



Vertical Optimization, LLC

...Growing Small Ideas Into Smart BusinessesTM

P.O. Box 7251
Silver Spring, MD 20907
Tel: + 1(202) 370 6165
www.vo-llc.com
info@vo-llc.com

**New Market
Development**

**Venture Management
& Asset Valuation**

**Risk & Development
Analytics**

EXCERPT

Nigerian Coffee
Market Assessment

Prepared For

Daddo Commodities (Daddo Group)

By Ed Konczal



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Coffee Industry

World coffee consumption has been increasing at a steady compound annual growth rate of 1.6% over the 1993-2003 period, with total consumption at 6.8 million metric tons in 2003 (World Resource Institute, 2005). The United States is the largest coffee consuming country in the world, accounting for 18% of world consumption (World Resource Institute, 2005). However, recent consumption growth has been driven by other countries such as Brazil, Russia, Poland and Ethiopia.

Within the United States, the specialty coffee segment is the major growth area with a 20% annual growth rate and total sales in 2006 of \$12.27 billion (Mintel, 2007).

Coffee requires specific temperature, rainfall, and altitude conditions that limit the growing region to tropical areas. There are two primary types of coffee, Arabica and Robusta. Arabica accounts for 70% of world production with a growth rate of 8.5% from 2005-07. Robusta comprises only 30% of the total market, but has been growing at a higher rate of 11.5% from 2005-07. Arabica is considered to be the higher quality and more aromatic of the coffees, while Robusta has a more bitter taste and is typically used in low-quality instant blends. Due to the quality difference, Arabica sold at \$1.24/lb in 2007, while Robusta sold at only \$0.87/lb (ICO). However, recent genetic modifications and steam cleaning technologies that improve Robusta's taste profile may allow growers to increase sales and price levels over time. Moreover, Robusta offers a unique advantage to farmers—it generates higher yields, can be harvested mechanically, and is less susceptible to pests and disease.

The coffee market is dominated by a few large producing countries, with the top five producers accounting for 2/3 of the world's coffee exports. As of 2006, the top three producers in terms of export volume were Brazil (30%), Vietnam (15%) and Colombia (12%). Brazil is the largest Arabica producer in the world, while Vietnam, a relatively new entrant, is now the world's largest Robusta producer (ICO).

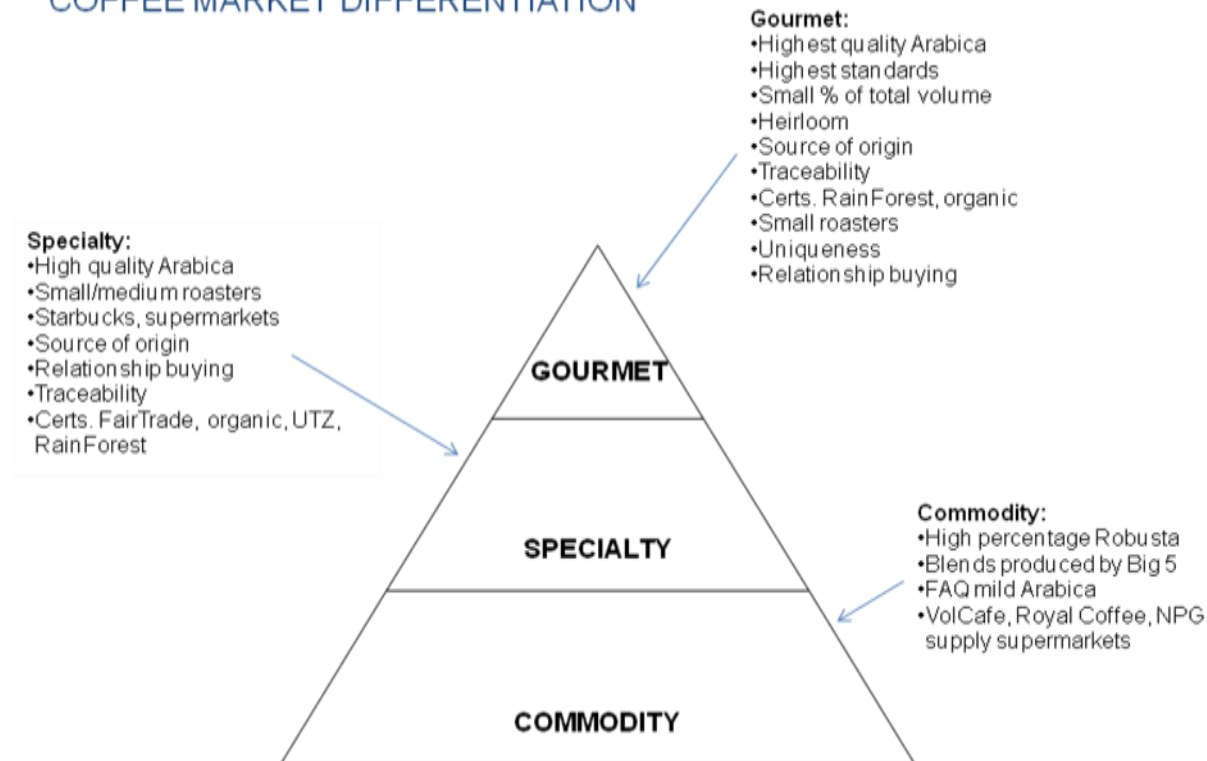
Coffee is a commodity and is subject to extreme price volatility. Short-term shocks are usually due to supply-side conditions in major exporting countries, such as frost in Brazil or rains in Central America. Over the long-term, prices have fallen for two main reasons: deregulation and supply increases. In 1989, the International Coffee Agreement, which had kept prices high between 1975-1989, collapsed leading to a decline in world coffee prices. During the 1990s, there were supply increases in the world coffee market, led by the expansion of Brazil's plantations and Vietnam's entry into the market in 1994. As a result, by 2001, the world price of Arabica coffee fell to below 60 cents a pound from highs of over \$2 a pound (ICO).

These low prices created an especially difficult environment for growers. Compounding the situation, coffee growers capture only a small and ever declining share of the value of the total coffee market. While coffee growers used to capture about 30% of the value of the final retail price of coffee in 1975, by 2000 they captured just 10% as downstream players became increasingly consolidated (Talbot, 2004). Coffee is typically harvested by farmers, processed by wet and dry millers, exported as a green bean, roasted, and then retailed. In the export stage, four companies - Neumann Kaffee, Volcafe, Ecom, Drefyus - control 40% of exports. Similarly, four roasters - Nestle, Kraft, Procter &

Gamble, Sara Lee - control 45% of that market. As a result, the bargaining power in this value chain rests with the exporters and roasters (Talbot, 2004).

Coffee Market Differentiation

COFFEE MARKET DIFFERENTIATION



Behind petroleum, coffee is the world’s second most commonly traded commodity and the second largest export earner for many developing countries. The global coffee market is divided between the “C” (commodity) market and the highly diverse specialty market. The specialty market offers opportunities for millions of coffee farmers throughout the world not only because of the higher prices that it consistently offers (relative to the C market) but also because of the ability of farmers to differentiate their product through origin and flavor. There is a tremendous opportunity for coffee farmers to access these markets because consumer demand continues to grow for higher-quality coffee that is grown using more sustainable practices. (ACDI/VOCA)

Broadly speaking, coffees can be divided into three commercial categories.

- **Gourmet or Exemplary quality** coffees have a high intrinsic value with a fine or unique cup. Usually of quite limited availability. Mostly retailed under straight estate or origin names. Usually very well presented washed coffees, including some superior washed robustas, but also includes some naturals (Ethiopian Harar, Yemeni Mochas, some Indonesian Arabicas), top organic coffees. True niche products. Usually, but not always, roasted by comparatively small firms and marketed through fairly exclusive outlets e.g. retail coffee shops or bars and upmarket delicatessens.

- **Specialty or High quality or premium brands**, good cupping coffees, well presented, but not necessarily visually perfect. Retailed both as straight origins and as blends. Includes good quality, well prepared organic coffees, and washed as well as superior quality natural robustas. The market for this quality band is much broader and includes a good percentage of today's specialty coffee. Also produced by leading multinational coffee companies and marketed through normal retail outlets such as supermarkets.
- **Commodity or Mainstream quality**, average quality, reasonably well presented but certainly not visually perfect. Will offer a decent, clean but not necessarily impressive cup.

In today's specialty market all three types of coffee are represented: exemplary and high quality coffees either as stand-alone or as a named blend component, and mainstream quality in many of the ready-to-drink and flavoured drinks that are sold alongside filter coffee and espresso.

For smaller exporters of top quality coffee the exemplary segment initially offers more promise. However producers or exporters of good quality coffee have three basic options open to them.

- Sell to the leading roasters (through the usual trade channels), if volume sales are required and the coffee sold lacks the flavour characteristics necessary to be marketed on its own;
- Sell to specialty roasters either direct or through importers or agents. The latter in most cases is the more realistic option as these importers or agents have a wide coverage of the small roasters and other retail outlets which are too small to import direct;
- Focus on specialty coffee retailers either by selling direct (for roasting in store) through specialty wholesalers or by selling through specialty roasters. The number of specialty coffee retailers importing direct is extremely small, however.

Premiums for specialty coffee can be considerable at the retail level but the premiums available for producers are inevitably much lower, although they can still be significant. It is sobering to realize that mainstream qualities, including robusta, account for an estimated 85%–90% of world coffee consumption, while the share of exemplary and high quality coffee is no more than 10% or perhaps 15% of the world market. This suggests that for many producers it would be inadvisable to ignore the mainstream market altogether. Instead they should concentrate on both: specialty for their top quality and mainstream for the remainder of their production.

A further point to note is that sales to small roasters are mostly on extended credit terms, something only an importer can easily afford. Inventory costs, late payment costs and even the risk of payment defaults are therefore part of the cost equation. Also, most roasters purchase subject to approval of the quality on delivery which means the importer will be left with any coffee that does not meet the roaster's expectations. In other words, the premium for specialty coffee at the wholesale level includes many more factors than just the quality.

About 40 percent of the world's coffee supply is robusta, a less expensive and often easier species of coffee tree to grow. The remaining 60 percent is arabica which is increasingly cultivated as a specialty or gourmet coffee.

Robusta is a more bitter-tasting coffee than arabica which is smoother and often prized by connoisseurs

Market Trends

Gourmet

According to the National Coffee Association, the global retail gourmet coffee market in 2008 was approximately \$48 billion.

The research firm Mintel International Group indicated that premium brews are driving sales at coffeehouses, doughnut shops and quick-service restaurants. "Coffeehouses have more than doubled their U.S. sales in the last five years to an estimated \$8.3 billion," Mintel said. "In another five years the market is expected to reach a staggering \$18.8 billion." According to the National Coffee Association, the popularity of traditional, consumer-brewed coffee has been declining since 2004, and Mintel's research found that only 35 percent of customers at coffeehouses purchase coffee beans there. More than 67 percent of coffeehouse visitors listed quality at the top of their list of needs. "Consumers are moving away from traditional coffee in favor of premium, specialty selections," said Billy Hulkower, an analyst for Mintel.

Specialty

Information Resources, Inc. reports that specialty coffee has reached a "tipping point." The market research firm projects sales of \$1.4 billion in U.S. grocery by 2012. Specialty coffee sales in grocery for the 52 weeks ending Dec. 31, 2008, were \$915 million and growing at an annual growth rate of 12 percent compared to 3 percent for traditional coffees. Total coffee sales (including flavored, liquid and coffee substitutes) across all channels are estimated at \$6.3 billion.

Coffee of all types earned \$3.3 billion in food, drug and mass market for the one-year period ending in March - the all-time high for the combination of ground coffee, bulk beans and instant.

This reverses a four-year downward trend. Unit growth in subcategories such as whole bean and ground is static or downward, according to Nielsen. The uptick can be attributed to price increases of 10 to 20 cents per 13-ounce tin the past year and comes despite the fact consumers are seeking value brands and trading down to private label coffee. Recent gains are the result of high-end coffee drinkers purchasing more expensive premium coffee for home consumption (instead of buying coffee at foodservice locations).

In the US—home to the largest coffee market in the world—demand for specialty coffees is the fastest growing of any coffee market segment. Today, specialty coffees comprise roughly 30% of the US market. Similarly, the primary market for organic and other certified coffee is located in the US and Europe. The market share of certified coffee in global coffee retail sales is estimated to represent approx. US\$ 3,500 million (<5%), with the segments of organic and fair-trade coffee accounting for <1% each. Shade-grown coffee is estimated to be a US\$ 30 million business in the US, representing about 1% of total sales in the gourmet coffee market.

Current market growth is driven by growing consumer interest in the health effects of the products they consume, as well as by the remarkable popularity of specialty gourmet coffees. This is reflected in growth rates of the certified coffee segment in recent years. Despite a predicted slowdown of

growth rates, the market for organic coffee has continued to grow at the same pace as the organic market in general in Western countries in the last years, showing a steady annual increase of 20% in retail sales. In 2006, retail sales of organic coffee in the US even increased 24% to US\$ 110.36 million. Compared to the share of organic products in the total food market (2%), the share of organic coffee in the total coffee market is still low (<1%) - hence the future potential is promising. The market for fair-trade coffee has grown even stronger and increased 53% in 2006, and it is estimated that the current world demand for organic and other certified coffees outstrips supply.

Payments for Ecosystem Services: Market Profiles

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Coffee Production Statistics of African Exporting Countries

	Type Of Coffee	P r o d u c t i o n (000 bag s)					
		2 003	2 004	2 005	2 006	2 007	2 008
World Production		104 079	115 558	109 630	126 820	116 212	134 163
Angola	(R)	38	15	25	35	36	50
Benin	(R)	0	0	0	0	0	0
Burundi	(A/R)	338	437	285	387	169	583
Cameroon	(R/A)	900	727	849	836	602	800
Central African Rep.	(R)	43	45	46	78	64	60
Congo, Dem.Rep. of	(R/A)	427	360	336	378	397	400
Congo, Rep. of	(R)	3	3	3	3	3	3
Côte d'Ivoire	(R)	2 689	2 301	1 962	2 847	2 150	2 500
Ethiopia	(A)	3 874	4 568	4 003	4 636	4 906	6 133
Gabon	(R)	0	0	1	1	0	0
Ghana	(R)	13	16	20	29	25	25
Guinea	(R)	366	316	525	473	387	335
Kenya	(A)	673	736	660	826	652	950
Madagascar	(R/A)	435	522	599	587	579	600
Malawi	(A)	48	21	24	17	19	25
Nigeria	(R)	46	45	69	51	44	50
Rwanda	(A)	266	450	300	254	252	383
Sierra Leone	(R)	36	15	60	31	41	20
Tanzania	(A/R)	612	763	804	822	810	917
Togo	(R)	144	166	140	134	125	130
Uganda	(R/A)	2 599	2 593	2 159	2 700	3 250	3 500
Zambia	(A)	100	110	103	56	61	70
Zimbabwe	(A)	92	120	66	45	29	50
Total African Production		13742	14329	13039	15226	14601	17,584
% of World Production		13.2	12.4	11.9	12.0	12.6	13.1

© International Coffee Organization website: <http://www.ico.org/prices/po.htm>

Consumption in importing countries/areas 2002/03 – 2006/07

Consuming Countries/areas	2002/03	2003/04	2004/05	2005/06	2006/07
World	84,513	86,850	87,596	89,850	91,881
North America	22,200	23,476	23,428	24,426	24,743
Of which					
United States	20,054	20,729	20,634	21,328	21,208
Western Europe (including the enlarged EU)	41,414	41,297	41,425	42,208	42,863
Of which					
France	5,431	5,038	4,773	5,113	5,540
Germany	9,448	9,136	9,183	8,915	9,082
Italy	5,404	5,525	5,626	5,484	5,820
Eastern Europe (excluding EU countries)	5,911	5,856	5,993	6,010	6,150
Asia and the Pacific	10,768	11,667	12,125	12,696	12,765
Of which					
Japan	6,717	7,152	7,023	7,271	7,265
Others	4,220	4,554	4,625	4,510	5,360

Source: ICO - in 000's of bags.

Current Industry Conditions

Total production in crop year 2008/09 was 128.1 million bags compared to 118.3 million bags in 2007/08 (Table 3). Crop year 2009/10 is now underway in all exporting countries. The latest official estimate of the 2009/10 Brazilian crop, most of which has already been harvested, is 39 million bags, comprising 28.4 million bags of Arabicas and 10.6 million bags of Robustas. However, there is a risk that recent heavy rains may affect the quality of the crop as well as flowering in crop year 2010/11. Vietnam has also been affected by bad weather which could have an impact on the current crop. Colombia, which recorded its lowest production level in 2008/09 since 1973/74, does not yet seem to be in a position to return to its normal production level in crop year 2009/10. On the other hand, increased production is expected in Africa, Asia and Central America.

With regard to Brazilian coffee supplies it should be noted that, in accordance with the programme of government support for producers, the first delivery of one million bags could take place in November if current price levels remain below the minimum price of R\$303.50 per bag. Although relatively firm, current levels of market prices in terms of the *real* are not yet high enough to dissuade growers from delivering part of their coffee to the government despite the additional costs involved such as preparation for delivery and transportation. Further deliveries are due in January and February 2010 at a minimum guarantee price of R\$311.70 and R\$314.40 respectively.

Exports during September totalled 6.9 million bags, bringing the total volume exported during coffee year 2008/09 to 97.6 million bags as against 96.1 million bags in the previous coffee year, an increase of 1.57% (Table 4).

Based on information received, my preliminary estimate of **opening stocks** in producing countries is around 16 million bags, which may be the lowest since records are held. **Inventories** in importing countries are currently estimated at around 26 million bags, the highest level recorded.

World consumption in recent years has been consistently buoyant. The total volume of consumption in calendar year 2008 is estimated at 130 million bags (Table 5). The growth in world consumption is largely attributable to increased domestic consumption in exporting countries and the growing demand in emerging markets. Consumption in the European Union seems to have stagnated over the last few years, accounting for only 31.3% of world consumption in 2008 compared to 27.6% for domestic consumption in exporting countries.

In conclusion, it should be noted that market fundamentals continue to favour firm prices given the buoyant consumption that makes it possible to maintain a balance between supply and demand. Levels of opening stocks in exporting countries for crop year 2009/10 remain low while production falls are expected in Brazil and other important producing countries where the quality of the coffee crop may be affected by bad weather conditions. If these falls in production are confirmed, exports will be reduced in coffee year 2009/10.

Global Coffee Sales Forecast (Retail sales, U.S.\$ millions)

2003	2008	2013*
\$32,773	\$53,663	\$62,801

*Forecast

Source: Euromonitor International, Chicago

Issues and uncertainties

The result of the projections indicates that global green coffee demand and supply would continue to grow, although at a rate slower than in the previous decade, and be almost in balance at around 7 million tonnes by 2010. The projections indicate that several major changes would take place in the world coffee market to 2010. ***First, most production growth would come from Asia and Africa, instead of Latin America where most coffee had been produced. Second, the growth of consumption would be faster in developing countries than in developed countries, in contrast to the trend over the previous decade. Part of the growth in consumption in developing countries would come from the increase within the producing countries, and partially because of this, international trade would grow slower. This scenario, however, is subject to sudden and substantial changes in the world coffee economy.***

Recent price crises have had an important implication for the world coffee economy. The price crisis, which has adversely and seriously affected incomes of all coffee producers, hit some producers more