

CONFIDENTIAL

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

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GOVERNMENT PROGRAM TO SUPPORT PRICES REACHES 3 MILLION BAGS

The latest PEPRO (put-and-call program) auction, held on October 8, traded 100% of the contracts, which represent 405,800 bags of 60 kg, for a total of nearly 3 million bags so far. The premium that the coffee growers paid gives them the right to sell the product to the government for R\$ 343.00 (US\$ 156,00) per bag at the contract's expiration date, in March 2014, irrespectively of the going price for coffee by then.

Source: Agência Estado

WHO WILL SURVIVE IN BRAZIL WITH LOW COFFEE PRICES?

Coffee prices in Brazil are likely to continue low according to experts and the devaluation of the Real (R\$) in relation to the US dollar may be the reason. The decrease in prices affects mainly Arabica growers – whose production costs are currently exceeding prices – and specially Brazil, the world's largest supplier of Arabica coffee. Growers likely to successfully make it through the adverse price scenario are micro and small family holders (with no employees), large and mechanized growers, and Robusta producers who usually have higher yields and lower costs.

Source: Valor Econômico

CAN LOW COFFEE PRICES BOOST BRAZILIAN CONSUMPTION FURTHER?



Carlos Brando



J. R. Mendonça de Barros

Both leading Brazilian economist José Roberto Mendonça de Barros and P&A's Carlos Brando presented on scenarios for the coffee business in coming years at the 21st Encafé. Barros approached the subject from a macroeconomic point of view and Brando filled in with a microeconomic perspective and challenges and opportunities for Brazilian roasters. The annual Brazilian coffee roasting industry conference was held in Guarujá, a beach resort in the state of São Paulo, on October 16 to 20 with over 300 participants. With a record participation of roasters, the event had relevant presentations, coffee trading roundtables, workshops and social activities in commemoration of ABIC's 40th anniversary.

Source: ABIC

GREAT POTENTIAL FOR SINGLE-SERVE MARKET

3Corações, one of Brazil's leading coffee roasters, announced investments of R\$ 150 million (US\$ 68 million) in the single-serve sector over the next 5 years. The brand will soon launch TRES, its line of machines with 16 options of capsules, including tea. According to ACNielsen, although approximately 700,000 single-serve machines are active in Brazil today, only 276,000 homes have them, a mere 0.6% of the total homes. The segment grew 12% in Brazil in 2012.

Source: O Estado de S. Paulo

BRAZILIAN COFFEE ARRIVES IN VIETNAM

A coffee shipment by Cooxupé to the United States made its way to Vietnam for decaffeination. The coffee will be shipped to the USA for final consumption. This is the first time that Brazilian coffee is "imported" by Vietnam.

Source: Folha Rural



BRAZILIAN COFFEES DRIVE SWISS EXPORTS

Coffee is the main agricultural product exported by Switzerland, a country with not a single coffee tree. Recent data released by the Swiss government shows that coffee imports by the country have reached US\$ 570 million from January to September 2013, with Brazil as the main supplier (23% of the total imported). After processing and roasting, Switzerland exported the equivalent of US\$ 1.8 billion of coffee during the same period, more than twice the exports of chocolate or cheese.

Source: Valor Online



SUSTAINABILITY AT THE CORE OF "TRAIN THE TRAINERS" CAPACITY BUILDING IN MINAS GERAIS

Embrapa Café and Emater-MG (Technical Assistance and Rural Extension Institute of Minas Gerais) have partnered to expand technology transfer efforts to coffee growers. More than 165 extensionists from 126 coffee municipalities have already been trained in sustainable technologies regarding yields, new cultivars, irrigation, mechanical harvesting and environmental legislation. Individual technical assistance to 350 growers is also underway; the idea is that these sessions will help to understand the current needs of coffee growers in Minas Gerais related to better technologies and management practices.

Source: Globo Rural

COMPETITION CREATED TO DIVERSIFY BRAZILIAN ORIGINS IN BLENDS

The Brazil Specialty Coffee Association (BSCA) organized the 1st Specialty Blends Competition in order to disseminate the use of the different Brazilian origins among roasters and baristas. For this event, cupping teams were formed, each composed of 2 Brazilians and 1 Swede from the winning team of the 2013 Nordic Barist Cup. Each team had to analyze samples of the best coffees from 11 Brazilian producing regions and create a blend with at least 3 origins in it. The winning blend was prepared with coffees from Bahia, Mountains of Espírito Santo and Mogiana (São Paulo).

Source: Communications Department of BSCA



BRAZILIAN CONSUMERS STILL DRINK LITTLE HIGH QUALITY COFFEE

Brazil is the leading coffee producing and exporting country, and the second largest consumer of the product. However, the majority of Brazilians are still consuming fair to good quality coffee. Estimates show that of the 20 million bags of coffee currently consumed in the domestic market, only 1.5 million bags are specialty. This may be yet another opportunity to increase consumption in a market that is progressively consolidating and growing more slowly.

Source: Uol Economia

INTERNATIONAL COFFEE WEEK IN NUMBERS

Besides what has already been reported here about this successful event, additional results of the fair have now become available. With 110 exhibitors, the 4-day event had 31 cupping sections, 168 hours of presentations for more than 5 thousand people and more than 100 meetings. Decision-makers, investors with long experience in the coffee business and also attendees who were seeking professional advice are some of the profiles of the participants of the International Coffee Week.

Source: Café Editora

TRAVELBOX: A NEW OPTION FOR COFFEE TRAVELLERS

If you are planning to come to Brazil for a coffee-related business trip or simply leisure, TravelBox can assist you with an interesting itinerary, designed specially for you. TravelBox has recently been founded by Maria Brando, P&A's former marketing consultant, to help travelers make the best out of their trips with the help of a customized itinerary filled with tips about attractions, restaurants, entertainment, and more. Inspired by her traveling related to coffee around the world, Maria can help you organize a great trip to Brazilian coffee areas, a perfect vacation or a nice experience anywhere. Please contact TravelBox at: Contato@travelbox.com.br; its website www.travelbox.com.br will be launched soon.



CAN BRAZIL'S PRODUCTION COSTS CREATE A FLOOR FOR ARABICA PRICES?

Considering that Brazil is one of the most efficient and competitive Arabica growers in the world, that the country is the major producer of this type of coffee and that Brazilian Arabicas sell at a discount to the ICE futures market in New York, fundamentals indicate that the average cost of Arabica production in Brazil should establish a likely price floor for Arabicas if future supply is to be ensured. Let's look at the numbers to see if this is true.

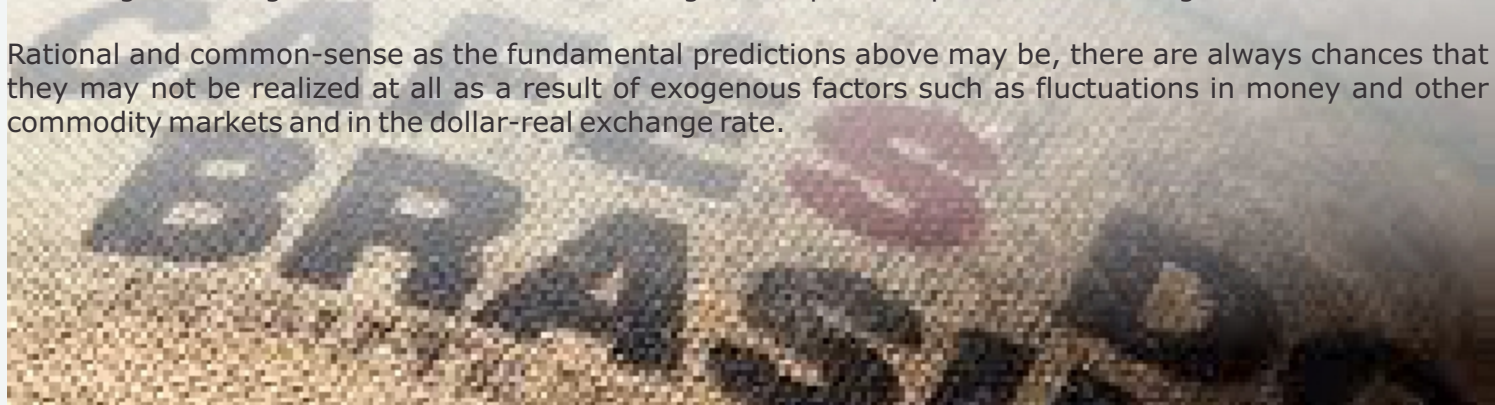
A P&A analysis of published Arabica production costs in Brazil indicates that the simple, unweighted, average for all regions is around US\$ 1.20 per pound, very close to the Ministry of Agriculture published cost of R\$ 343 per bag of 60kg, i.e., US\$ 1.18 per pound. This, of course, includes depreciation, capital investments in land, plantation and infrastructure, and growers' profits. Average direct out-of-the-pocket costs, which exclude the items just mentioned, are about US\$ 0.95 per pound. Since internal prices in Brazil are now less than US\$ 0.80 per pound, therefore below direct out-of-pocket costs, even if we account for Brazilian differentials against ICE, one may conclude that no price floor will be set by Brazilian production costs.

However, it may be premature to reach such a conclusion. First, the level at which growers are definitely losing money has now been reached and the natural reaction to low prices – decreased use of inputs, insufficient husbandry, diversification and abandonment – will be intensified. Second, the results of these actions will not be felt immediately but in the following season and, especially, the one after that. Third, if the largest and most efficient Arabica grower is to continue producing and even increase output in response to growing demand, prices will have to bounce and move at least above direct production costs. Fourth, since future demand is skewed in favor of Robustas, the rise in prices need not be very large to recover losses that seem imminent and to entice the expansion of production required to meet consumption growth.

Analyzing the current situation from a different perspective, New York coffee exchange prices in US dollars in 2001 to 2004 were the lowest in recent history, but the costs of production and the exchange rate at that time rendered prices in reais still profitable, as was demonstrated by the expansion of Brazilian production. This is clearly not the case today, with a currency that remains overvalued and, most importantly, costs of production that were impacted by inflation in the period, especially in regard to labor, which benefited from tremendous wage escalation in real terms. Again, if Brazilian Arabica production is not to shrink but instead to expand to meet demand growth, US dollar coffee prices cannot fall much further in the medium term.

The analysis above indicates that US dollar Arabica prices may fall still further in the short run. However, they are, first, very unlikely to get even close to the levels prevailing in 2002 and, second, will have to bounce back to current levels and above in the next year or two in order to exceed production costs in the world's most competitive producer. The intensity of recovery may be faster and/or stronger if the shift from Robusta towards Arabica that started recently retains its momentum or intensifies. The price recovery is also likely to be stronger the longer it takes to start because negative impacts on production will be greater.

Rational and common-sense as the fundamental predictions above may be, there are always chances that they may not be realized at all as a result of exogenous factors such as fluctuations in money and other commodity markets and in the dollar-real exchange rate.



Brazilian Prices

October 31, 2013

Main Producing Regions / Farm Gate

Arabica Naturals (R\$/ 60 kg bag)	
Cerrado-MG fair average quality T.6	260,00 ↓
Mogiana-SP fair average quality T.6	255,00 ↓
South Minas fair average quality T.6	255,00 ↓
Arabica Pulped Naturals (R\$/ 60 kg bag)	
Cerrado-MG	295,00 ↓
South Minas	290,00 ↓

+ 15.7%

Conilon/ Robusta (R\$/ 60 kg bag)	
Colatina-ES fair average quality	190,00 ↓
BM&F (US\$/ 60 kg)	
Dec 2013	137,20 ↓
Mar 2014	141,30 ↓
Sep 2014	143,20 ↑
Real R\$/ Dolar US\$	
October 31	2,20 ↓

Source: www.qualicafe.com.br

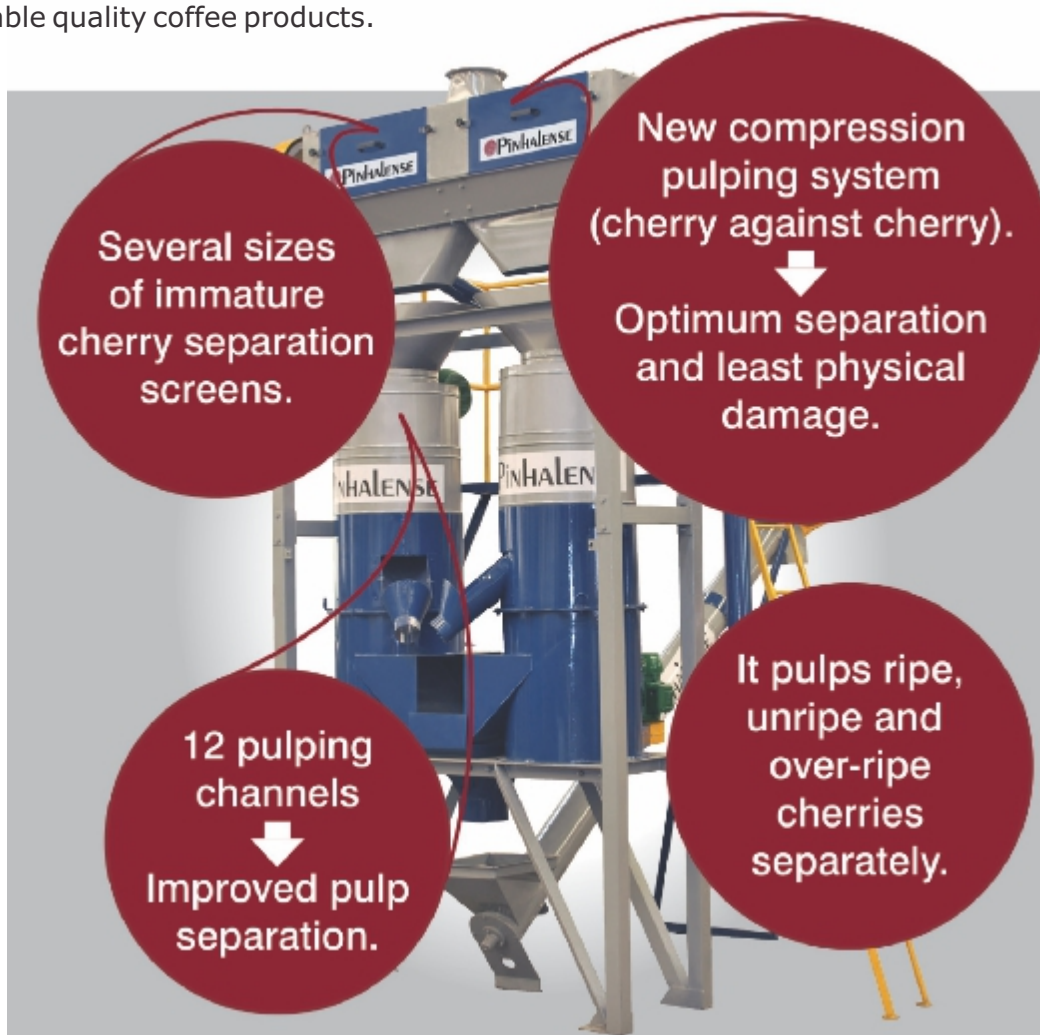
MAXIMIZE INCOME BY PULPING CHERRIES AT DIFFERENT STAGES OF MATURATION

The quality of harvesting is expected to worsen even further with the current low coffee prices. More unripe, partially ripe and over-ripe cherries will be picked in an attempt to lower harvesting costs by means of fewer picking rounds, partial stripping, etc. In this scenario, cherry separation becomes critical in order to produce top quality coffee out of 100% ripe cherries only.

The first separation step is Pinhalense's exclusive eco-friendly mechanical siphon that separates the less dense "floaters" – the over-ripe and dry cherries – from the denser fraction – unripe and ripe cherries – that sink. Water is fully recycled in these patented machines.

The second separation step is performed by unripe cherry separators that also act as pulpers. These dual-purpose Pinhalense machines have advantages over cherry separation *after* pulping, namely, superior separation of other-than-ripe cherries, least physical damage to coffee, improved pulp separation and, very importantly, the ability to pulp other-than-ripe cherries at different degrees of maturation separately: unripe, partially ripe and over-ripe cherries.

This last advantage of the Pinhalense system – the ability to pulp other-than-ripe cherries – is especially relevant at times when coffee prices are low and the volumes of these cherries increase. Their quality and price can be maximized by pulping them and selling to specific markets, e.g., the soluble industry and the domestic market in producing countries, whose expansion is often associated with the availability of lower priced, reasonable quality coffee products.



Contact peamarketing@peamarketing.com.br to learn more about Pinhalense new ecologic wet mills designed to produce high quality specialty coffees as well as coffees for domestic consumption and other uses.

TOP QUALITY COFFEE... AND OTHER COFFEES WITH ADDED VALUE