



Thesis: Coffee prices to appreciate

Last Update: May 25, 2019

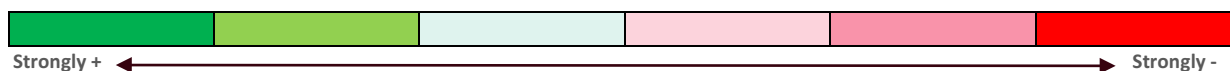
Coffee Prices to rise ↑	<i>Coffee prices, as measured by Arabica beans traded on ICE, have fallen sharply since 2011. Prices, at \$0.90-\$0.95/lb., are considered below production costs. Consequently, farmers have voluntarily switched to other crops or forced to shut-down. The coffee futures curve is upwardly sloping (implying higher futures prices) and speculator sentiment is bearish (a contrarian indicator). Once the Brazilian real stabilizes, pricing could be expected to firm as demand growth continues, especially in China.</i>
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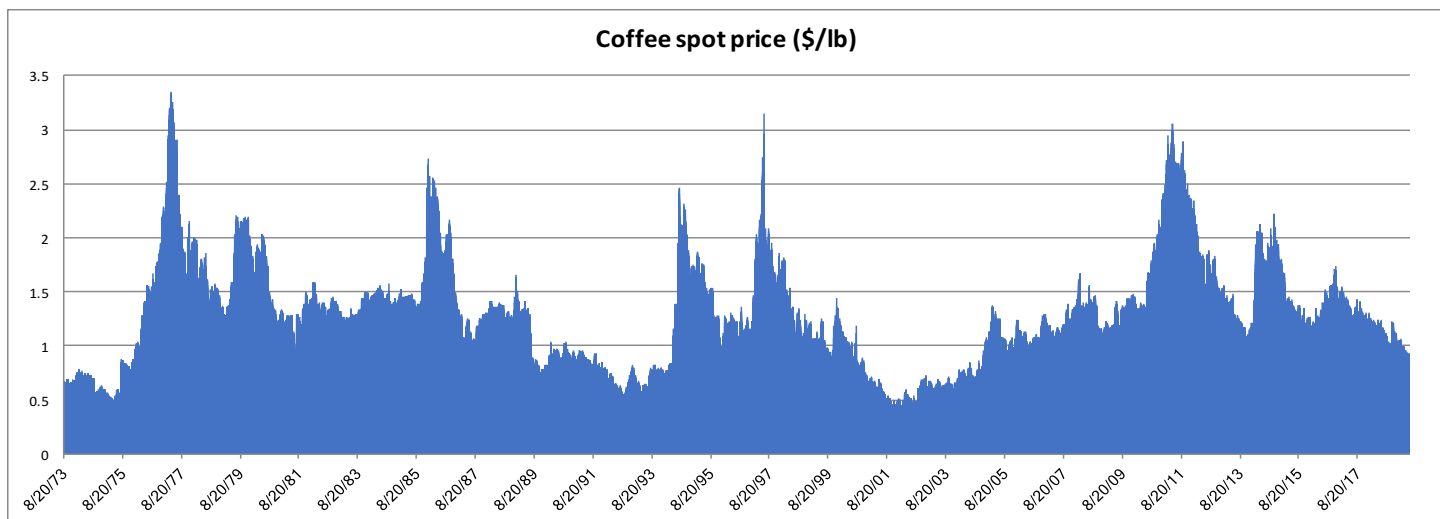
Overview:

Legend has it that coffee was discovered by a goat herder in the Kaffa region of Ethiopia, who noticed his goats grew rather jumpy after nibbling on the plant. It is believed that the coffee beverage was developed in the Yemeni city of Mocha circa 1400. Coffee prices (< \$1/lb.) are expected to rise based on spot trading below production costs, as well as market indicators such as contango in Futures. On an inflation-adjusted basis, spot prices are almost 40% above their October 2001 low (\$0.63 inflation-adjusted) indicating some downside risk. Global Production costs are now considered to approximate \$1.00-\$1.20/lb., implying that the present day's prices are unsustainable.

Coffee rises	Coffee declines
<ul style="list-style-type: none"> Sentiment is negative. The commitment of traders report shows moderate bearishness amongst speculators (a contrarian indicator). 	<ul style="list-style-type: none"> Large low-cost Brazilian farms are increasing production and market share
<ul style="list-style-type: none"> The Brazilian government is undergoing reform of the economic system which should <i>eventually</i> boost the economy and its currency. Economists expect Brazilian GDP to accelerate slightly to 1.4% in 2019. 	<ul style="list-style-type: none"> Brazilian real (and other EMK currencies) is declining (lowering production cost).
<ul style="list-style-type: none"> The current day high inventories are expected to decline by 2020. 	<ul style="list-style-type: none"> Much coffee is purchased "off the exchanges" in long-term contracts (blurring supply-demand analysis).
<ul style="list-style-type: none"> Long term demand growth remains positive in the 1.5%-2.5% range. Coffee increasing share in China which is attributable to the rising middle class. 	<ul style="list-style-type: none"> Inventories were high in 2018 resulting in an oversupply situation.
<ul style="list-style-type: none"> Farmers are switching to other crops. Coffee plants are delicate and sensitive to Climate change, El Nino and diseases. 	<ul style="list-style-type: none"> Futures market is in Contango, meaning an investment in coffee could result in losses even if the spot price remains flat.
<ul style="list-style-type: none"> Brazilian coffee production is expected to have an "off year" (thus lower yields per hectare). 	<ul style="list-style-type: none"> The only available ETF is structured as an exchange traded note (counterparty risk with Barclays).

Heat Map legend





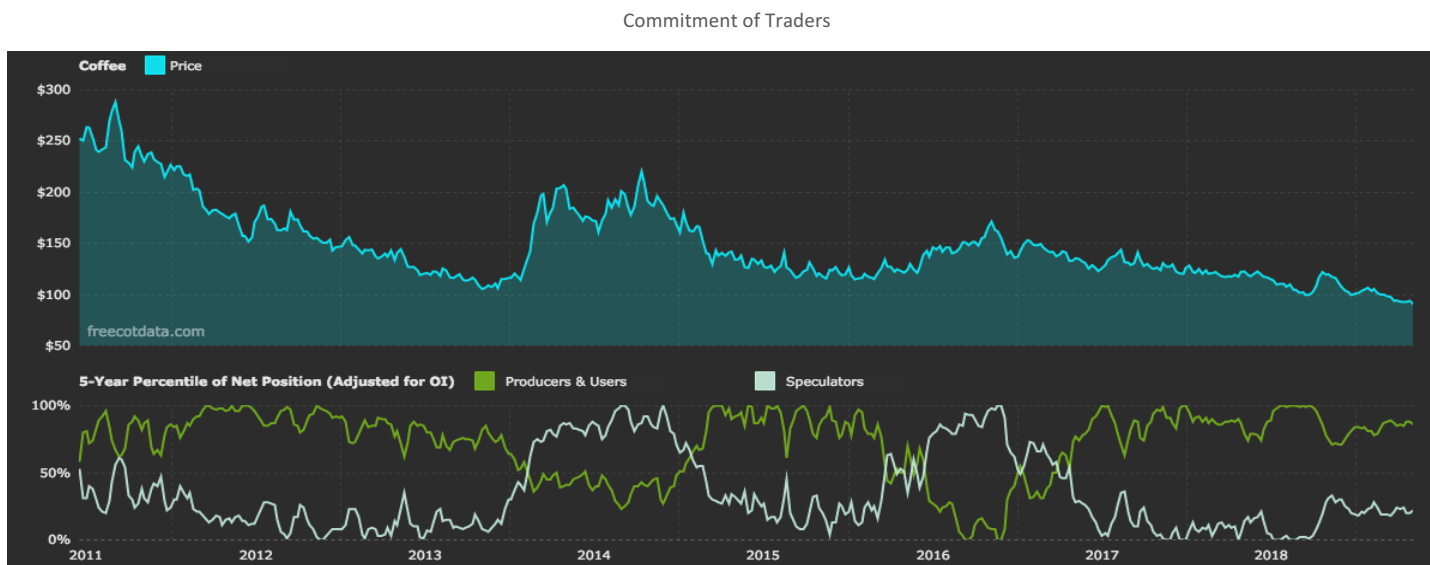
Notes:

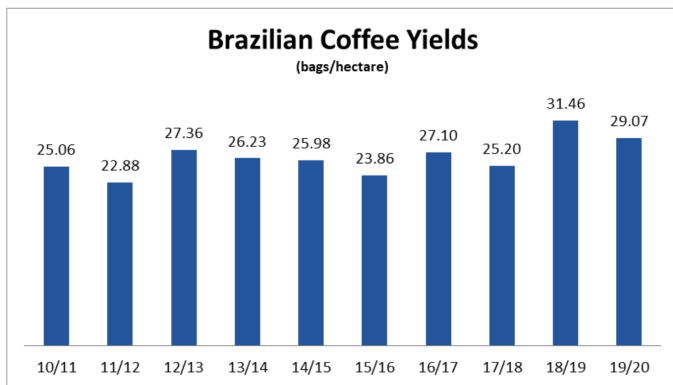
- Additional sources of information on coffee can be found in: Daily Coffee News, USDA Foreign Agricultural Services, and the International Coffee Organization.

ETFs/Futures:

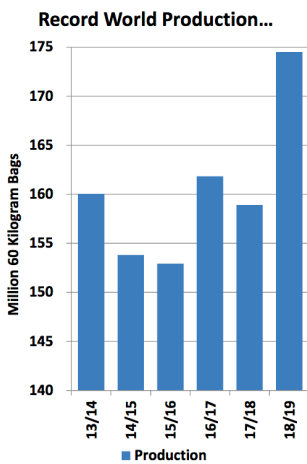
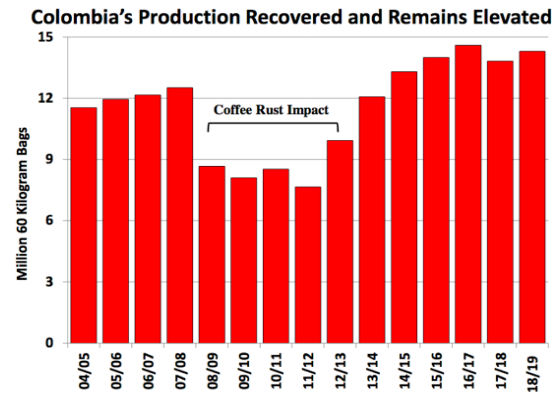
Ticker	Name	Comments
JO	iPath Bloomberg Coffee Subindex	Fairly liquid, <0.5% expenses, exchange traded note (ETN) and thus counterparty risk with Barclays Bank PLC.
KC (ICE codes)	Coffee C contract	Contract Size: 37.5k pounds of Arabica coffee, Listed Contracts: Mar, Ma, Ju, Sep, Dec. https://www.theice.com/products/15

Charts supporting or contradicting the above thesis (charts are retained given the evolution of the data over time)

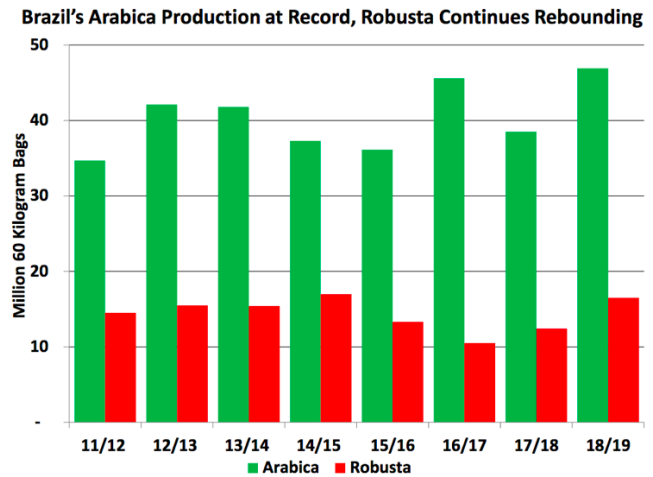
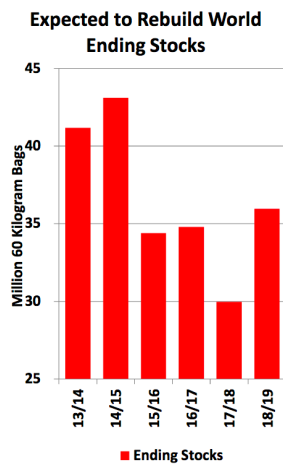




Source: ATO/Sao Paulo

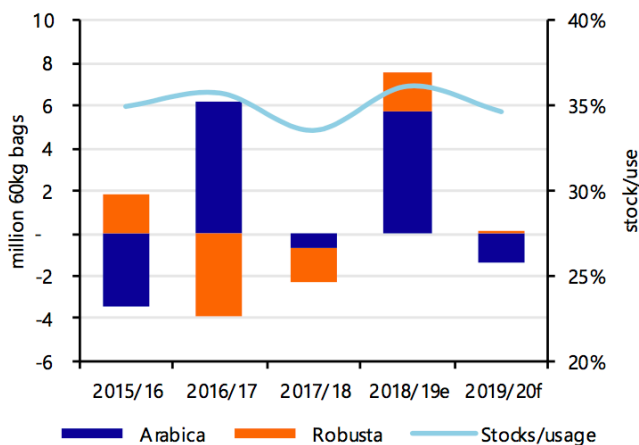


Source: USDA



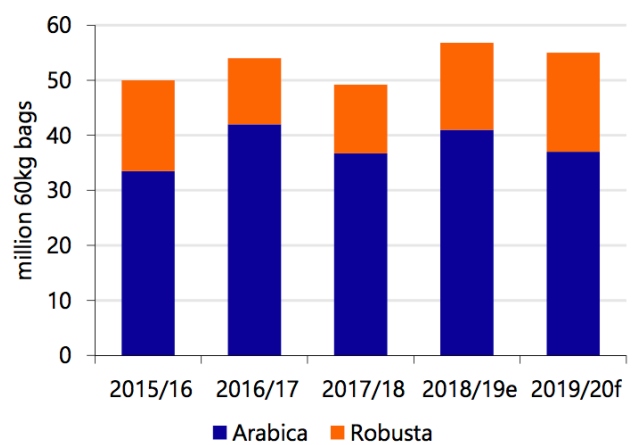
Source: USDA

Figure 9: Global coffee supply/demand balance, 2015/16-2019/20f



Source: Rabobank 2019

Figure 10: Brazilian coffee production, 2015/16-2019/20f



Source: Rabobank 2019

Brazilian Real vs US Dollar



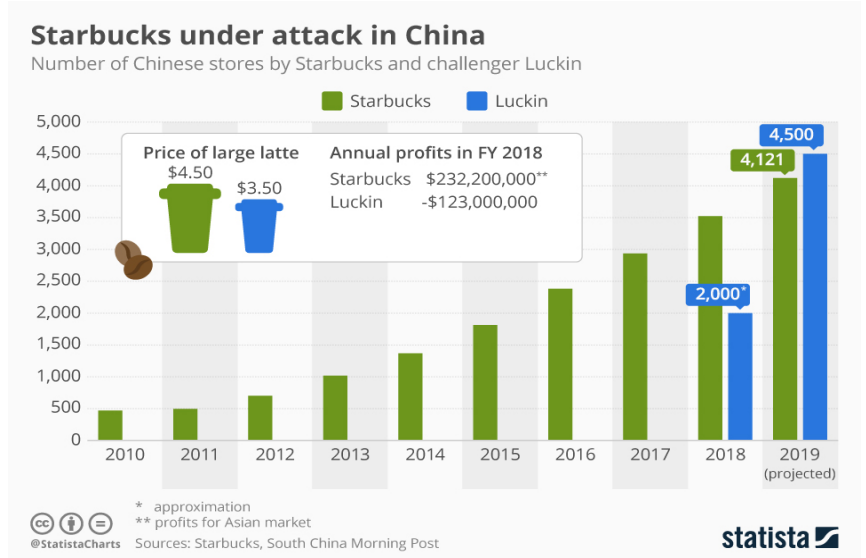
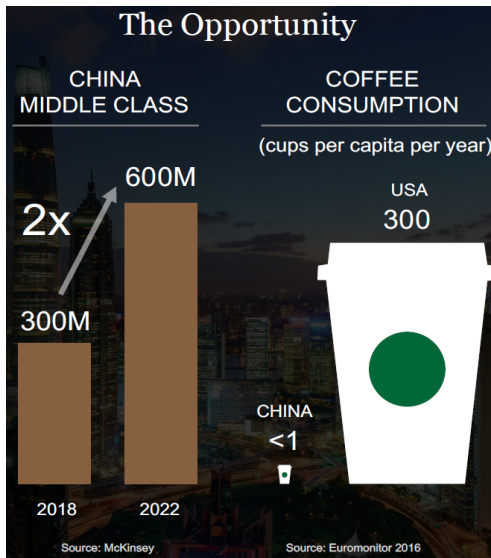
Brazil macroeconomic data

	2017	2018	2019E	2020E
Real GDP (%Y)	1.1	1.1	1.4	2.5
Private consumption	1.4	1.9	1.8	2.7
Gross fixed investment	-2.3	4.1	0.9	6.4
Current account (% GDP)	-0.4	-0.8	-1.1	-1.6
CPI (%Y)	3.5	3.7	4.0	3.9
Policy rate (eop, %)	7.00	6.50	6.50	8.00
Fiscal balance (% GDP)	-7.8	-7.1	-6.8	-5.4
Int'l Reserves (\$US bn)	374.0	374.7	375.0	375.0

Source: Government Data, Morgan Stanley Latam Economics

China: End-Market demand, as measured by growth for Luckin Coffee

	For the three months ended or as of					
	December 31, 2017	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018	March 31, 2019
Total stores	9	290	624	1,189	2,073	2,370
Pick-up stores	4	83	356	903	1,811	2,163
Relax stores	5	15	22	45	86	109
Delivery kitchens	0	192	246	241	176	98
Cumulative number of transacting customers (in thousands)⁽¹⁾	11.1	485.0	2,917.8	5,984.3	12,529.5	16,872.3
Average monthly transacting customers (in thousands)⁽²⁾	4.0	179.5	1,207.6	1,877.4	4,325.9	4,402.0
Average monthly total items sold (in thousands)⁽³⁾	8.6	487.5	4,001.0	7,760.3	17,645.1	16,275.8
Freshly brewed drinks	8.0	451.7	3,743.7	6,220.4	13,418.8	13,077.2
Other products	0.5	35.8	257.3	1,539.9	4,226.4	3,198.6



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