

CONFIDENTIAL

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

- **PRODUCTIVITY, MINIMUM WAGE, SUSTAINABILITY AND SYSTEMIC SOLUTIONS (PAGE 3)**
- **INNOVATIVE WAYS TO ACQUIRE COFFEE MACHINERY (PAGE 4)**

CAN DRIEST JANUARY IN RECENT HISTORY CHANGE MARKET?

Reduced rainfall in the South Minas and Mogiana regions in the month of January may cause substantial losses in the 2014 crop – volume and quality – and reduce prospects for 2015. Earlier estimates that coffee prices may only recover in 2015 in spite of the announcement of several programs to support the coffee sector by the Brazilian government may prove wrong. Better husbandry during the past years when coffee prices were good led to higher yields which would in turn lead to a high output in 2014 in a scenario of elevated world supply and lower consumption growth. Things may change now. According to Cecafé, lower prices in the international market have caused revenues from Brazilian green coffee exports to drop 18% in 2013 (January-November) compared to 2012, to US\$ 4.7 billion.

Sources: Valor Econômico, Peabirus and P&A

ADVERSE WEATHER IN BRAZIL AND FUTURES CONTRACTS IN NY

Even though it is still too early to quantify losses due to the adverse weather in Brazil, the coffee and sugar March contracts reacted strongly to the lack of rainfall in January. Arabica coffee had a strong increase of 4.3% in the New York ICE Futures and the March contract closed at US\$ 1.25/lb. Arabica prices rose 5.6% at the São Paulo BM&FBovespa exchange in January.

Sources: Reuters and Valor Econômico



GREEN COFFEE EXPORTS GROW DESPITE PRICES

The latest report by Cecafé indicates that the volume of green coffee exports from Brazil increased 10.2% in 2013 compared to 2012, totaling approximately 31.2 million bags. Exports of differentiated coffees also increased 5% in 2013, reaching 5 million bags. Coffee represents 2.1% of total Brazilian exports and 5.5% of total agribusiness exports.

Sources: Cooxupé and Agência Estado

FUNDS TO FINANCE COFFEE HARVESTING AND STORAGE

The Brazilian Coffee Fund (Funcafé) released R\$ 300 million (US\$ 137 million) to support coffee harvesting. Coffee growers can use the funds to cover pre-harvesting, harvesting and coffee processing costs during the coming crop with a payment deadline of December 2014. Those who use the funds to finance coffee storage will have the payment deadline extended to October 2015.

Source: MAPA

GREAT QUALITY NATURALS AT 2013 CUP OF EXCELLENCE LATE HARVEST



The 3rd Cup of Excellence Late Harvest Competition was held for the first time in Espírito Santo do Pinhal, state of São Paulo, in January. Organized by BSCA (Brazil Specialty Coffee Association) in partnership with APEX (Brazilian Trade and Investment Promotion Agency), the contest had a woman as a winner for the first time. The best natural coffee of the Brazilian 2013 crop, which scored 92.22 points, came from her Nossa Senhora Aparecida Estate, in the municipality of Carmo de Minas, state of Minas Gerais. According to BSCA's executive director, the high quality presented by the natural coffees surprised the international jury.

Source: BSCA

“LONG-LIFE” COFFEE?

A Bulgarian biologist living in Brazil since 1989 created a technology that allows filter coffee to be preserved for up to 6 months without losses or changes to its chemical components, flavor or aroma after it is prepared. Storage of the coffee beverage should be in a plastic package, for example. The scientist has already filed for a patent for his invention, which took almost 11 years to be completed. A blend of roasted and ground coffee (Arabica and Robusta) was used to conduct his research.

Source: Valor Econômico



MINAS GERAIS ENACTS FAMILY FARMING LAW

A recent law signed by the governor of Minas Gerais establishes the guidelines for sustainable rural development of family farming in the state. The new law will be fundamental for the creation of jobs, improvement of income, implementation of safety standards and the production of better quality food. Minas Gerais is the first Brazilian state to sanction this type of law.

Source: Diário do Comércio

BRAZILIAN SINGLE-SERVE IN ARAB GULF

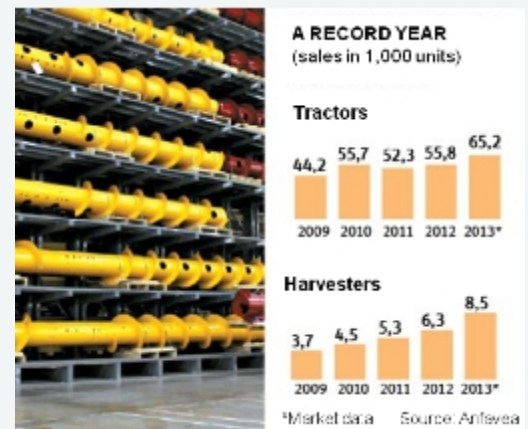
Starting in March, Dubaians and visitors to the country will be able to taste specialty coffees produced in Minas Gerais, Brazil. Fazenda Caeté, located in the South Minas region, has recently closed a deal to supply gourmet coffee in single-serve format to a supermarket chain in the popular business and tourist Middle-East destination of Dubai.

Source: Revista Cafeicultura

RECORD SALES OF AGRICULTURAL MACHINERY IN 2013

Agricultural machinery companies ended 2013 with a great performance: sales of tractors grew 17% (65,200 units sold) and those of mechanical harvesters expanded 36% (8,545 units sold) compared to 2012. Last year's sales surpassed the records of the 1970s when production started to move to Central-Western Brazil.

Source: Folha de SP



Pictures of the Month

3rd CUP OF EXCELLENCE LATE HARVEST - ESPÍRITO SANTO DO PINHAL, STATE OF SÃO PAULO



Source: Department of Agriculture, Supply and Environment of Espírito Santo do Pinhal, São Paulo State

PRODUCTIVITY, MINIMUM WAGE, SUSTAINABILITY AND SYSTEMIC SOLUTIONS

Brazil is moving towards a 4-year average productivity of 25 bags/ha (1.5 tons/ha or 610 kg/acre) for Arabicas while Robusta (Conilon) productivities already exceed 30 bags/ha (1.8 tons/ha or 730 kg/acre). Vietnam in turn is on its way to reach 50 bags/ha (3.0 tons/ha or 1,200 kg/acre) in Robustas. In both countries coffee growers receive between 80% and 90% of the FOB export price. There is no poverty in coffee growing areas of Brazil and Vietnam; much to the contrary, prosperity is evident even in times of low coffee prices like now.

The rest of the coffee producing world has an average productivity of about 10 bags/ha (0.6 tons/ha or 243 kg/acre) and it is estimated – no firm data are available – that on average these countries transfer 60 to 70% of FOB price to growers. But a frequent traveler to coffee growing areas like myself knows that there are islands of high productivity in all these countries, in Latin America, Africa and Asia. I have visited many such growers who are often our clients in the machinery or consulting business. Since these high-productivity growers are normally surrounded by low-productivity ones, why don't the latter adopt the high-productivity practices used next doors?

Considering the importance to agriculture of the so-called "demonstration effect" – actual examples that work and can be copied –, this gap in productivity may seem puzzling but in fact it is not. Low productivity growers may want to employ efficient techniques but they often do not have access to plant material, to inputs (e.g.: fertilizers and pesticides) and tools at competitive prices, to equipment to retain the quality of their product, and/or to finance when the previous items are available, to mention only a few reasons. At a more basic level, they may lack the education to absorb technology or cultural and institutional barriers prevent them from doing so. In summary, many solutions to increase productivity lie beyond farm gate and outside the reach and control of growers themselves. The same holds for the ability to increase their participation in the FOB export price.

The hard facts above lead to interesting conclusions and suggestions. For example, there is today a trend in some importing countries to require that the agricultural products that they consume are produced in a manner that workers are paid at least a minimum wage. In the case of coffee, an easier to measure and more efficient proxy of a fair reward for farm work may be minimum productivity instead of minimum wage, especially considering that most coffee in the world is produced by small growers who are self-employed. And this fair reward may be improved by more efficient coffee trading chains and lower taxes that would enable a larger share of export prices to be transferred to growers.

Still on the productivity front – a key area to ensure economic sustainability – programs and actions must also focus outside farm gate to ensure that growers, especially the micro and small ones that abound in many producing countries, have access to technology, inputs and equipment, finance and marketing skills. Besides better extension services and grower education, that alone cannot solve the problem, systemic approaches are required to make markets for inputs and equipment more efficient, finance available to small growers and coffee trading more competitive. Rather than to concentrate only on growers themselves, programs to improve and to increase volumes of sustainable coffee have to undertake the much harder task of improving the efficiencies of markets and the provision of government services, fairer taxation included, all of which have political and business implications that will have to be addressed if major actual change is to be expected.

There is a substantial record of sustainability and welfare programs involving hundreds or even thousands of coffee growers, with positive results at their own micro-level. However, the scalability of such programs to reach more growers with fewer resources is yet to be achieved. Perhaps scale is to be achieved with macro programs that address the systemic deficiencies mentioned above and provide greater returns for a much larger number of growers.

Brazilian Prices

January 31, 2014

Main Producing Regions / Farm Gate

Arabica Naturals (R\$/ 60 kg bag)	
Cerrado-MG fair average quality T.6	305,00 ↑
Mogiana-SP fair average quality T.6	300,00 ↑
South Minas fair average quality T.6	300,00 ↑
Arabica Pulped Naturals (R\$/ 60 kg bag)	
Cerrado-MG	325,00 ↑
South Minas	320,00 ↑

+ 8.3%

Conilon/ Robusta (R\$/ 60 kg bag)	
Colatina-ES fair average quality	235,00 ↑
BM&F (US\$/ 60 kg)	
Mar 2014	147,00 ↑
Sep2014	155,00 ↑
Dec 2014	156,90 ↑
Real R\$/ Dolar US\$	
January 31	2,43 ↑

Source: www.qualificafex.com.br

INNOVATIVE WAYS TO ACQUIRE COFFEE MACHINERY

At a time of low coffee prices, creativity is required to ensure that needed coffee processing equipment reaches growers. Quality and premiums for better coffees become even more important when prices are low. But barriers to buy equipment to produce quality coffee grow too. What is the way out?

Financing is the more obvious answer: to buy now and to pay later when coffee prices are likely to be higher. But financial institutions may be wary of the coffee growers' reduced ability to pay. That is where creativity enters. Pinhalense may arrange long-term financing – 3 to 5 years – at competitive interest rates; however the minimum amounts that can be financed are usually larger than the needs of the typical small grower. This calls for “bundling” equipment for several growers together, which may be done by growers' associations and cooperatives that import the wet milling, drying and/or hulling equipment and sell it to growers using the same favorable financing terms.

The financing package above is also available for coffee traders who may want to import the equipment themselves and transfer it to their own coffee suppliers by means of either barter deals, whereas the machines are paid with coffee deliveries, or straight sales with repayment schemes based on the Pinhalense financing after the traders' transaction costs are covered. This type of operation benefits both traders and their suppliers in several ways. First and foremost, small growers get the equipment they need to process their coffee and to deliver a quality product with added value. Traders gain access to coffees with improved quality. Last but not least, a loyalty relationship is created that may benefit both sides.

The type of operation described above can also be performed with governments, foreign-aid agencies and non-government organizations (NGOs) acting as the importers of equipment. Pinhalense has already “partnered” with cooperatives, traders, governments, NGOs and foreign-aid programs in Latin America, Africa and Asia to provide coffee processing equipment to growers who are either too small or face other limitations to import equipment directly. The characteristics of the financing, export-import, and transfer-to-grower transactions may vary depending on the type of importer and country of destination but they have shown to be a win-win operation for all parties involved.

An alternative to ownership of equipment by individual growers is central wet milling or drying facilities owned by growers' associations, cooperatives or traders themselves. There are substantial economies of scale in central milling, whose equipment is used more intensively. Other advantages are the possibility to have more skilled and better trained operators, more elaborate and reliable quality control, and the use of the central mill as a catalyzer for both group buying of inputs and sales of coffee. Pinhalense may of course offer the credit lines described above for the import of central facilities for wet milling, drying and dry milling.



MECHANICAL SIPHON LSC-5X



PULPER (GREEN SEPARATOR) AND MUCILAGE REMOVER **ecoflex-1X**



ROTARY DRIER SRE-025X



HULLING, POLISHING AND GRADING SET C2DPRC X

Contact P&A or the Pinhalense / P&A agent nearest to you to discuss your equipment needs and the financing available to import it.