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Before starting my intervention I would like to take a minute to thank the members of this Consultative Forum for their interest in listening to my ideas and to especially thank my good friend Jose Sette for giving me this most honorable opportunity to address you. As the grandson of a coffee producer in Guatemala and being a Coffee Market Risk Consultant, this moment has been but a dream. I have had the good fortune, through my job, to travel to most of the coffee producing world seeing first hand the effects that price can have on the largest and smallest producer, as well as the influence price has on the buy side of the equation. As we all know, most of the available financial instruments that aid in the managing of price risk are mostly accessible to the larger players in our industry. There have been many attempts to build access roads and mechanisms to support the smaller participants but unfortunately with very little successes. A few examples of these efforts are Cooperatives, Direct Sales and even minimum price structures that eventually have failed. In my opinion, it is not the lack of effort that has doomed these ambitious undertakings, it's the lack of understanding of the instruments that have made things difficult in point, a lack of Education!!

It is extremely challenging to convince the small producer that all Risk Structures and contracts eventually end with a strict price setting point. It seems that when the market has been low, producers seek help from whomever they can to sell at levels higher than the market can offer; but as soon as the market changes and goes higher than the levels contracted, that same producer forgets the help he had been receiving; in some cases for years, and then seeks to get even a higher price than what seemed fair just a few months before. What is the answer to the query? Default. Why? Lack of Education.

It seems as if it is a one way street. This attitude only ends up hindering long term relationships. Both sides of the equation have to be in balance if there is ever going to be true sustainability in our coffee world. The market is never static. As a matter of fact it is larger than any single participant; it has a heart beat, it has a breath, it lives and we must live within it. There is no perfect answer. It may be obvious that with millions of producers and only thousands of roasters this balance is difficult to achieve. It may also be obvious that when a roaster makes a buying mistake or the market level goes significantly against him, he has a final customer to which he can pass on the pain in the form of price increases. For the producer on the other hand, the buck stops with him. There is no place where the pain can be spread; but

this is no excuse for not respecting the balance. Every action has a reaction. We are all living in the same world, within the market, it is the market that gives us the possibility to exist. One can't live without the other; many have found workable solutions within the boundaries of reality. Unfortunately, most have not. As a risk consultant please believe me when I say that this is easier said than done. Most solutions involve not only money, but vision and heart. What comes around goes around and we are most definitely currently living this reality. Those on the buy side that did not build proactive solutions for potentially adverse price levels have found themselves having to even change blends to keep point of purchase levels attractive to their consumer. Consumers which in turn reject the new taste profile may end up making the decision to change anyway. Therefore the roaster looses them as loyal customers. It becomes a vicious cycle. The price adjustment leads to changes in taste which lead to less sales. Then, more adjustments to quality lead to even less sales and so on. Markets are perfect, but we need education to understand what they tell us, they have a voice, and I believe that time and time again they tell us that the "Cure for High prices are High Prices" and the cure for "Low Prices are Low Prices"

Now, in my twenty plus years of speaking to both sides of the equation, many issues have come up. Currently, I don't hear so much that the market level is the issue. The issue is Volatility: the uncertainty of which way and how fast the price changes. So, historically coffee has had a yearly volatility of about 35%, all this means is that from today's price level we can expect that next year's level will change by 35%. Unfortunately we cannot predict if up or down. In all the years our industry has never had such a tight supply and demand picture. We are basically drinking what we produce. In all of history, we have not had so many outside forces influencing our market: cheap interest rates, trillions of dollars looking for yield, global currencies being moved as if by the wind, the emerging markets leading the developed world, as if the tail wagging the dog, the media telling us more than we probably need to know thus moving nimble capital around the world as fast as lightning. Having said this, and in an effort to segregate our world from that of large capital movements, we do measure our real coffee availability by the levels of specific differentials, which by the way, at times during the last three years have been even more volatile than the terminal markets themselves. It is this differential that in reality tells us the value of a specific coffee. It is this differential that gives us the final outright price. The producer and roaster really live on the basis of the outright price. It is unfortunate that many small producers basically look only at the differential, priding themselves on having contracted the highest differential level possible just to see it melt away by a large move on the terminal markets. Historically, the differential contributes only the final

10% to 20% of price; so why then are we so keen on the smaller piece? Let's look more closely on how to effectively deal with this component of price.

Currently, we have only two tools to transfer risk, or hedge. Hedging is the act of transferring risk to others. It is done at terminal markets and it is done based on benchmark contracts such as the "C" for Arabicas at ICE, the London Coffee Robusta at LIFFE and the Brazilian Naturals at BM&F. The other hedging alternative is Structured Products. These are mostly based on the existing contracts traded on exchanges but tweaked by combining options and futures to come up with effective risk transfer structures.

Nowhere can we find a tool to transfer differential risk. Today we must find the specific buyer or seller for the differential, making it difficult if not impossible to act anonymously in the market place. The terminal markets offer us the ability to act independently without being seen by our counterparty. Whereas the differential market is currently totally transparent, so we know who buys and who sells; a tremendous psychological barrier. So here is an idea, a thought that I have been looking at. I have borrowed from a proven market, the Natural Gas market in the United States. This is how it works:

Basically there are ten to twenty natural gas "hubs" located at pipeline interconnections around the US and several in Canada. I will refer to these in order to emulate the various coffee producing regions.

The Henry Hub, located near Erath, Louisiana is the delivery location for the natural gas futures contract on NYMEX ---- which is similar to the ICE Coffee and its delivery points.

As the Henry Hub futures contract developed during the 1990's, the OTC market developed natural gas basis contracts between the Henry Hub and
the other "Hubs" located around the US and Canada. Since natural gas is basically a homogenous commodity, only price differentials are important --- similar to our coffee diffs, coffee is coffee only the origin differs.

These basis contracts evolved when several well established media services surveyed cash traders at "bid week". "Bid Week" is defined as the period near the expiration of the futures contract, typically the third to last business day prior to the delivery month. This established the industry index price at each location for each month, also known as the monthly location index price.

These OTC "location" basis contracts were simply the monthly location; index price (ie Houston Ship Channel) MINUS the Henry Hub futures settlement price, which is the same thing as saying FOB DIFF price which is ICE Arabica futures settlement level PLUS or MINUS the given physical coffee… if you will.

For example, if the Houston Ship Channel index was $4.45 and the NYMEX futures settled at $4.250, the basis would be $0.20 (per mmbtu).

The location indexes comes out around the last of the month, prior to the delivery month or a day or two after the futures contract expires. ----- Or basically our FOB diff plus or minus country port.

In the year 2000, the Commodity Modernization Act allowed for the NYMEX to create “cleared” OTC products. As a result, many popular locations were
selected to be traded and cleared as a “clearport” product at NYMEX. The natural gas basis contract is now a cleared OTC Clearport product. We could clear our OTC Coffee DIFF contracts at ICE just like any other coffee contract.

For most locations, the differential prices are now in the minus $0.250 to plus $0.250 per mmbtu range, and the margin is in the $200-600 range. The contracts are one fourth of the size of the futures contract (2,500 mmbtu vs 10,000 mmbtu) with options also being available. We could build our differential contracts in fifths to allow participation of even the smallest players.

OK, so what does all this mean? There is proof that in another prominent industry differential contracts work. Not all the contracts that they listed trade; that is left up to the market to decide, but the frame work is there. The largest challenge for the coffee industry is building a reliable and trustworthy settlement instrument. We need a number to which we would net our prices at the end of the life of the contract, were we would mark to market our profits and losses. A true number that the industry would respect as the number to settle to. So why not say 50 bags of coffee and FOB differential? FOB differentials should be discoverable but we need anonymity. These contracts could trade through brokers on the OTC market to later be given up for clearing at the exchange to insure accountability. Roasters could go through the same OTC channel and anonymously trade the DIFF contracts and have the exchange to support price changes and keep the financial side of the equation leveled. Even smaller roaster could participate.

Another product that has been designed is the overlay of a smaller contract size over the ICE or LIFFE coffee contracts. This product already exists as a 50 bag equivalent contract that represents the ICE and LIFFE markets, in essence replicating these contracts but smaller, thus allowing access to medium and smaller players into the hedging world. These 50 bag contracts not only trade as a futures contract but options are also available. One disclosure that does have to be made, is that due to the nature of the instrument, certain minimum financial requirements have to be met, as per the United States Commodity Futures Trading Commission or CFTC. For the smallest of participants, these instruments can be accessed through the aggregate financial strengths of Cooperatives and/or Associations.

Well, I have said a lot about many realities or maybe even some dreams, but I think it is up to us with our collective intelligence to solve most of these mysteries. They do affect all stakeholders, producers, roasters and eventually our final consumers. Coffee has been around for thousands of years and may I be so bold as to say that it will be around for thousands more. The realities of the business might be changing, or better yet have changed, and will continue to change; but its existence is all but guaranteed. To ensure it, we need to build risk management tools, we need to think out of the box, and I for one am willing to stretch my neck out there to think the impossible… but we need to educate our stakeholders. We can and will build tools to transfer risk but nothing will get done if the players don't understand them. The tools are there and will be there to be used, but without the education they will stay hidden in a drawer or even worse, lay life less on a drawing board. We need to educate within a free market and give our stakeholders choices. The only thing I can guarantee today is that Volatility is here to stay and we need to learn how to live within it and to take advantage of what the market tells us. Listen to it.

Again many thanks, and I am looking forward to your questions.