

CONFIDENTIAL

7th

Anniversary
Issue

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

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DROUGHT ALSO AFFECTED IRRIGATED AREAS

Even irrigated coffee has suffered with the drought in South Minas. The strong heat at the beginning of the year increased water losses from both the soil by evaporation and the plant by transpiration, but losses are not as bad as those of non-irrigated plantations. The farms of Ipanema Coffees in the Alfenas region have registered production losses between 15 and 20% with an expected higher volume of smaller beans (screens 13 and 14). Approximately 40% of Ipanema's coffee areas are currently irrigated. Researchers at Procafé Foundation who have recently visited coffee regions all over Brazil noted that some coffee areas will not produce beans larger than screen 17 whereas 15% of the coffee crop is usually composed of beans with sizes 17 and larger.

Source: Valor Econômico

CONILON PRODUCTION INCREASING IN ESPÍRITO SANTO

The harvesting period for Conilon coffee comes to an end in Espírito Santo and yields should be higher than last year. Incaper, the institute in charge of research and rural extension in Espírito Santo, estimates that Conilon production will reach 9.5 million bags in the state, an increase of 15% compared to 2013. Although growers are happy with the quality of the product, current coffee prices are disappointing, with an average of R\$ 222 (US\$ 101) per bag whereas in 2013 it was sold for R\$ 240 (US\$ 109), not a good price either.

Source: Globo.com

BSCA PRESENTS BRAZILIAN SPECIALTY COFFEES TO INTERNATIONAL BUYERS DURING WORLD CUP

To take advantage of the FIFA World Cup in Brazil, Apex, the Brazilian Trade and Investment Promotion Agency, brought 2,300 buyers, investors and decision makers from 104 nations to visit clients in the country and to watch the soccer games, as part of a project called Projeto Copa do Mundo (World Cup Project). The Brazilian Specialty Coffee Association (BSCA) will take the foreign coffee buyers to farms and processing facilities in order to promote the quality and sustainability of the Brazilian coffee production chain. Roundtables, technical discussions and cupping sessions are some of the activities to be carried out during the site visits.



Source: BSCA

ANOTHER YEAR OF LOW SALES OF SEEDS AND SEEDLINGS

Even with the recent recovery of coffee prices, growers have been cautious about new investment in the renovation of plantations. The market for coffee seedlings has gone down at least 25% in several coffee areas of Brazil according to some sources; many claim that the fall is much greater. Growers are still paying old debts and prefer not to renovate coffee fields due to high costs (that can reach R\$ 10,000 or US\$ 4,550 per hectare in some cases) and because it requires the interruption of part of the production. Procafé Foundation, that sells coffee seeds in many parts of the country, notes that the demand in 2014 has not reached 200 kilograms when the average annual demand is 2,000 kg.

Source: CNC

CREDIT LINE FOR WORKING CAPITAL RELEASED

The National Monetary Council (CMN) recently approved the allocation of R\$ 900 million (US\$ 409 million) of Funcafé's budget for working capital loans to support Brazilian coffee cooperatives and the roasting and soluble industries. The interest rate for this line of financing is 7.5% per year, valid since July 1st, 2014. R\$ 400 million (US\$ 182 million) will be available for cooperatives, R\$ 300 million (US\$ 136 million) for the roasting industry and R\$ 200 million (US\$ 91 million) for the soluble industry.

Source: Globo.com

NEW FUNGUS THAT PROTECTS COFFEE QUALITY

A new fungus named *Cladosporium cladosporioides* was discovered, as part of a 20-plus-year research effort by Epamig, the Minas Gerais Agriculture and Livestock Research Institute, in partnership with the Federal University of Lavras (UFLA), and coordinated by the Coffee Research Consortium / Embrapa Café. The fungus has properties that prevent the development of other fungi that are detrimental to coffee quality. The discovery has generated a biotech product whose patent was applied for by Epamig and UFLA that are seeking partnerships with industries and traders to offer the new product to growers.

Source: Embrapa Café



NEW COFFEE VARIETY BEING TESTED IN MINAS GERAIS

A new coffee variety more resistant to drought and diseases developed by Procafé, a member of the Coffee Research Consortium, is being tested in South Minas with good results. The variety, called Acauã Novo, a crossing of the Sarchimor and Mundo Novo varieties, results from a research project that has already lasted approximately 40 years. In spite of the lack of rains in 2014, the Acauã Novo did not present any problems related to poor grain formation and yields were good. The new variety is already highly demanded by coffee growers, especially those in the driest regions of the Cerrado.

Source: Globo.com

ABIC RENOVATES COFFEE PROMOTION PROGRAM

ABIC, the Brazilian Coffee Roasters' Association, is raising funds from member companies to start a new marketing campaign to promote internal coffee consumption focused in the Purity Seal. An advertising agency has been hired to coordinate the program due to start after the World Cup and to concentrate on specialized magazines, digital media and cable TV. The Purity Seal was launched by ABIC 25 years ago as part of a broader program; it certifies that packages bearing the seal contain only coffee. More than 2,000 coffee samples are collected by the association every year and tested in high-tech labs to monitor purity.

Source: Valor Econômico



SUSTAINABLE USE OF COFFEE GROUNDS AT BRAZILIAN NESTLÉ FACTORY

Nestlé's soluble coffee factory in the town of Araras, state of São Paulo, is using coffee grounds to generate energy for its facilities. The decision has led to savings of 25% of the total energy used. Approximately 97% of the coffee grounds left over in the process are pressed to reduce their moisture content and mixed with wood chips to be burned in a boiler to generate steam for the main areas of the factory. The remaining grounds are composted for use as organic fertilizer.

Source: Globo Rural

SHARP FALL IN SALES OF AGRICULTURAL MACHINERY

Agricultural machinery manufacturers are going through a difficult period, especially in the mechanical harvesting segment. Sales of grain harvesters decreased 25% to 2,559 units in the January to May period. Sales of tractors have also been affected: 21,800 units were sold until May, or 18% less than the same period in 2013.

Source: Folha de São Paulo

DEMYSTIFYING THE ACTIONS OF FUNDS IN THE COFFEE MARKET

The recent past of the Arabica coffee market has been marked by high price volatility in the New York exchange. In this issue of the Outlook we would like to bring to light the main cause of this volatility: the funds that invest in coffee contracts.

There is a lot of criticism about the behavior of funds. Critics say that the funds take positions against the growers and that they do not follow market fundamentals making coffee prices plummet. The funds are even criticized for being capable of market manipulation.

It is necessary to demystify these funds as non-human or evil entities. Funds are nothing more than a pool of investors who invest their economies in this financial product and hire a manager to operate and to make investment decisions on their behalf. In other words, market funds do not have self-control or a misgoverned action. Their market positions, sometimes buying coffee contracts other times selling these contracts, are the result of deliberate decisions by a professional manager, a person, a human being.

Given that it is a manager who operates these funds then he or she must take rational decisions to pursue the best return for people who invested money in the fund under his or her responsibility. Good fund managers will always place their bets on the market seeking the best outcomes for their investors. It is true that these managers do not care about coffee growers' opinions in their decision making process. But it is worth asking: do coffee growers have any concern about fund managers' performance when they take the decision to hold coffee, to stop growing coffee or to plant more coffee?

In the same way that the production from a single coffee grower in Brazil cannot affect the global crop the positions taken by a fund manager cannot alone move the market. There are several funds in the market and they are not able to coordinate with each other in order to manipulate prices. What does happen sometimes is that they take similar positions in reaction to relevant news or material facts. It is the so-called herd behavior.

But the most relevant in this case is that the investment alternatives of a fund manager who invests in coffee are many and they are not restricted to the coffee market alone. Funds that invest in coffee contracts are generally agriculture commodities funds. The fund manager may invest in futures of any commodity, e.g.: cocoa, maize, sugar, cotton or other.

If a fund manager expects that a specific position in the cocoa market will yield more than a position in the coffee market, this manager will decrease the fund's coffee position and increase its cocoa position. This is because the fund has limited resources to invest. If this is the market's general expectation, there will be fewer buyers in the coffee market and this will make coffee prices fall. And something similar may happen in the cocoa market in the opposite direction. Is there anything evil about this? Does it justify any market intervention?

Coffee growers and traders tend to restrict their analysis to the ups and downs of the coffee market fundamentals only. They are right about this, but they must also consider the correlations and scenarios of other agricultural commodities before they criticize the funds' behavior.

Fund managers are also exposed to competition from other markets like money, foreign exchange, stocks, gold, metallic commodities, etc. If their investors want to increase their investments in money markets, they may withdraw from agriculture commodities. And this may also impact the coffee market since the manager will have to undo some positions in order to have enough resources for his or her client's withdrawal.

Finally, once the funds' behavior and their way of doing business are demystified, it is worth to mention the benefits that they bring to the market as a source of liquidity. Their presence in the market floor guarantees a relevant number of deals. And this raises the odds of a permanent presence of a buyer or a seller willing to close deals. In other words, they contribute to price formation, i.e., they ensure that the market price will be the result of many deals (and opinions). And this tends to better reflect the market fundamentals.

Brazilian Prices

June 30, 2014

Main Producing Regions / Farm Gate

Arabica Naturals (R\$/ 60 kg bag)	
Cerrado-MG fair average quality T.6	415,00 ↓
Mogiana-SP fair average quality T.6	410,00 ↓
South Minas fair average quality T.6	410,00 ↓
Arabica Pulped Naturals (R\$/ 60 kg bag)	
Cerrado-MG	455,00 ↑
South Minas	450,00 ↑

+ 11%

Conilon/ Robusta (R\$/ 60 kg bag)	
Colatina-ES fair average quality	240,00 ↓
BM&F (US\$/ 60 kg)	
Jul 2014	205,00 ↓
Sep2014	209,15 ↓
Dec 2014	215,40 ↓
Real R\$/ Dolar US\$	
June 30	2,20 ↓

Source: www.qualicafe.com.br

PINHALENSE HIGH-EFFICIENCY, SUSTAINABLE BUCKET ELEVATORS

IMPORTANCE - Elevators are often treated as a secondary component in the purchase of a coffee mill, with the focus resting only on the choice of the processing machines themselves. This is a big mistake because poorly designed and wrongly chosen elevators can impair the proper operation of the machines, cause damage to coffee, increase power consumption and negatively affect the performance of the full mill. It is not uncommon for clients to complain that their machines are not performing to satisfaction and, upon verification, Pinhalense has to explain to the client that the fault is with the non-Pinhalense elevator that is not feeding the machine properly and reducing its capacity or causing the coffee damage that has been mistakenly blamed on the machine, or else.

DESIGN - Elevator design and construction require specific skills and technologies as well as sophisticated product development and field trials, specially so when the product to be transported is coffee. What makes the manufacturing and supply of elevators for coffee more challenging than for other products is that coffee has a much higher value and physical damage causes substantial prices losses. In addition, margins in the coffee business are small which makes efficiency critical at all stages of processing.

Besides the use of poorly designed or low-tech elevators available in many markets, another mistake is the use of grain elevators whose speed is much higher than acceptable to handle coffee. These elevators lack the specific features required to handle the different coffee products found along the processing chain, from recently harvested cherries to export quality green beans.

COFFEE SPECIFIC - Pinhalense offers coffee elevators specifically designed for each and every processing stage. Fresh cherries, wet parchment, dry coffee with impurities and beans of different sizes and qualities pose different design challenges because they require specific features such as perforated buckets and bases, low-shock intake hoppers, low-friction discharge heads, self-cleaning devices, etc. Pinhalense elevators are equipped with a wide array of different pulleys for specific coffee products and processing conditions. All coffee elevators supplied by Pinhalense are selected according to specific needs and requirements when the processing lines are designed or individual machines are quoted. Sometimes different types of elevators are used in the same project or mill to cope with specific processing challenges.

SELF-CLEANING - One of the main competitive advantages of Pinhalense dry mills are the self-cleaning elevators that enable the processing of different coffee lots without the need to clean elevators as products are switched. Coffee mills have always handled different coffee qualities; however, the variety of coffee products has greatly increased in modern mills because of multiple origins, specialty coffees, micro lots, certification, traceability, etc. At the same time that the capacity of the mills increased, more flexibility was called for. In order to process large and small lots efficiently, a modern mill has to be able to switch products quickly, which is not possible with conventional elevators. When coffee products are changed, the base of each and every elevator has to be thoroughly cleaned in a cumbersome and time consuming process. If this is not done, different lots and qualities can be mixed, yields cannot be measured, and traceability is not possible. This is what happens in conventional coffee mills.

Pinhalense self-cleaning elevators enable the switching of coffee types without the need to clean elevator bases resulting in no time loss between lots. The use of these elevators greatly increases the efficiency of coffee mills because many hours of idle time are avoided.

SUSTAINABLE - Labor safety has always been a major Pinhalense concern in the design of both the machines themselves and the equipment layout (product flows). All Pinhalense elevators come with belt protectors, service ladders, catwalks with safety railings and other safety items. The layout of Pinhalense coffee mills takes into account minimum safety distances between machines, elevators and other pieces of equipment in order to ensure the free, unencumbered transit of operators and visitors alike. Still another area where Pinhalense minimizes or avoids the use of labor in tedious and unhealthy conditions is in the cleaning of the base of elevators every time coffee types or lots are changed in a processing line.

CONCLUSION - Whenever you buy Pinhalense machines and mills with their respective elevators, you can rest assured that the elevators have been carefully selected and customized for your specific needs and the specific requirements of the machines that the elevators feed. Do not run the risk of using elevators that may affect negatively the performance of your state-of-the-art Pinhalense machines and mills.