

# CONFIDENTIAL

**YOUR BEST SOURCE OF INFORMATION ABOUT THE BRAZILIAN COFFEE BUSINESS... AND MUCH MORE. THIS ISSUE:**

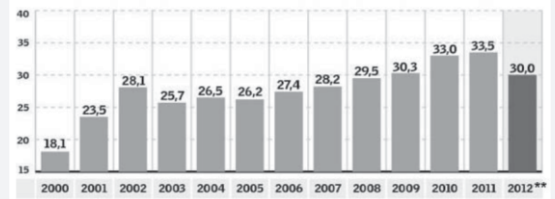
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## **BRAZILIAN COFFEE EXPORTS TO DROP IN 2012**

Brazilian coffee exports may drop between 10% and 15% this year in relation to 2011, when Brazil exported 33.5 million bags. Even with a record crop of more than 50 million bags, exports should not surpass 30 million bags in 2012. Coffee production in the country suffered from atypical rains during the harvesting season, which affected quality and supply to the market.

Source: Valor Econômico

**Brazilian Coffee Exports\* (million bags)**



Source: Cecafé (green and processed coffee)

\*\*Estimate

## **LARGEST COFFEE MILL IN THE WORLD OPENED IN MINAS GERAIS**



Cooxupé, the twelve-thousand member coffee cooperative in Minas Gerais, has inaugurated the world's largest coffee mill called Japy. With capacity to process the equivalent of 5 million bags per year under one roof, the Japy mill was completely equipped with Pinhalense technology for destoning, size grading, density separation, blending and loading regular bags, big-bags and containers in bulk. The Japy complex was designed with the latest technologies and automated to allow coffee to be transported, processed and stored in bulk and big bags without manual handling, in a totally mechanized process. With the new R\$ 75 million (US\$ 37.5 million) complex, that occupies an area of 40,000m<sup>2</sup> (430,000 square feet) and has bulk unload and load bays and batteries of storage and in-process silos, Cooxupé will double its capacity to store and process coffee.

Sources: DCI and Phábrica de Ideias

## **COFFEE PROFITABILITY PLUMMETS IN CURRENT SEASON**

The average profitability of the coffee activity has fallen dramatically in Brazil this year; it can be as much as 40% lower depending on the production model. In South Minas, for example, the average price of the coffee bag decreased 24% until September when compared to the same period of 2011. Labor costs, on the other hand, are approximately 30% higher this season. According to the Association of Coffee Growers' Unions, Sincal, total production costs in mountainous regions, which account for 72% of the coffee area in Brazil, are around R\$ 400 to R\$ 450 per bag (US\$ 200 to US\$ 225), while prices are currently between R\$ 350 and R\$ 400 (US\$ 175 to US\$ 200) per bag. The production model used greatly affects profitability in coffee: while mechanized coffee areas show good results, farms in mountainous areas have higher harvesting costs and are barely covering operational costs.

Source: Valor Econômico

**OUT-OF-POCKET DIRECT COSTS FOR TYPICAL COFFEE FARMS: IN DIFFERENT AREAS OF BRAZIL IN 2012**

Municipality	Producing area	State	Yields (bags/ha)		Cost		US\$/lb
			bags/ha	ton/ha	per bag		
					R\$	US\$	
Manhumirim	Matas of Minas	Minas Gerais	27	1.62	390	192	1.45
Luís Eduardo Magalhães	West Bahia	Bahia	50	3.00	173	85	0.64
Santa Rita do Sapucaí	South Minas	Minas Gerais	30	1.80	352	173	1.31
Guaxupé	South Minas	Minas Gerais	25	1.50	370	182	1.38

Costs were calculated by CNA in partnership with the Federal University of Lavras (UFLA). They consider only direct production costs such as labor, fertilizers, agrochemicals, energy, tributes and taxes, and do not consider depreciation of equipment and mills.

## **CONILON PRODUCTION ON THE RISE IN RONDONIA**

The Conilon (Robusta) output in Rondonia, in the Northern part of Brazil, should exceed 1.6 million bags in 2012 according to Conab, a 15% growth compared to the previous crop. The municipality of Cacoal is responsible for a large share of this production. Rondonia state is the second largest producer of Conilon in Brazil and the 5<sup>th</sup> in total coffee production.

Source: Peabirus

## **FLOWERING PROBLEMS IN SOME REGIONS**

Growers, consultants and researchers of several producing regions have reported abnormal coffee flowering: flower buds were "burnt" before blossoming. According to a Procafé researcher, the problem is caused by low water availability which causes dehydration of the plant; buds that are more exposed to sun are the most affected. The effects of this phenomenon are not yet possible to be evaluated.



Source: Cafépoint

## **NEMATODE ALERT IN ESPÍRITO SANTO**

The growing infestation levels of nematodes in the state of Espírito Santo, caused by reduced use of organic matter as well as the monoculture model, is worrying Conilon growers. The symptoms are hard to identify and could be mistaken for nutritional deficiencies. Growers should monitor their plantations closely in order to identify the problem as soon as possible.

Source: Agrolink

## **TECHNOLOGIES ADAPTED TO CERRADO CONDITIONS**

The Coffee Research Consortium has developed different techniques to improve coffee cultivation in Cerrado-type (savannah) areas of Brazil. Among them is controlled water stress, which helps to make flowering more uniform; and phosphate fertilization, that allows significant increases in productivity. Another important technique is the use of Brachiaria grass between coffee lines to incorporate nutrients, particularly phosphorus, into the soil and to control weed since it reduces the need for reaping and herbicide application.

Source: Embrapa Café

## **ICAFE VISITS FEDERAL UNIVERSITY OF LAVRAS**

The Federal University of Lavras (UFLA) in Minas Gerais received the technical manager of the Coffee Institute of Costa Rica (Icafe) in a visit to Brazil aimed at strengthening partnerships with various educational and research institutions, and also to promote the 24th International Conference on Coffee Science (ASIC 2012), to be held in Costa Rica in November 2012.

Source: UFLA

## **SPECIALTY COFFEE MARKET EXPANDS IN BRAZIL**

Brazilians are consuming more specialty coffee. Recent estimates indicate that out of the 19 million bags consumed in the domestic market in 2011, 1 million correspond to specialty or gourmet beans. Although the popularity of specialty coffee grows, it will hardly dominate retail; whereas a kilogram of traditional quality coffee costs R\$ 13 (US\$ 6), on average, a kg of specialty in Brazilian supermarkets may cost from R\$ 30 to R\$ 50 (US\$ 15 to 25) according to ABIC. Brazilian specialty coffees are also gaining space in international markets, with Japan, the United States and the European Union being the main importers.

Source: IG Economia



## **Pictures of the Month**

### **ARABICA FLOWERING**



Sources: CaféPoint and Abacafé

## POOLING EFFORTS: SUSTAINABILITY AND THE SMALL GROWERS

It is estimated that 80% of the world's coffee is produced by small growers and, the joke goes, the remaining 20% is in Brazil! Indeed Brazil concentrates a large share of the world's mid-size and large growers but the average area under coffee per grower is about 7 ha (17.3 acres) and small holders outnumber the other growers by a large portion. One advantage of Brazil is perhaps legislation that prevents the subdivision of farm land below a minimum area that is judged necessary to remain economically feasible in the activities that predominate in a given area. In other words, land subdivision has a limit that when reached forces the heirs to run the property together as a whole.

If the coffee market is concerned with the sustainability of its supply chain and if 80% of the world's coffee is produced by small growers, the key question here is if the small grower will be sustainable in the mid and long run. On the one hand, the tendency is for the average coffee holding size to fall as a result of generational changes. On the other hand, not only the cost of living grows but, most importantly, growers' aspirations also grow as a natural result of development. To make matters worse, we know that in the long run the tendency is for the real price of commodities to fall as a result of technology and other factors. Not a promising scenario at all!

Maybe market forces or government intervention will take care of the problem and cause huge flows of rural workers to urban areas and the creation of shanty towns as it has already happened in some countries and is currently happening in others. This process may lead to more sustainable *farming* but will it create a more sustainable *world*?

The diseconomies of scale involved in "small farming" are huge, specially in access to technology, a subject we know well in what regards post-harvesting of coffee and cocoa. The price of coffee wet milling equipment only doubles when capacity is increased four fold. A large coffee or cocoa drier costs only twice the price of a small drier with one-tenth of the former's capacity. A similar process happens with other types of equipment, e.g., tractors, sprayers and even irrigation. Attempts to develop specific equipment for small growers often succeed on the technical side but fail as often on the cost / price side, sometimes miserably. This phenomenon is compounded by lack of access to credit for small growers to acquire equipment and inputs too.

The issue of credit brings up another problem that pesters small coffee growers: their limited bargaining power not only when buying equipment and inputs but also when selling their crop. It does not take a PhD in economics to know and understand that on average a small grower pays more and sells for less than a mid-size or large grower in the same way that goods often cost more in a corner store of a low income neighborhood than in a middle-class supermarket.

All in all, the small grower is left with its own low-cost labor as a comparative advantage, even though he or she is often forced to "consume" its meager savings or its own limited capital. Truth is that this labor is not low-cost but only "sold" or computed (or not) at a rate below market level. Without exaggeration, the prospects seem bleak for small growers. Is there a way out?

The recipe may be simpler than one thinks: to reverse the process. Instead of making technology compatible with small coffee farming and subsidizing credit to small growers, the focus should be on bringing growers together to benefit from economies of scale in technology and to gain bargaining power by buying and selling as a group. Equipment sharing, joint processing facilities, group purchasing, group certification and pooling of coffee to be marketed are some useful paths. Easily said than done, of course, but are we trying hard enough?

Cooperatives have existed for well over 100 years and growers' associations are not that new either but their use is not as widespread as desirable. Perhaps these traditional forms of association have to be refreshed or revamped and innovative forms of association, country and culture sensitive, have to be developed to cater for the needs of micro and small coffee growers and to empower them lest they will disappear in the long run. The real barriers may be more behavioral and sociological than technical and should be dealt with accordingly. This is the challenge for governments, agencies and companies concerned with the plight of the small coffee grower.

## Brazilian Prices

October 31, 2012

### Main Producing Regions / Farm Gate

Arabica Naturals (R\$/ 60 kg bag)	
Cerrado-MG fair average quality T.6	385,00 ↓
Mogiana-SP fair average quality T.6	380,00 ↓
South Minas fair average quality T.6	380,00 ↓
Arabica Pulped Naturals (R\$/ 60 kg bag)	
Cerrado-MG	405,00 ↓
South Minas	400,00 ↓

+ 6,6%

Conilon/ Robusta (R\$/ 60 kg bag)	
Colatina-ES fair average quality	290,00 ↓
BM&F (US\$/ 60 kg)	
Dec 2012	200,75 ↓
Mar 2012	205,45 ↓
Sep 2013	206,70 ↓
Real R\$/ Dolar US\$	
October 31	2,03 =

Source: [www.qualicafe.com.br](http://www.qualicafe.com.br)

## CENTRALIZING ON-FARM MILLING

There are indeed huge economies of scale in on-farm coffee processing. Let's address another example besides those found in the Outlook section of this Confidential. If a small handpulper priced at X is supplied to 100 small coffee growers the total bill will be 100X. If this small pulper is driven by an electric-motor the bill doubles to 200X. If each grower produces an average of 50 bags, a single pulper to process the coffee produced by *all* 100 growers as a group will cost only 14X! A *central* Pinhalense wet mill, including not only a pulper but also an unripe cherry separator, a rotary screen to separate unpulped cherries, and a mucilage remover will cost about 50X.

In summary, a modern eco-friendly wet mill with a mucilage remover, able to process high quality washed coffee, costs only one-fourth (25%) of what it would cost to equip each grower with a conventional high-water-consumption small pulper. If one compares pulpers alone, the cost of the central milling alternative falls from 25 to 7%, not including the further benefits of modern vs. old technology and a water-intensive vs. a water-saving system.

Investments in Pinhalense central mills benefit from large economies of scale, as per the example above, because these mills are not an "agglomerate" of individual small pulpers put together, one next to the other, which clearly does not enjoy economies of scale. Much to the contrary, each and every Pinhalense central mill is specifically designed according to the specific features of the coffees to be processed coming either from an estate or from a group of small growers.



In reality, the technical requirements to process coffees produced by many small growers are more complex than those typical of coffees coming from a single state. Variety, degree of maturation, impurity content, size distribution, etc. may all be different from one lot to the other. Pinhalense has lengthy experience in responding to all these differences and variations because it has the unique ability to select and combine the components of its wet mills according to both the characteristics of the incoming cherries and the requirements of the markets to which the coffees will be supplied.

The quality of harvesting is falling, even at the realm of the small grower, and markets are becoming more diversified, with the growth of consumption in the producing countries themselves and in emerging markets. Therefore it becomes ever more important to process properly all cherry fractions that reach the wet mill, irrespectively of their degree of maturation, in order to preserve their intrinsic quality. Pinhalense equipment is very well known for doing exactly this. It is no wonder that Pinhalense was behind the

development of pulped natural coffee and pioneered the pulping of partially ripe and over-ripe coffee cherries with great gains to farmers and processors, let alone the full preservation of quality of the ripe cherries that are perfectly separated from pulp and not damaged.



Pinhalense excels in helping small growers to benefit from economies of scale in processing and to enjoy the same technology, quality and profit advantages available to large growers and estates. Economies of scale in central drying will be the subject of a future Confidential newsletter.