

CONFIDENTIAL

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HIGH PRICES BOOST RENEWAL OF COFFEE PLANTATIONS



Record high coffee prices will enable Brazilian coffee growers to renew their coffee plantations. As worldwide coffee demand keeps growing and some important producing countries fail to increase production, the renewal of coffee plantations in Brazil seems crucial. Renewal is part of growers' strategy to make coffee plantations more productive by increasing the number of plants per hectare while retaining the ability to use mechanical harvesting to reduce production costs.

Sources: Reuters / Brasil Online

MOST OF SOUTH MINAS MAY BE MECHANIZED

A recent study developed by the Federal University of Lavras (UFLA) indicates that 68% of the coffee areas in the South Minas region may be mechanized, despite the mountainous terrain and the rainy climate. South Minas, responsible for 25% of the national coffee production, has less than half of its coffee area currently mechanized. Harvesting costs can be reduced by over 60% with mechanization, according to UFLA, depending on the system adopted by each farm. Whereas manual picking costs R\$ 2,400 (US\$ 1,500) per hectare on average in Minas Gerais, semi-mechanized stripping costs approximately R\$ 1,250 (US\$ 760) per hectare. When harvesting is done with large mechanical harvesters, costs fall to around R\$ 900 (US\$ 550)/hectare. P&A estimates that 18% of the coffee harvested in Brazil is already done with the use of these machines, especially in Western Bahia and the Cerrado of Minas.

Sources: Valor Econômico

STUDY MEASURES GHG EMISSIONS FROM COFFEE PLANTATIONS

A study conducted by researchers at the University of São Paulo concluded that Arabica coffee plantations in the main producing areas of Minas Gerais state have low levels of greenhouse gas (GHG) emissions, ranging from 2.00 ton/ha to 4.95 ton/ha, depending on the region, which is 2 to 4 times less than the GHG emissions for other grains. The study only considered emissions "before farm gate". The study was funded by Italian roaster illycaffè, as part of its plan to inform consumers about the greenhouse gas emissions of its products.

Source: Valor Econômico

"BLACK HEART" WORRIES COFFEE GROWERS

A physiological disorder in the coffee bean called "Coração Negro" (Black Heart) is worrying coffee growers in Southern Minas. Upon cutting normal-looking coffee beans that fall from trees, one finds that one or two of the beans are black. This disorder is associated with periods of high temperatures and dry weather occurring about three months after blooming. As "Coração Negro" is associated with specific environmental conditions, the phenomenon will only stop after weather returns to normal. Growers are alert for pests and diseases whose dissemination may be facilitated by the Black Heart phenomenon.

Source: Pólo de Excelência do Café



Brazilian Prices

March 31, 2011

Main Producing Regions / Farm Gate

Arabica Naturals (R\$/ 60 kg bag)	
Cerrado-MG fair average quality T.6	545,00 ↑
Mogiana-SP fair average quality T.6	540,00 ↑
South Minas fair average quality T.6	540,00 ↑
Arabica Pulped Naturals (R\$/ 60 kg bag)	
Cerrado-MG	585,00 ↑
South Minas	580,00 ↑

+ ~8%

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

São Gabriel da Palha-ES fair average	205,00 ↓
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BM&F (US\$/ 60 kg)

May 2011	344,00 ↓
Jul 2011	340,45 ↓
Sep 2011	332,00 ↓

Real R\$/ Dolar US\$

March 31	1,62 ↓
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Source: Qualicafex

20th ANNI VERSARY OF ILLYCAFFÈ QUALITY COMPETITION



The traditional Ernesto Illy Quality Competition for Espresso Coffee had its 20th Brazilian edition in 2010 and the corresponding award ceremony took place last month. The competition distributed more than R\$ 180,000 (US\$ 109,000) in prizes to the winners. Only two producing states competed for the top places: São Paulo, which had 3 finalists included in the top 10 best coffees, and Minas Gerais, where the other 47 finalists came from. Coffee samples were evaluated by Brazilian and foreign specialists and the great winner was a coffee from the municipality of Timburi, South-West of São Paulo, whose grower won the prize of R\$ 50,000 (US\$ 30,000).

Source: Revista Cafeicultura

10 ROASTERS HOLD 75% OF BRAZILIAN MARKET

The coffee industry has never been so concentrated in Brazil. Data collected by ABIC indicates that the 10 largest coffee roasters in the country are now responsible for 75% of domestic market sales. This participation has almost doubled since 2003, when the 10 leading companies accounted for 43% of sales. 3 Corações, the second largest coffee roaster in Brazil, has recently announced the acquisition of Café Fino Grão, the second best-selling brand in Belo Horizonte, capital of Minas Gerais state. This announcement comes only four months after Sara Lee acquired Café Damasco. Concentration in the coffee industry is notably higher in larger cities with local and regional coffee brands still very strong in smaller cities and towns.

Source: Valor Econômico

SARA LEE EXPANDS IN BRAZILIAN NORTHEAST

Sara Lee, coffee market leader in Brazil, has started an expansion plan in northeastern markets, where its participation is still small in relation to 3 Corações, its main competitor. While Sara Lee accounts for 30% of coffee sales in the central and southern areas of Brazil, the company's share is only 9% in the Northeast. The multinational has acquired and reopened a roasting plant in Salvador, Bahia, which is estimated to produce 20,000 tons of coffee per year from locally sourced Arabicas and Robustas.

Source: Valor Econômico

BRAZIL TO BE PORTRAIT COUNTRY OF SCAA EVENT

Brazil will be the Portrait Country of SCAA's 23rd Annual Event, to be held in Houston, Texas, between April 28 and May 1. Participants will have the opportunity to learn more about Brazil's diversified coffee production and its many producing regions, besides the latest innovations and sustainability practices employed in the production of high quality coffees. The *Cafés do Brasil* booth will be at a prime location on the show floor and several promotional activities are being planned for the event, from presentations to entertainment.

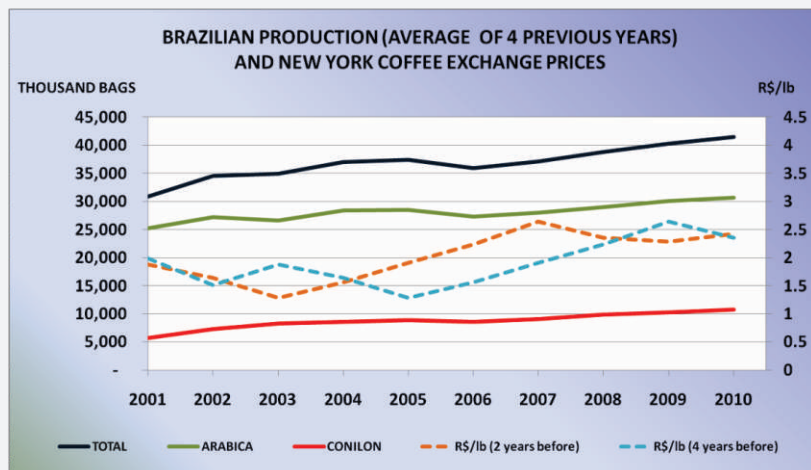
Sources: MAPA and P&A

PinHALENSE Máquinas Agrícolas and **P&A** international marketing

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HOW AND WHEN BRAZILIAN COFFEE PRODUCTION MAY EXPAND



Last month's Outlook ended with a graph that is repeated here and explained. The graph on the left-hand side uses four-year averages of Brazilian crops in order to abstract from the on-off cycle and to identify mid-term trends. Prices for a given year are those prevailing 2 and 4 years before because that is the time it takes for production to increase in response to a price incentive. The average prices in the New York coffee exchange have been converted to the Brazilian currency.

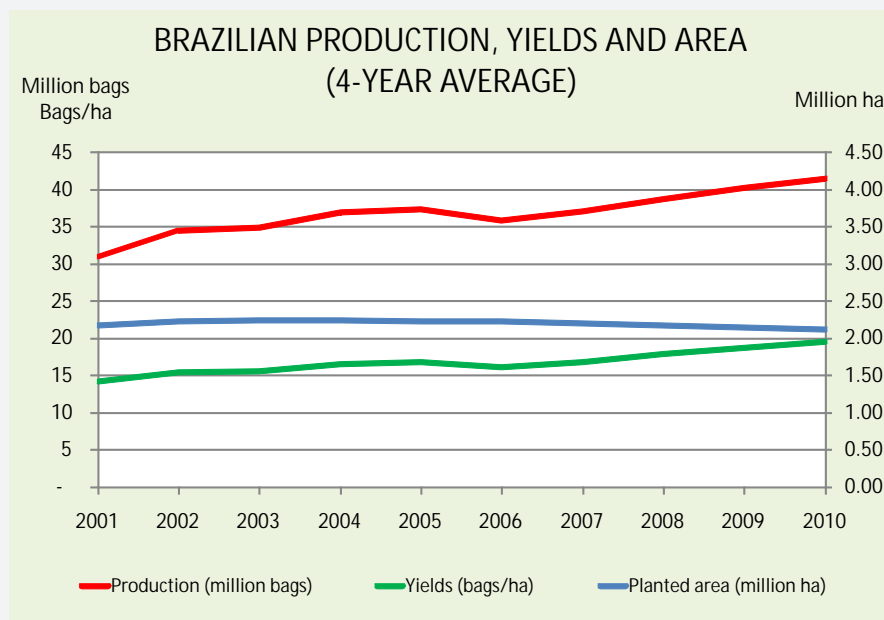
Brazilian production increased consistently in the last 10 years in response to coffee prices in the range of R\$1.30 to 2.60 per pound. If

the past holds lessons for the future, we should expect a large expansion now that prices are above R\$4.50/lb. How and when will it take place?

Last month's Outlook described ways to increase coffee production and indicated how long it would take. Even though new planting was described as the slowest and most expensive way, let's start with it. Will Brazil embark on a new massive coffee planting program? This is highly unlikely because coffee land prices have increased markedly, up to three times in some areas. In addition, new coffee plantations would have to displace other crops, including sugar cane and eucalyptus, planted as a result of multi-year land lease contracts. Even the argument that growers themselves already hold land that can be planted may not resist a sound economic analysis of the costs of developing new coffee areas vis-à-vis other options to increase production.

If one can again learn from history, the graph below shows that the area planted with coffee has remained relatively stable in the last 10 years and that coffee production has increased because yields per hectare have grown by almost fifty percent in the period, from 14 to 20 bags/ha. This substantial increase in yields has resulted from more intense use of technology. Coffee yields have increased because of more intense fertilization, better cultivation practices, plague and disease control, let alone denser planting and better varieties. Irrigation also played a role in recent years.

Increases in yields are likely to be accelerated in response to high coffee prices, with more intense fertilization and better husbandry in the forefront for progressive yield gains and irrigation to account for major yield hikes. Recent studies show that even a small rainfall deficit can cause substantial crop losses (45% in 10 years in the case of an experiment in South Minas) and the cost of irrigation equipment has been falling in real terms. Pruning, that has been increasing and has even taken the form of the "zero-crop" system described in Confidential No. 19, is likely to be discontinued while coffee prices remain high. If the Brazilian option is for increased yields and not major new plantings, the 2012 and especially the 2013 crops should already show sizable increases, with a good potential for the 2014 on-year crop to be the largest ever, in the absence of climate problems.



At a time when the world is hungry for land to plant food crops, coffee production should be increased by means of higher yields and not new planted areas. If today Brazil and Vietnam account for only 25% of the area planted with coffee in the world but together the two countries respond for almost 50% of world production, there is huge potential for other producing countries to increase their coffee yields. Will this be the opportunity?

PINHALENSE, P&A AND SPECIALTY COFFEE: AN IMPORTANT DIFFERENTIAL AND ADDED VALUE FOR CLIENTS



As manufacturers and suppliers of coffee processing equipment and traders and consultants in the area of post-harvesting technology, marketing and promotion of coffee consumption, Pinhalense's and P&A's activities are closely related to specialty coffee in many different ways, from the transformation of basic and applied research results into actual machines to the inducement of research in areas where the two companies detect the need for new products and solutions. Pinhalense has its own highly specialized research and development team that is devoted to post-harvesting processing. Pinhalense and P&A also have an important role in the introduction and dissemination of technologies and habits, from new processing techniques to coffee consumption. A few examples of Pinhalense's and P&A's involvement with specialty coffee are found below.

THE PULPED NATURAL / SEMI-WASHED PROCESS: coffees that dry with part of or all the mucilage, gain body and sweetness, and have become a key component of espresso and other blends.



Pinhalense in Brazil and P&A abroad were instrumental in the creation of this new, intermediate processing system that enabled, first, the repositioning of Brazilian coffees as a high quality product and then moved abroad to change and modernize the concept of wet milling elsewhere.



A NEW PARADIGM IN WET PROCESSING: coffees that derive from 100% ripe cherries irrespectively of the harvesting system; processing coffee that is free from adstringency and other defects for a new world of high pressure extraction and new coffee products.

Pinhalense and P&A are pioneering efforts to wet mill coffee not only to obtain top quality parchment but also other product fractions that are processed to maximize their qualities for specific markets. This ensures maximum returns for growers and processors in spite of the fact that the selectivity of harvesting is falling as a result of labor costs and scarcity.



Pinhalense and P&A are spear-heading efforts to ensure that grower and labor incomes are protected and enlarged with the use of modern appropriate harvesting and post-harvesting technology.



COFFEE DRYING TECHNOLOGY: world leadership in the drying of parchment, cherry and green coffee.



A lot of research and development has gone into perfecting the line of SRE rotary driers that are today the world's best selling drying machines, with close to 20,000 units sold in over 50 countries. Today Pinhalense can produce one large SRE-150X drier per hour with the help of computer - operated machine tools and robotics. Pinhalense is now launching a new line of highly efficient heat exchangers with different options of temperatures, air flows and fuels in order to supply hot clean air to dry quality coffee efficiently.

PROCESSING GREEN COFFEE ACCORDING TO MARKET REQUIREMENTS: providing the grades and qualities that clients require.

The lines of Pinhalense size and shape graders and MVF gravity separators make use of the latest scientific findings and the company's own research to prepare any type of product the market requires with the highest efficiency. Pinhalense and P&A have helped introduce size grading and size-dedicated densimetric separation in several countries in order to meet the demands of both the specialty and commercial markets, with important gains for traders and processors.



A BETTER ENVIRONMENT INSIDE AND OUTSIDE: dust aspiration, noise reduction, energy conservation and control of contamination.

Coffee science has greatly enhanced Pinhalense efforts to create a better environment for workers in coffee mills, for the mills' neighbors, and for the wider environment that has to absorb water and air emissions from the mills. A wide array of environmental protection items has been added to Pinhalense's product line in recent years: energy-saving machines, water filters, dust suction hoods, cyclones, air filters, low-noise fans, etc.



PROMOTION OF COFFEE CONSUMPTION: expanding markets and developing uses for all types of coffee.



P&A created the ICO Guide to Promote Coffee Consumption and applied its recommendations to develop programs in India, Mexico, El Salvador, Costa Rica and Colombia. Both the ICO Guide and the techniques that P&A has been using in its Consumption Workshops incorporate a scientific marketing approach to promote coffee consumption that

P&A developed based on the experiences of Brazil and other countries. P&A has been recently combining its expertise in both coffee processing technology and consumption development to create an integrated approach that uses promotion in producing countries as a means to add value to coffee and to create markets for the different coffee qualities that derive from less selective harvesting. P&A is currently carrying out another ICO project, this time to develop a network in the internet that is fully devoted to coffee matters, the Coffee Club Network (www.coffeeclubnetwork.com).



Dear reader,
Learn how the art and science of specialty coffee processing can help your business.
Come visit us at Pinhalense Booth #730 at SCAA Exposition.



P&A (peamarketing@peamarketing.com.br) has associated companies in the fields of coffee marketing and advertising ([GSB2 - gsb2@gsb2.com.br](mailto:gsb2@gsb2.com.br)) and coffee trading / exporting, blending and quality evaluation ([Qualicafex - qualicafex@qualicafex.com.br](mailto:qualicafex@qualicafex.com.br)).