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Coffee Update

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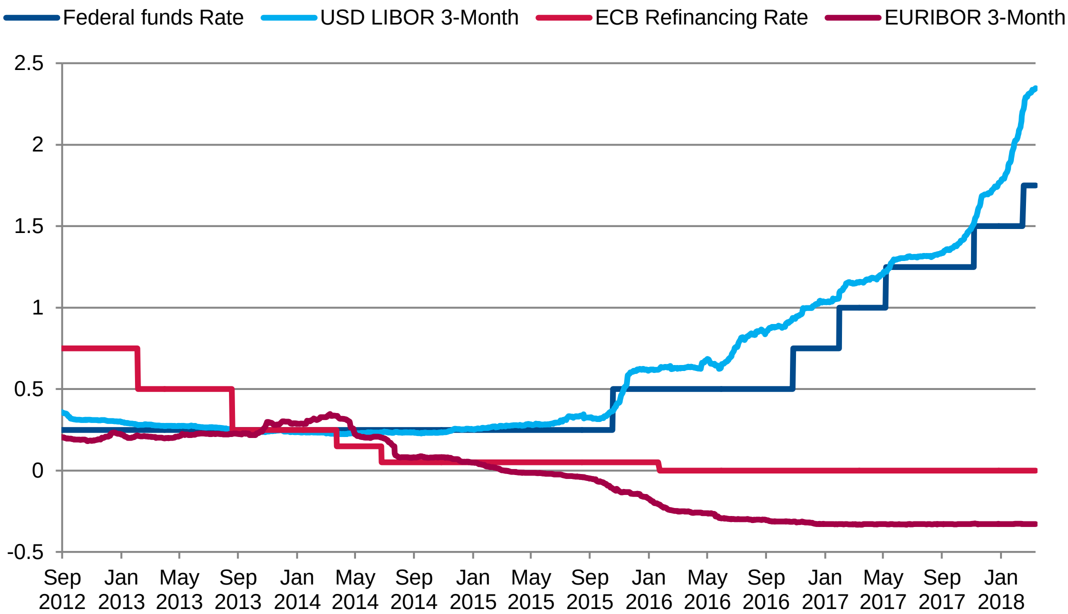
Executive Summary

- We have revised our forecast for the Brazilian 17/18 crop higher to 52m bags from 50.6m bags. We estimate exports for the 17/18 crop year to be 30.8m bags
- We have also revised our 18/19 crop forecast to 60-62m bags from 58m bags due to beneficial weather causing a bumper Conilon crop of 17m bags
- Our Vietnam forecast remains unchanged at 28.1m bags. Vietnam exports have set a 3 year high, frontloading shipments due to the incoming Conilon crop
- We see Indonesian production at 11.5m bags in 18/19; this includes 2m of Arabica. Government policy to support domestic demand has been successful with local consumption improving to 5m bags
- Marginal producers strong performance last year have been compounded by this year's large Brazilian crop as stock levels are already high
- We would hold a short position in the Arabica but we believe the risk is too high to open a new short position for the sake of a potential 15cts/lb move on the downside
- Our global production figure has been revised higher to 158m bags, due to higher marginal producer output and a higher Brazil crop. This leaves the global balance flat as we do not believe demand has increased above 158m bags
- We believe sustained weakness in the Real could see the large Conilon crop come to market, March's Conilon shipments were 62,807 bags
- European demand for Conilon coffee is muted

Macro Update

The bullish macro picture has failed to translate into the market structure. The global macro-economic picture denotes a healthy affair. In the US, the economy has continued to perform well. The unemployment rate has remained at 4.1% this year, the lowest level since 2000. Technically, the US in in full employment and by association, the pace at which this level falls decreases the closer to 0 it becomes. However, capacity utilisation figures suggest that there is still spare capacity in the US economy.

Fed Funds Rate vs USD LIBOR 3-Month vs ECB Rate vs EURIBOR 3-month*: The divergence of interest rates in the US and Eurozone continues.*



Source: Bloomberg

"…average hourly earnings rebounded in March to 2.7% y/y…"

US productivity did not increase in Q4 2017, this is important to better living standards within the economy. What's more, average hourly earnings rebounded in March to 2.7% y/y, but remain below 2.8% y/y in January. However, the University of Michigan Consumer Sentiment reached the highest level since 2000 at 102 in March. Signifying that despite the weak wage growth, sentiment is strong. It is worth noting that since the birth of the consumer sentiment figure in 1978 until today, the average reading has been 85.9.

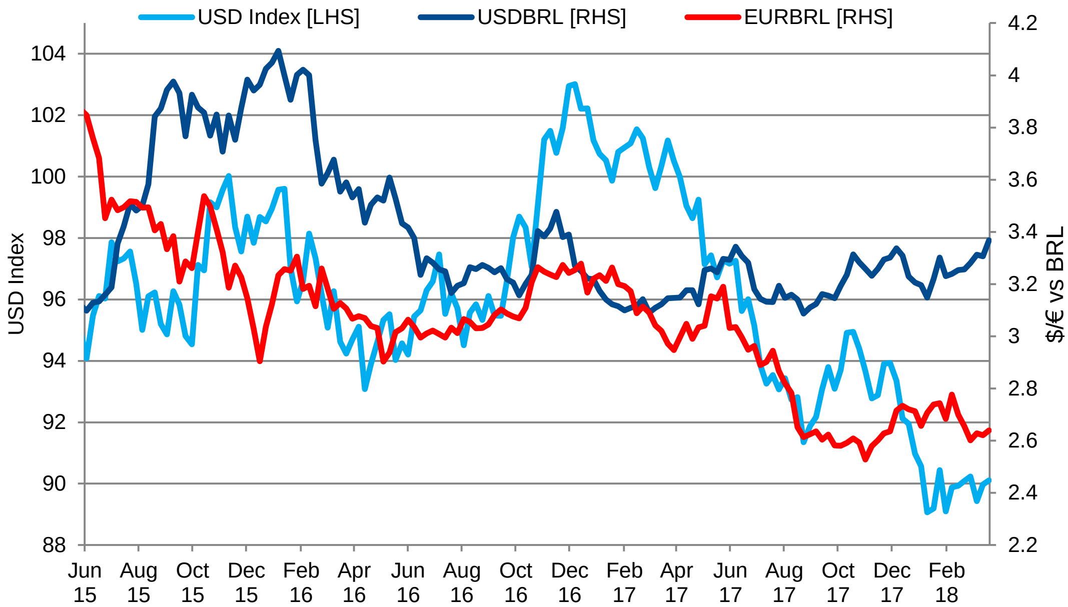
However, there are threats to the economy. With interest rates rising, although not to historically high levels, it remains to be seen if US economy can withstand this pace. Household debt in the US increased at an annualised rate of 5.2% in Q4 2017. The most since Q4 2007, debt has fallen since then but an increase in interest rates is likely to be felt by the consumer.

Another risk to the economy is the protectionist rhetoric that is being endorsed by the Trump administration. The anti-dumping and import tariffs that have been introduced, while not surprising or new, will impact world trade and if we see retaliatory measures, could impact economic growth. Although the dollar is already on the back foot, this could weaken the greenback on a global scale. We do not know the full implications of the tariffs at this time and therefore it's hard to decipher the exact implications.

In Europe, the cyclical upswing is still intact. Despite fear from the market that the European economy is softening, we believe that in the near term, Europe will remain healthy. There are growing questions as to how long the current strength can continue. Some market participants see the softer Markit manufacturing PMI this year is a sign of a slowdown in the Eurozone. However, further inspection suggests that this is not the case; the tail off in PMIs is predominately due to bottlenecks and bad weather, not economic weakness.

"…CPI is forecast to rise to 1.4% y/y in March…"

USD Index vs USDBRL vs EURBRL: *Political uncertainty has caused the BRL to weaken in recent weeks as the dollar index stabilises around 90.*



Source: Bloomberg

The ECB has suggested that they will taper bond buying in September of this year. It's widely thought that Mario Draghi will start to raise interest rates at the beginning of next year.

Price pressures within the Eurozone remain stubbornly low; CPI is forecast to rise to 1.4% y/y in March from 1.1% y/y in February. Consumer confidence in the euro area hit a multiyear high in March at 0.1y/y. Endorsing the consensus of strong demand in the euro area.

Protectionist risk within Europe has largely abated, for the time being, as Angela Merkel has secured her coalition. Her relationship with Emmanuel Macron is one that we see developing and helping to secure the immediate to medium term outlook for the European Union. However, the geo-political risk involving Russia is a worry not just for Europe but other major economies. The actions to expel Russian diplomats by the UK, EU and US have kick-started wider sanctions on Russian oligarchs and entities by the US. We do not believe this situation has run its course.

The impact on the global commodity markets could be significant. Knowing Russia's role in the metal, oil and gas markets, rising geopolitical tensions could prompt some further strength in the markets. The response from the EU, UK and US indicated how frustrated they are with Russia's meddling in the running of their countries and their support of Syria.

"…we anticipate a resurgence of shale production above $70/bbl."

In our opinion, the oil market is on its way to rebalancing, following the extension of the oil cuts in January. The re-emergence of shale oil provides a headache for the oil industry; we anticipate a resurgence of shale production above $70/bbl. The time lag between the rig restarting and the oil being produced is worth noting. Although, the rising Baker Hughes rig count is an indication of future oil supply. The potential sanctions on Iran from the US pose a much more immediate threat to the oil market. Iran has increased oil exports significantly since January 2016. Iran averaged just over 2.1m b/d during the last Iranian year which ended on the 20th of March. In addition to this, Iran exported another 428,000 b/d of condensates.

In the coming quarter, we believe investors would do well to watch geopolitical tensions, especially regarding potential sanctions on Iran. Military action in Syria will likely provide some short-term spikes to the upside. However, we expect geopolitical tensions will subside in the long-term. We also do not expect a trade war. The next OPEC meeting in June is an event to watch, as well as the inventories at Cushing Oklahoma in the US and the Baker Hughes rig count.

Coffee S&D Update

Arabica 2nd Month vs Robusta 2nd Month: *Arabica is down 6.9% YTD vs Robusta which has consolidated and is up 1.15% YTD.*

Source: Bloomberg

Since our last report, price momentum for the 2nd month Arabica contract has been weak. The continuation chart topped out at 133.50cts/lb (03/01/2018) and has gone on to reach a low of 115.30cts/lb. However, there remains robust support around 115. At this time, the stubbornness of the trade is holding out, which has kept a floor on prices thus far. The S&D outlook indicates that the trade's resolve will be tested in the coming months. Non-commercials have registered a record short position which could leave them vulnerable to a short covering rally.

Brazil

"We estimate Brazilian exports for the 17/18 crop year will be 30.8m bags…"

We have revised our 17/18 production figure to 52m bags from 50.6m bags. This is due to a stronger Arabica crop of 40m bags with Conilon making up the balance of 12m bags. We estimate Brazilian exports for the 17/18 crop year will be 30.8m bags; this includes soluble as well as green coffee. Exports from July 2017 to March 2018 have reached 23.5m bags. Working with a domestic consumption of 20.5m bags, carry over on 30th June is expected to be 4.118m bags.

"For the 18/19 crop year, our production forecast has risen to a range of 60-62m bags from 58m bags…"

At a time when research houses are revising down their production forecasts for the 18/19 crop, we have increased ours. For the 18/19 crop year, our production forecast has risen to a range of 60-62m bags from 58m bags. Our reasoning, back in November, when we last released a report, we had various weather concerns. Producing areas needed near perfect weather to achieve output of 65m bags. However, since then, these concerns have abated and rains have been beneficial to the crop, thus we have increased our production forecast.

"Conilon shipments picked up in March to 62,807 bags, this is in front of a predicted 17m bag 2018/19 crop …"

Rains have favoured the Conilon crop and the trees are full of large cherries suggesting a strong yield. It is worth noting that Conilon shipments picked up in March to 62,807 bags, this is in front of a predicted 17m bag 2018/19 crop. This leaves a 44m bag Arabica crop. Incorporating the carry-over from the 17/18 crop year of 4.118m bags and using the lower range of our forecast of 60m bags. This could leave a total of 64.118m bags worth of coffee available. Indeed, we see carryover stocks increasing substantially into the 19/20 season.

The ICE London certified stock decline has abated in recent months, suggesting any exports from Vietnam have gone straight to the industry. The strength in the Conilon crop may give impetus to a rise in certified stocks in the coming months, further fuelling the bearish argument. However, this largely depends on the movement of the BRL and the rule change regarding warehousing procedures for Robusta.

Vietnam

"Exports in the first 6 months total 14.392m bags…"

Our production figure for the 17/18 Vietnamese crop is consistent with our last report at 28.1m bags. Exports in the first 6 months total 14.392m bags, the pace quickened between January and March to a 3 year high. According to our production figure, exports of 14.392m bags, leaves another 13.708m bags until the next season. Domestic consumption is 2.2m bags, leaving a balance of 11.5m bags left to ship would mean 1.916m a month.

Shipments in the last 3 years have averaged 25.17m bags and we expect this year's figure to fall short of that level, even though the Q1 shipments have set a 3 year high of 8.6m bags, which could be anticipation of the large Conilon crop. The large Conilon crop may prompt Vietnam exports to slow for the remainder of the year. In our view, the Vietnamese farmer does not have the infrastructure to hold large carry-over stocks. This could support exports next crop year, similar to the 15/16 season.

11.5m bags until next season would leave a tight Robusta outlook, however, as mentioned the Conilon crop is expected to offset this. Assuming Brazilian producers make the Conilon crop available for export. Shipments out of Vietnam have been elevated since December 2017 despite the TET festival in February; 25,000 tonnes were bought by Indonesia in January. The decline in certified stocks has abated in recent months despite Vietnams strong exports.

Indonesia

"We have revised our demand figure higher for Indonesia to 5m bags from 4.5m bags."

Production for 4th largest producer is expected to be 11.5m bags for the 18/19 crop. This involves 9.5m bags of Robusta and 2m Arabica. We have revised our demand figure higher for Indonesia to 5m bags from 4.5m bags. Consumption of coffee in Indonesia has risen 47.1% since 2010; the policy of the Coffee Association of Indonesia has been to focus on promoting domestic consumption; we attribute the 500,000 bag increase to this policy.

The remaining 6.5m bags are available for export. Japan, which consumes 7.9m bags, imports 6.02% of their total consumption from Indonesia. Accordingly, the US, Europe and the Middle East also import Indonesian crop. Comments from the Indonesia Trade Promotion Center suggest Indonesian producers may be targeting the Australian market.

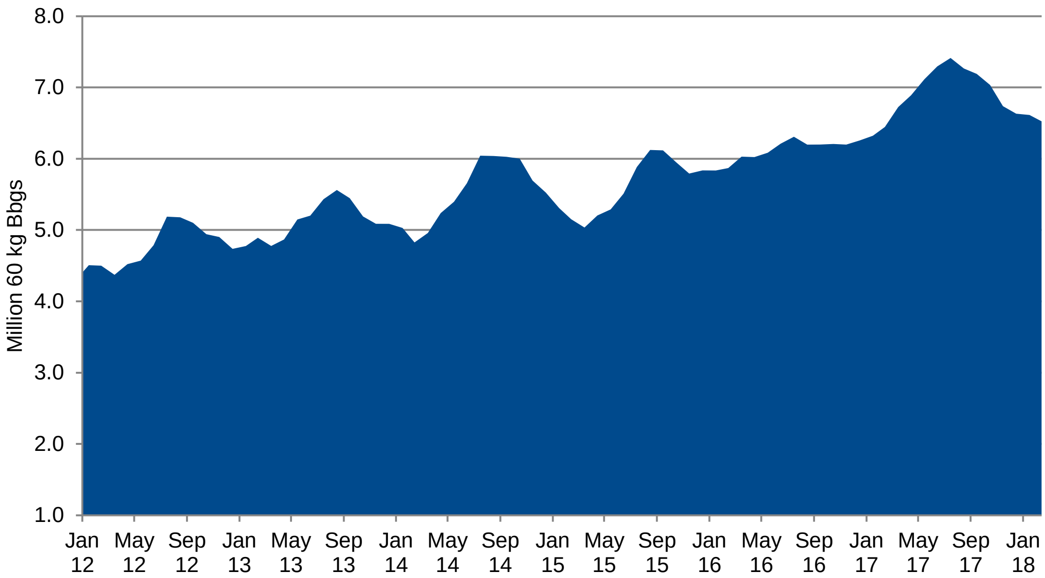
Global Balance

"The 17/18 season production has been raised to 158.5m bags."

Due to the above revisions, there have been changes to the global balances. The 17/18 season production has been raised to 158.5m bags. The increase by 4.1m bags comes from another strong Honduras crop of 7.5m bags. Looking at ICO figures for shipments in the first 5 months of this 17/18, global shipments are up 1.5m bags. The following producers stand out and make up the remaining balance; Uganda, Ethiopia, India, Nicaragua and Guatemala. Notably, according to Ihcafé, Honduras shipments so far in are 3,641,170 bags vs 3,626,398 bags last year.

As a result of an increase in Indonesian consumption our demand figure for 17/18 has increased to 158.5m bags. This leaves the global balance as flat for this crop year.

Green Coffee Association Stocks: *The pace of withdrawals has slowed in recent weeks but the general trend of rising inventories prevails.*



Source: GCA, Bloomberg

For the 18/19 crop year it is too early for a global production number. However, the strength in the Brazil crop is expected to cause a significant surplus. As mentioned, this comes off the back of strong production from the marginal producers which prompted an increase in certified stocks. Arabica certified stocks have declined from 2,319,310 bags to 1,954,482 bags at the beginning of April. Inventory bottomed out at 1,892,259 bags at the beginning of February. Robusta certified stocks saw outflows for the first few months of 2018. Withdrawals have abated and stocks stand at a total of 7,912 lots. Accordingly, GCA stocks have fallen 12% from July last year to 6.525m bags.

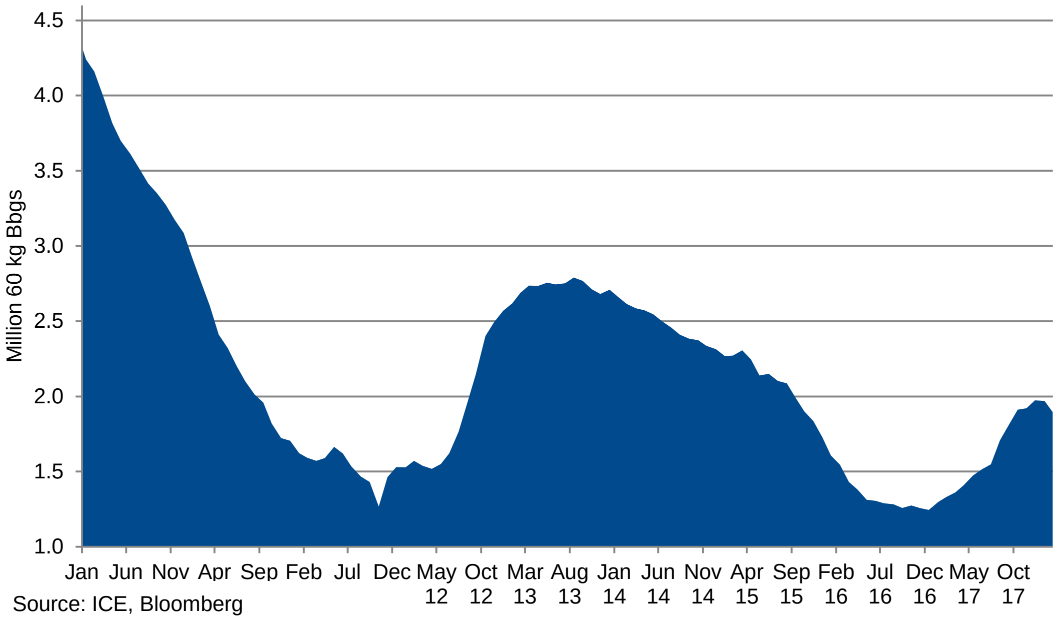
We believe coffee will be plentiful in the 18/19 season which will keep prices under pressure. The large Brazilian crop expected in the 18/19 season, off the back of strong output from smaller producers in 17/18, suggests that prices will remain under pressure. Indeed, previous bumper crops in Brazil were not as large as the incoming crop. In addition to this, smaller producers' output was considerably lower. Due to the Conilon crop, we envisage stocks could start to climb causing downward pressure on the market. However, as mentioned above, shipments from Vietnam are going straight to industry and not being graded for exchange stocks.

Our preliminary consumption number for the 18/19 season is 160m bags

Our preliminary consumption number for the 18/19 season is 160m bags. Consumption in the US and EU has been flat in recent years. Demand in the Far East has improved but it is coming from a very low base and thus the marginal impact on the world supply & demand balance is limited. Studies on the price elasticity of demand have found that coffee is relatively inelastic. Therefore, macro-economic upswings have a limited effect on demand.

At this time, we do not believe consumption is strong enough to match current production levels and has led to a surplus in the market. Origin consumption is increasing, but in our opinion it will take a couple of years for world demand to catch up with current output.

ICE Exchange Total Coffee Inventory: *Stocks have started to rise but remain low by historical norms.*



Source: ICE, Bloomberg

Financials

The fundamental picture suggests lower prices but in today's markets the fundamental outlook is half the story. The non-commercial net short reached a record level at -61,685. The number of traders also reached a new record at 562. The risk reward for prices at this level is too high. We do not envisage a significant inflow of fresh short positions at this level. In our opinion, we would not open short position for Arabica right now for the sake of 15cts/lb move on the downside. Fundamentally, we believe there is capacity for lower prices as the Brazilian crop hits the board. The Brazilian Real is key. Weakness in the Real would make the Brazil crop more competitive.

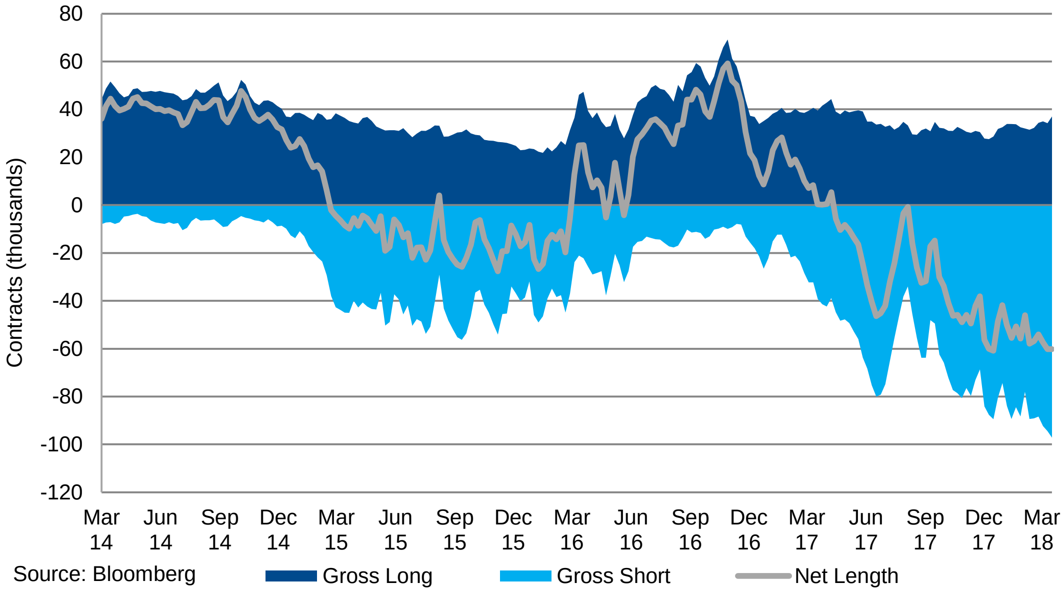
"In our opinion, we would not open short position for Arabica right now for the sake of 15USd/lb move on the downside. "

The moves in the Real to R$3.40 to $1 (11/04/2018) will increase the competiveness of Brazilian coffee. We believe this will support exports for both Arabica and Conilon. Even though the Conilon crop is usually set aside for the domestic consumption which we have at 20.5m bags, however the favourable differential for importing countries is likely to be too strong for Brazilian farmers. Accordingly, carryover stocks for Conilon could be low going into next season.

"We see little reason for the fund community to unravel their short position."

We see little reason for the fund community to unravel their short position. They make money when rolling the contract and the fundamental picture does not suggest any change in this in the near term. In our opinion, we would hold an existing short position in the Arabica market. In previous years, the trade may have tried to have a go at the funds, however, this metric has abated and the funds hold the cards, although they will not take delivery. A potential story on the upside is not a short term strategy; due the availability of coffee and the low prices. Producer margins are likely to have been squeezed; this may cause them to hold back their selling until prices improve. As mentioned earlier, if the Conilon crop surprises to the downside, the Robusta market may be tight. This may prompt a spike to the upside in the London contract. However, stocks are already elevated and the decline has abated, we would need to see inventory fall below 1.1m bags to indicate a tighter outlook.

Commitment of Traders Managed Money Net Position: *Speculators have extended their net short to record levels as they benefit from the roll.*



Source: Bloomberg

For the NY contract, there is also little argument for the bulls. The impact of a surplus weighs on the market a lot longer than a deficit. The replenishment of not just origin stocks but also inventory in consuming countries will cap prices on the upside for in the medium term. The on and off cycle that dominates Brazilian output could support prices for the 19/20 season. We believe that there will need to be a significant weather event to prompt a drawdown in global stocks. Otherwise, high inventory caps prices on the upside.

A long-term argument for the upside is the lack of renovation and farm care to the coffee trees due to weak margins experienced by farmers. Lack of revenue could prompt farmers to reduce farm care. Specifically, a reduction in the use of fertiliser would likely lead to a significant reduction in the yields. Local prices in Brazil have started to fall which is consistent with the looming crop. This is evidenced by Colombian farmers asking for aid due to lack of income.

Conclusion

"…think pessimistic sentiment could be reaching its nadir."

We anticipate both markets will remain under pressure due to the large incoming crops. However, in our opinion the risk of opening a short position at this level outweigh the rewards as we think pessimistic sentiment could be reaching its nadir. In our view, the large net short does not feed a bullish argument just yet as due to the term structure the funds have no reason to start unloading their positions.

The bulls may have to wait a little longer before entering the market. One story could be the low prices squeezing margins and causing a reduction of farm care going into next season. Although, surpluses are harder to shake off than deficits and this could cap prices on the upside.

"We believe Chinese demand is coming from a low base and is behind the curve."

Consumption looks set to grow in the coming years from origin demand. We believe Chinese demand is coming from a low base and is behind the curve. Admittedly, it is a growth market but we believe strong demand is still a long way out. Interestingly, Chinese distrust of milk has provided significant headwinds to Chinese demands. The bullish argument may have to wait a little longer.

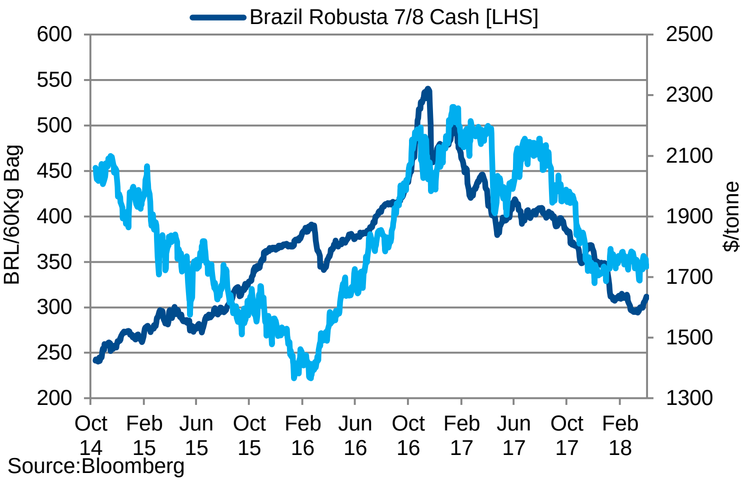
APPENDIX

Brazil

Crop Year	Production (M bags)	Exports (M bags)
11/12	49.725	29.855
12/13	56.5	30.909
13/14	56	31.018
14/15	50.50	36.573
15/16	51.3	35.484
16/17	56	33.082
17/18	52	30.808 (E)
18/19	60/62	

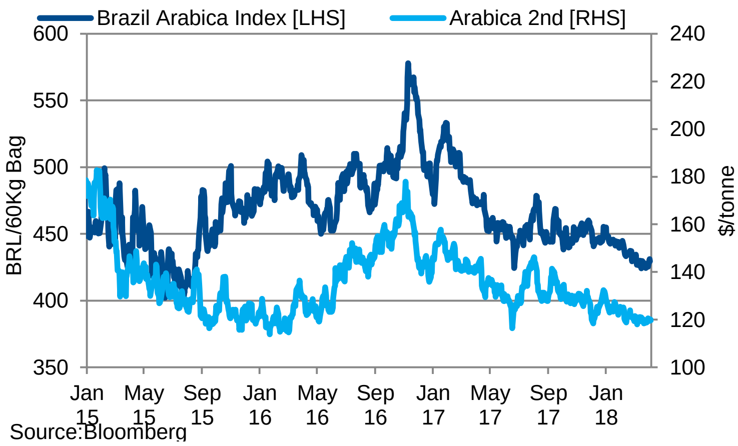
Source: Bloomberg, Sucden Financial, Cecafe

CEPEA Brazil ESALQ Robusta 7/8 Cash Price vs 2nd Month Robusta



Source:Bloomberg

CEPEA Brazil ESALQ Arabica Index vs 2nd Month Arabica



Source:Bloomberg

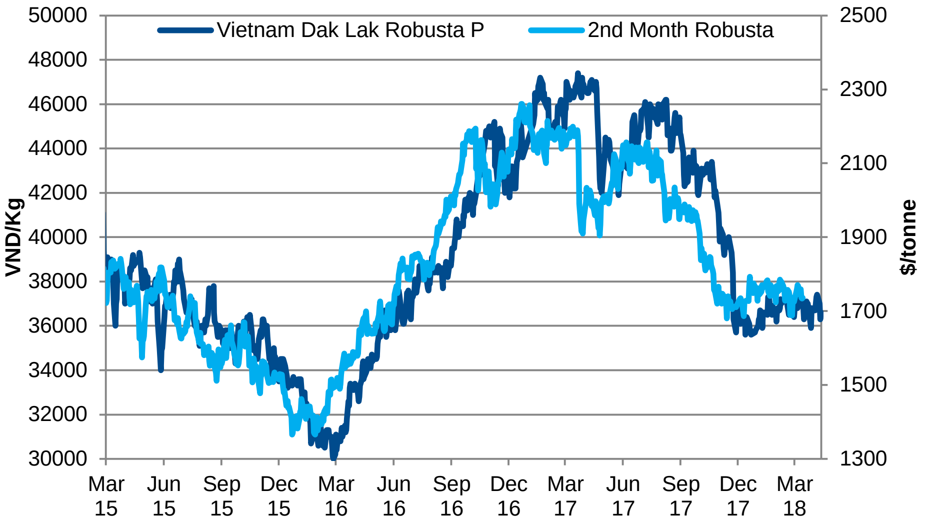
Brazil Exports Calendar Year

2013		2014		2015		2016		2017		2018	
January	2,567,872	January	2,780,355	January	3,058,483	January	2,809,026	January	2,646,584	January	2,717,630
February	2,232,519	February	2,930,002	February	2,747,025	February	2,938,361	February	2,590,952	February	2,498,114
March	2,591,392	March	2,782,556	March	3,134,534	March	3,102,523	March	2,833,454	March	2,523,719
April	2,775,451	April	3,117,426	April	3,209,230	April	2,458,225	April	2,240,212	April	
May	2,580,846	May	3,015,673	May	2,930,329	May	2,529,042	May	2,602,588	May	
June	2,363,496	June	2,960,845	June	2,683,792	June	2,450,947	June	2,191,622	June	
July	2,232,764	July	3,037,055	July	2,879,707	July	1,967,328	July	1,873,431	July	
August	2,660,238	August	3,095,886	August	2,906,060	August	3,044,488	August	2,610,209	August	
September	2,726,534	September	2,989,593	September	3,190,760	September	3,068,374	September	2,441,736	September	
October	3,234,855	October	3,346,513	October	3,531,666	October	3,363,064	October	2,902,113	October	
November	2,699,059	November	3,153,172	November	3,497,405	November	3,277,106	November	2,963,138	November	
December	2,996,072	December	3,217,758	December	3,249,992	December	3,262,022	December	3,023,032	December	
	31,661,098		**36,426,834**		**37,018,983**		**34,270,506**		**30,919,071**		**7,739,463**

Source: Bloomberg, Cecafe

Vietnam

Vietnam Dak Lack Robusta Price vs 2nd Month Robusta



Source:Bloomberg

2013		2014		2015		2016		2017		2018	
January	219	January	143	January	132	January	170	January	140.3	January	201
February	100.4	February	184.1	February	92	February	119	February	146.4	February	129.9
March	157.9	March	278.3	March	130	March	181	March	168	March	180
April	110.8	April	210.8	April	104	April	186	April	134.8	April	
May	110	May	137	May	106	May	162	May	122.2	May	
June	88.4	June	108.1	June	104	June	158.5	June	122.2	June	
July	90.7	July	89	July	107	July	139.8	July	101	July	
August	83.7	August	98	August	92.59	August	152.7	August	95	August	
September	63.6	September	97	September	87	September	129	September	79.5	September	
October	61.2	October	96	October	89	October	117.3	October	79.1	October	
November	80.4	November	84	November	96.2	November	114.7	November	100.5	November	
December	125.6	December	115	December	152	December	148.1	December	158	December	
	21,528,333		**27,338,333**		**21,529,833**		**29,635,000**		**24,116,667**		**8,515,000**

Source: General Statistics Office Vietnam, Vietnam Agri-Ministry

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