of the total consumption of roasted and ground coffee in the country, it accounted for 7 to 8% of the total sales in 2008, which reached R$ 6.5 billion (US$ 2.8 billion), according to the Brazilian Coffee Roasters' Association (ABIC).

Sources: Folha de São Paulo and Agência Estado


## SARA LEE PREPARES CAFÉ DO PONTO EXPANSION

Sara Lee will invest around R$ 30 million (US$ 13 million) in a roasting plant in Minas Gerais to support the expansion of the Café do Ponto coffee shop chain in Brazil. The company plans to open 50 stores until the end of 2010. With this growth, Sara Lee intends to strengthen retail sales of its own coffee brand Café do Ponto, that holds only 1% of market share at supermarkets in the country.

Source: Cidade Biz

# THE FUTURE OF COFFEE PRODUCTION IN BRAZIL

The table on the right presents a snapshop of the profitability of coffee production in Brazil, Robusta and Arabica, using average figures across the board, from yields to costs to exchange rates.

| VARIETY | FARMGATE COST (US cents/lb) | FARMGATE PRICE (US cents/lb) |
|---|---|---|
| ROBUSTA (CONILON) | ~35 (30-40) | ~70 (+) (65-75) |
| ARABICA | ~95 (85-110) | ~90 (-) (85-105) |

It is obvious that Robusta growers are making extraordinary profits whereas Arabica ones are barely making ends meet, if that much. Brazilian growers of Robusta are very competitive internationally, with costs of production comparable to those of Vietnam. The costs of producing Arabica in Brazil are still competitive when compared with those of other countries, but the large negative differentials for Brazilian naturals in relation to the C Contract at the New York exchange (NYBOT) are rendering Arabica growing unprofitable in Brazil.

The future of Conilon/Robusta growing in Brazil looks bright from either perspective, domestic market or exports. A quick and rough projection of Brazilian Robusta demand for 2009 indicates 7.5 to 8.5 million bags for domestic roasters, 3 to 4 million bags for the soluble industry (about 80% of which will be exported as soluble coffee ) and 1 to 2 million for exports, using a conservative figure. Adding the estimates above, one arrives at a range of 11.5 to 14.5 million bags of demand for a Brazilian supply of about 11 to 12 million bags. Conilon production has definetely room to grow, more so considering that current production costs allow exporters to be much more aggressive in foreign markets, which makes the export estimate above indeed conservative now and in years to come.

Conilon production may expand in three different ways: higher yields in current areas, new plantings in traditional Conilon areas, and the opening of new areas. Technology developed in the leading producer state of Espírito Santo has constantly improved yields to first 6, then 10 and now a record breaking 12 tons/ha whereas the average yield for the state is still under 2 tons/ha. There is much space for growth in existing areas, specially considering that the high yields reported above have not been obtained in test plots but in actual plantations and refer to 4-year sliding averages. Since high-yielding Conilon is mostly planted in low altitude areas that are not very far from the ocean and benefit from lower labor costs, the existing techonology will have to be tested and most probably adapted as Conilon moves into the highlands of São Paulo and Minas Gerais that are considering this alternative to Arabica production. Another area that is gaining attention is quality improvement with increasing interest in the production of washed Conilons for the high end of the domestic market and exports.

The future of Arabica production in Brazil is much more difficult to predict. However, it is already clear that if the current cost-price relationship remains, there will be no expansion but probably no erradication either yet, perhaps some abandonment. Arabica growers' hopes that the devaluation of the local currency, the Real, in recent months would improve their profitability were frustrated by the fall in international coffee prices and the widening of Brazilian differentials. Holding roughly one-third of Arabica world exports, Brazil has grown used to seeing international Arabica prices fall when the Real is devalued. In passing, Vietnamese growers are learning that the same phenomenon is also happening to them, in the case of Robustas, since they supply about one-third of world exports as well. These are the hardships of having a large market share!

In spite of the “safety net” of domestic consumption, that absorbs about 30% of the average Arabica production, Brazilian growers of Arabica will have to gain competitiveness in order to retain their current share of world exports. This task is difficult but not impossible because there are still large traditional areas to be tecnified, irrigation may lower production costs by ensuring production in dry years, and there are new frontiers to be explored, specially technological but also geographical. However these are mid to long-term solutions. In the short run, improved farm management, better use of existing financial instruments and value addition have a better chance to enhance the competitiveness of Brazilian Arabicas. Whether they will suffice will be seen in this and the next crop.

# Brazilian prices

March 31, 2009

## Main Producing Regions / Farm Gate

| Arabica Naturals (R$/ 60 kg bag) | | |
|---|---|---|
| Cerrado-MG fair average quality T.6 | 265,00 | = |
| Mogiana-SP fair average quality T.6 | 265,00 | ↑ |
| South Minas fair average quality T.6 | 268,00 | ↑ |

| Arabica Pulped Naturals (R$/ 60 kg bag) | | |
|---|---|---|
| Cerrado-MG | 280,00 | ↑ |
| South Minas | 285,00 | ↓ |

| Conilon/ Robusta (R$/ 60 kg bag) | | |
|---|---|---|
| Colatina-ES fair average quality | 205,00 | ↓ |

| BM&F (US$/ 60 kg) | | |
|---|---|---|
| May 2009 | 124,80 | ↑ |
| Jul 2009 | 129,70 | ↑ |
| Sep 2009 | 134,00 | ↑ |

| Real R$/ Dolar US$ | | |
|---|---|---|
| March 31 | 2,32 | ↑ |

# A BETTER MOUSE TRAP...

No, Pinhalense has not entered the business of making mouse traps. Yes, there is a global crisis but demand for coffee and machinery remains healthy. Pinhalense is producing coffee equipment as usual and selling it well around the world. Crises and opportunities indeed go together.

The reference to a “better mouse trap”, an English expression that epitomizes the search for ever better technology, relates to Pinhalense's permanent quest to offer to clients a perfect line of coffee processing machinery. For almost 60 years Pinhalense has been striving to develop and produce the best coffee processing equipment, the “best coffee trap”, a good trap that “catches” the clients and leads them into a process of making more money with the help of Pinhalense equipment.

It is sensible to bring up this subject at a time when the world faces the worst crisis in 80 years. Economic and financial crises tend to slash investment budgets and to trigger a process of “down-trading” whereby the initial cost of coffee processing equipment — the capital investment — often becomes the overriding decision factor in the purchase of new machinery. Nothing could be wronger in the purchase of coffee processing equipment that will last at least 25 years than to ignore the stream of benefits that higher quality, more efficient machines will make possible over their lifetimes. However, the contagious pessimism of crisis times often induces otherwise sensible managers into decisions that focus on minimizing investment at the expense of a long and healthy stream of benefits.

This wrong decision making process is more flawed the lower the interest rates are. Interest rates have never been so low in recent years. If interest rates are low, future gains have a much stronger effect to shorten the payoff period because the stream of future benefits has a higher net present value. Therefore the choice of machines based only on their price tag, ignoring the future stream of benefits, may lead to wrong decisions that will be regretted for a long time, over the useful life of the equipment.

Leaving the “economese” and the “financese” aside and using plain good English, truth is that with the current global crisis and low interest rates, it is more important than ever to choose high-efficiency coffee processing equipment. Higher initial price, higher capital investment will be fully offset by a healthy stream of future gains due to, for example, selective pulping of only fully ripe cherries; parchment that is free from pulper cuts, bruises and other damages; beans that have been dried with controlled temperature; smaller hulling losses; no down-grading of bold beans in size graders; lack of sound beans in the rejects of densimetric separation, etc. A different type of example refers to less flexible layouts, i.e, fewer elevators and silos in order to minimize investment at the expense of operating efficiency, with the negative result that, for instance, idle time is greatly increased when small lots are processed or high capacity processing is hampered by design bottlenecks.

Do not be deceived by short-term “virtual” investment gains that will be reflected in a perpetual stream of processing inefficiencies and losses, let alone the negative impacts of less than ideal product quality. Do not allow the neurosis of the crisis to bias the sound analysis that should orient your investment decisions, that may adversely impact the performance of your mill and company for many years to come.

Pinhalense is your coffee machinery manufaturer partner in good and bad weather, when coffee prices are high or low, in good years and crisis years.

We apologize if this note is rather irreverent, but irreverence is yet another way to weather the crisis... Indeed we need a better mouse trap for the world financial system.