

CONFIDENTIAL

ISSUES NOS. 1 TO 43 OF COFFIDENTIAL CAN BE FOUND AT SITE www.peamarketing.com.br

THIS ISSUE:

- HOW LONG WILL HIGH PRICES LAST AND WHEN WILL OVERSUPPLY OCCUR? (PAGE 3)
- PINHALENSE WEEDING EQUIPMENT GOES ABROAD AS NEW FACTORY IS OPENED (PAGE 4)

PLANTED AREA WILL NOT GROW IN RESPONSE TO HIGH PRICES

The record-high prices of Arabica coffee in the NY Coffee Exchange (ICE) and in the Brazilian market should not cause the expansion of plantations in Brazil, according to specialists. The planted area will probably remain stable, close to the current 2.1 million hectares; coffee growers will instead invest in increasing yields, reducing production costs and enhancing quality. Analysts estimate that prices will fall as supplies normalize in two years.

Source: Agência Estado

FOOD INDUSTRY UNDER PRESSURE FROM RAW MATERIAL PRICES

The high prices of commodities in international markets and in Brazil itself have led the Brazilian food industry to adjust the retail prices of their products. Sara Lee, for example, has recently increased the price of Café Pilão in supermarkets by 15%. Pilão is the current market leader in the R&G segment in Brazil.

Source: O Estado de S. Paulo



BRAZILIAN PER CAPITA CONSUMPTION IS THE HIGHEST IN 45 YEARS

Consumption of roasted and ground coffee in Brazil reached the historical mark of 4.81kg/person, equivalent to 81 liters of the beverage, in 2010. Per capita consumption in Brazil is already higher than those of Italy and France, which are large coffee consuming countries. Brazilian domestic consumption totaled 19.1 million bags of coffee in 2010, 4% more than in the previous year, and estimates are that it may increase 5% in 2011.

Source: Agência Estado

RUSH TOWARDS COFFEE MACHINERY DURING SHOW TEC



The fourth edition of Show Tec (Agribusiness Technology Show), in the city of Guaxupé received 12,000 visitors last February. The booths that exposed coffee processing equipment such as separators, pulpers and dryers were the most sought after by the public, including Pinhalense's. Organizers believe that the high coffee prices are causing growers to look for ways to increase the quality of their products. The fair, organized by Cooxupé cooperative, occupied an area of 9,000 m² (97,000 sq.ft) and generated R\$20 million (US\$12 million) worth of business transactions.

Source: Cooxupé and P&A

IMPLEMENTATION OF CUP QUALITY LEGISLATION DELAYED

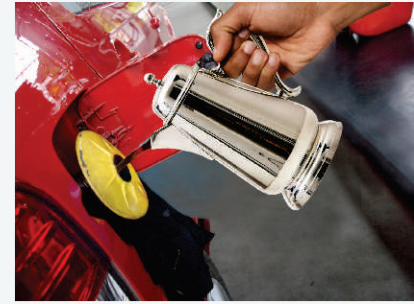
The implementation of cup quality evaluation, that is part of the recently enacted regulation that establishes a minimum quality standard for R&G coffee produced in Brazil or imported from other origins, will be delayed by two years. During this period, the Brazilian Ministry of Agriculture (MAPA) plans to develop adequate monitoring capability with the training of more than 340 coffee cuppers and several institutions to evaluate R&G coffee according to standards that measure cup quality on a 0 to 10 point scale, with 4 being the lowest acceptable grade.

Source: MAPA

BEYOND THE CUP: BIODIESEL FROM COFFEE GROUNDS

A recent study conducted by researchers at the University of São Paulo (USP) proved that it is possible to produce biodiesel with oils extracted from wasted coffee grounds. One kilogram (2.2 lbs) of coffee grounds can generate 100 ml (3.5 oz) of oil and 12 (0.4 oz) ml of biodiesel. Considering that Brazil consumes around 18 million coffee bags (1.08 million tons) per year, the amount of biodiesel that can be produced is very significant. Although researchers believe that it is hard to collect coffee grounds to produce biodiesel in industrial scale, coffee biodiesel could be viable at small scale projects.

Source: R7



COFFEE LEAF MINER RESISTANT PLANTS SUCCESSFULLY CLONED

Embrapa and Prócafé Foundation researchers succeeded in cloning coffee plants that are resistant to the leaf miner pest. The clones are being developed in labs with the use of a technique called somatic embryogenesis. The cloning process takes two years to be completed. There are already 400 clone seedlings in the Prócafé Foundation test fields. The next step is to distribute the clones to South Minas cooperatives.

Source: EPTV

COFFEE GERMLASM BANK TO STRENGTH BREEDING PROGRAM



Minas Gerais state, that accounts for almost half of Brazilian coffee production, is establishing a germplasm bank in order to collect different coffee genotypes from the *Coffea* genre. The objective of the project, coordinated by the Minas Gerais Agriculture and Livestock Research Institution (EPAMIG) is to collect plants resistant to different pests and diseases and also with different morphological aspects (height and plant architecture) to be used in genetic enhancement programs. The plants are being collected in research institutions, private companies and coffee farms in the states of Minas Gerais, São Paulo, Espírito Santo and Paraná. The bank contains plants of the Bourbon variety obtained from centennial plantations.

Source: Pólo de Excelência do Café

COCA-COLA TO INTRODUCE HOT AND COLD COFFEE IN BRAZIL

Sales of the Coca-Cola Company in Brazil grew 11% last year, more than double the company's worldwide growth of 5% and ahead of China's 6%. The company has been expanding its sales to Brazil's "new middle class" whose purchasing power has increased considerably in recent years. In order to further strengthen its presence in the country, Coca-Cola has recently announced its plans to introduce hot and cold ready-to-drink coffees in Brazil in the near future. The country is currently Coke's fourth largest market in terms of volume after the US, Mexico and China.

Source: O Globo



Pictures of the Month

MOUNTAIN GROWN COFFEE IN BRAZIL



Photos: Noésia Delai (Itaguaçu/ES); Lucas Louzada (Vargem Alta/ES)
Source: CaféPoint

HOW LONG WILL HIGH PRICES LAST AND WHEN WILL OVERSUPPLY OCCUR?

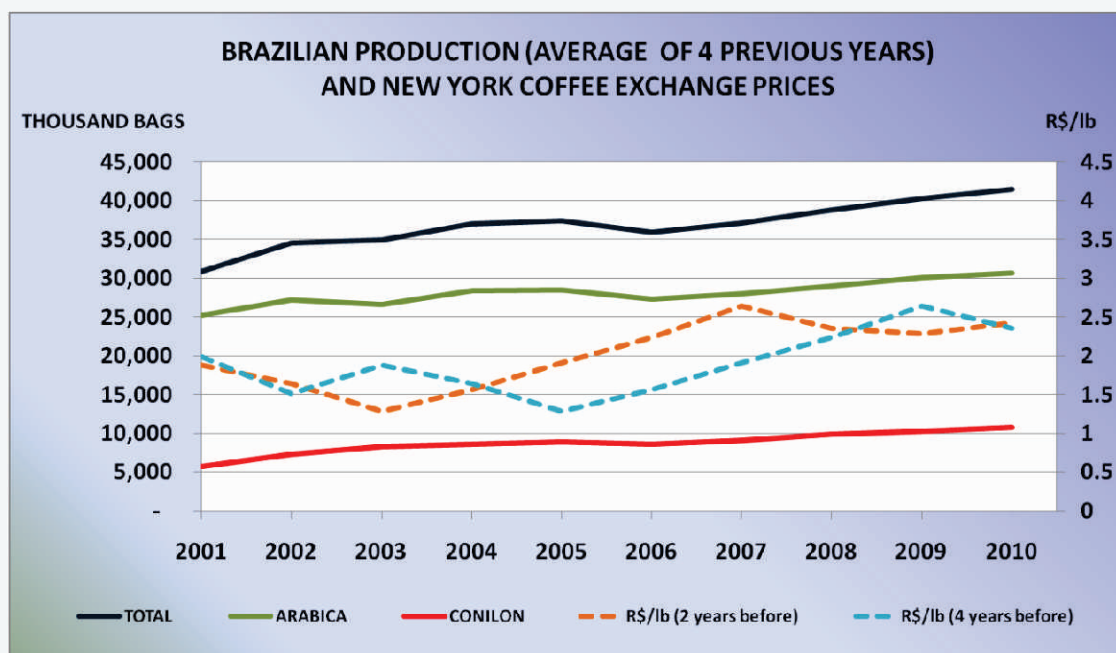
Is the current, sustained surge in prices something new and different or just another event in the historical “roller-coaster” of coffee prices? There may be enough reasons to claim that things are different this time. Firstly, coffee price escalation is riding the wave of a similar process for most commodities, agricultural or not, unlike earlier events when coffee prices soared as a result of a supply crunch, usually a frost or a draught in a key producing region. Secondly, as argued in Confidential No. 42, the weakening of the US dollar and the strengthening of currencies in major producing countries, specially in Arabica ones but in some Robusta too, require the US dollar prices of coffee to go up to entice production to continue and even to increase to meet growing demand.

Yet another reason that seems to make the price hike different this time is the wide(ning) price gap between Arabicas and Robustas, first, and between higher and lower quality Arabicas too, especially in Brazil but also in other producing countries. Does the wide(ning) price gap between Arabica and Robusta mean that the ability to use lower cost Robustas to replace higher cost Arabicas in coffee blends reached its limit? Or does it mean that the strengthening of currencies has been more pronounced in Arabica than Robusta producing countries, again as argued in Confidential No.42? The current hunger for higher quality Arabicas and the smaller interest for Robustas is usually attributed to reduced supply in key Latin American producers of mild washed Arabicas. However, the actual reason may lie on a change in the profile of consumption, with increased demand for better products as quality trickles down from the specialty coffee niche market to the more mainstream segment of single-serve consumption at home, i.e., the coffees we branded as *differentiated* at Confidential No. 26. The acceptance of washed Brazils as deliverable at ICE’s “C” Contract may be yet another indication of this new reality: a supply squeeze of top quality coffees coupled with a growing market for *large volumes, consistent quality, differentiated* coffees.

The extent and speed of the reaction to high prices to be expected in the coffee producing areas of the world will vary greatly depending on the organization and dynamics of the coffee business and the access to technology and inputs in each growing country. Although coffee seedlings are in short supply or lacking in most places, this is only the beginning of a process that most analysts agree will generate oversupply by 2015 the latest. Oversupply may however occur earlier because growers have a wide array of tools to increase coffee production besides new planting in new areas, which is the slowest and probably most expensive way to achieve this goal.

In the very short run – next crop – growers may resort to improved post-harvesting processing to increase their volumes of higher quality coffees, the product in the shortest supply. Irrigation and the suspension of pruning are other tools that may impact yields in the next crop. In areas where coffee is shaded, greater yields can be also obtained immediately by thinning out the shade. Better husbandry, especially fertilization, will improve yields two years from now – the crop after the next – as will the renovation of plantations using pruning techniques. Opening up new coffee areas will produce results in only three to four years, depending on irrigation, varieties, climate, etc., reason why we agree that overproduction will certainly occur in 2015 the latest.

What to expect from Brazil, the largest producer and one that tends to react quickly to price increases, will depend greatly on exchange rate parities, i.e., whether its local currency will remain strong and overvalued. If the past stores answers for the future, it may be helpful to analyze the graph below.



If Brazil increased production at times when local-currency-denominated New York coffee exchange prices were in the range R\$ 1.5 to 2.5/lb, what to expect now that these prices are above R\$ 4.50/lb?

PINHALENSE WEEDING EQUIPMENT GOES ABROAD AS NEW FACTORY IS OPENED

Pinhalense has been manufacturing weeding equipment for over a year now, with sales restricted to the Brazilian market. Clients who visited Pinhalense last year had the opportunity to see this equipment being manufactured in the main factory and some visitors also saw field demonstrations of these tractor-mounted machines that can be used for most crops, coffee included.

This month of March 2011 will be important in the short history of Pinhalense weeding equipment because the new product line will be made available for exports and a new manufacturing facility will be opened to make initially this product and then other machines to support coffee harvesting.



TPSV - 090



TPP - 160



TPL - 220

Pinhalense's third factory is also located in Espírito Santo do Pinhal, state of São Paulo, on a 4-acre plot bordering the main access highway to the town, a strategic road for the coffee business because it links the producing regions of Mogiana and South Minas to each other and to Santos harbor. The new manufacturing facility is initially housed in a 60,000 square-foot warehouse that has been fitted with state-of-the-art machine tools, modern material and product handling equipment, and an eco-friendly painting station. Plans already exist for the construction of a second warehouse of the same size, next to the first one, as sales expand and the product line grows.

The main product now available for exports is the tractor-mounted weeding equipment that may be used for both soil clearing before planting and weeding between the rows of perennial crops like coffee, oranges, nuts, etc. In both cases, the organic material cut by this hammer-mill type of weed-cutter is left on the top of the soil. The cutting shaft operates close to but above the soil in order not to revolve top soil in the case of preparation for direct planting or the cutting of micro-roots in the case of perennial crops. The field performance of the new equipment has been so satisfactory that all sale estimates have been surpassed and the construction of the new factory had to take place much earlier than expected.

The new weeding equipment is connected to the P.T.O. of a tractor with a minimum engine size of 25HP, available in widths from 0.90 to 2.20m (35 to 85 inches) and with options to operate behind the center of the tractor or skewed to either side if weeding below the branches of perennial crops is required.

Several models of the Pinhalense line of weed cutters can be seen in operation at www.youtube.com/Coffidential.

Brazilian Prices

February 28, 2011

Main Producing Regions / Farm Gate

Arabica Naturals (R\$/ 60 kg bag)	
Cerrado-MG fair average quality T.6	525,00 ↑
Mogiana-SP fair average quality T.6	520,00 ↑
South Minas fair average quality T.6	520,00 ↑
Arabica Pulped Naturals (R\$/ 60 kg bag)	
Cerrado-MG	575,00 ↑
South Minas	575,00 ↑

+ ~11%

Conilon/ Robusta (R\$/ 60 kg bag)

São Gabriel da Palha-ES fair average	230,00 ↑
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BM&F (US\$/ 60 kg)

Mar 2011	352,00 ↑
May 2011	355,00 ↑
Jul 2011	348,65 ↑

Real R\$/ Dolar US\$

February 28	1,66 ↓
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Source: Qualicafex