

(Slide 1) – Title

Excellencies....

Ladies and Gentlemen...

Looking at average price level, as reflected for example by the ICO indicators, we can say that the coffee crisis is over.

Many of us would judge average prices of last months economically sustainable.

Still one aspect has to be considered, which is the price paid to growers; in short, what is the grower getting for his coffee despite and beyond the up and down of international coffee prices.

Looking at ICO data we can see that there are instances where the local market is only vaguely linked to international prices.

(Slide 2) In this chart we can see the dynamics of the ICO Robusta Indicator in relation to the price paid to growers in some producing countries; the curves are not always synchronous.

(Slide 3) Comparing the ICO Arabica Indicator and a group of Arabica coffees we get the same experience; here too there are instances of asymmetry.

There could be many reasons for this behaviour, in a way it can be a measure of the internal “efficiency” as well as a measure of the quality and relative availability, or scarcity, of a specific coffee origin; from another point of view it could be considered a protection for the farmer, in case of low international prices, but is also a filter, a sort of net, that limits the benefit for the growers in case of increasing prices.

There is another aspect of the recent history to analyse.

The coffee crisis has been a period of redistribution of production among producing countries (and areas/regions within) based on competitive advantages.

Globalisation, free movement of goods, WTO negotiations, are in some way facilitating this process, which is, almost by definition, continuous and never ending.

The level and changes in international price are certainly an important factor but there are many other issues and conditions that impact the economic decision to increase or decrease production: this is clearly seen in **(Slide 4)**.

There are cases of countries that have substantially increased production (for example: Ethiopia, India and, of course, Vietnam) and other decreased (Costa Rica, Ivory Coast, Mexico, Indonesia), in the same period; it is clear that there are other relevant factors that make coffee production interesting and profitable for some countries while not for others.

(Slide 5) We can only expect similar trends to continue in relation to:

- Production cost and productivity
- Quality standard and specialization
- Commercial performance and client satisfaction

In conclusion, the coffee crisis is over but not for everybody: we can expect that frictions, movements and instability on the production side will continue.

Rather different is the situation on the consumption side; Europe, the biggest market, is showing a lacklustre performance.

(Slide 6) During the last three years, global consumption in the first 11 European markets did not show any significant growth in volume or in value. In 2004 total volume was about 940.000 Tons for a total value of € 7,6 billion; R&G is about 70% and soluble reached a 30% share of the market.

(Slide 7) Some segments were more dynamic - Espresso +11% in value, Soluble +7% in volume but only +2% in value – but is not enough to change the overall market that lost 1,8% vs. 2003 and only a small growth of 0,6% vs. 2004.

The three years trend for the R&G market is negative: -2,6% vs. 2003 and -0,4% vs. 2004.

In some countries, the medium term tendency shows signs of a structural weakness.

(Slide 8) Since 1997 the French market is slowly shrinking in volume while the total value of the market is about stable.

The modern distribution, which development in past years was sustaining the dynamics of consumption, is now showing, at least in some markets, some difficulties due to the strengthening of the action of Hard Discounts.

(Slide 9) The economic situation and the inflationary effects of the introduction of the EURO have stimulated sales of the hard discount sector; in France, for example, sales growth has been of 6% vs. an average of +2,3% and a slower growth for Hypermarkets, which was below 2%.

If we look at prices, we can see that against the current trend of other FMCG (Fast Moving Consumer Goods), of durable goods and of services, the coffee category has experienced a deflationary dynamics.

(Slide 10) In Germany for example, in years 2002-2004 the R&G average selling price lowered from €/Kg 6,81 to €/kg 6,02 (-12%); **(Slide 11)** in the small espresso niche prices lowered from €/Kg 13,60 to €/kg 12,46 (-10%)

(Slide 12) In Italy we can see a clear tendency in the last three years with an average price reduction of 9%.

Considering the reduction of cost of raw material but also the average inflation of all other costs in the period, we can conclude that the previous examples are the result of a recessionary context of the coffee market, characterised by low volume and declining sales and margins.

With stagnation comes an increase of competition based mainly on prices and therefore a substantial acceleration of promotional activities.

(Slide 13) In Italy, more than 40% of all coffee is permanently sold on promotional terms.

(Slide 14) In France the increase of production and distribution costs have eroded the lower cost of raw material and the promotional pressure reached a minimum of 27,2% in July 2004; it quickly regained strength in the following months.

The consumers' behaviour is changing, too, by favouring "value for money" rather than "brand" and "status". It seems that branded products are less appealing and have lost a bit its sense of high quality and excellence.

(Slide 15) The trend of growth for sales in the grocery segment is negative as well. In Italy it was 6,3% in 2002 and 7,7% in 2003 while in 2004 lowered to 1,6% and 2,1% in the first quarter of 2005.

(Slide 16) The share of products of the low price range is increasing: in Italy between 2003 and the first 5 months of 2005 the total share of products with a price range of 20% below the average, increased from 29,3% to 32,5%.

(Slide 17) A 2003 research done in Germany shows that 92% of consumers declare they are paying attention to promotional activities (it was 87% in 2001), and only 60% accept to pay a premium for a superior quality (it was 69% in 2001).

This environment stimulates an increase of competition based on price, special offers and promotion and force many roasters to look for cheaper sources of raw material to retrieve profit and efficiency margins.

(Slide 18) The case of Germany is emblematic: in 2003 to 2004 imports of Colombian coffee passed from 11,08% to 8,74% while Vietnam increased from 13,21% to 18,59%.

(Slide 19) Also in a market like U.K., dominated by soluble, imports of Vietnam increased from 25,5% to 34,2%.

An even clearer picture can be seen at a macro-economic level.

(Slide 20) In this table we have the retail prices of roasted coffee in Germany for the period 1970-2004: from 1999 to 2004 the average price level lowered by 27,6 %!

(Slide 21) In the smaller Swedish market, where 99% of the coffee is Arabica, we had, in the same period, a price reduction of 21,7%!

We have even more structural changes to observe!

(Slide 22) This chart shows the dynamics of consumption in Italy, divided by Food and Non-Food sectors, since 1985, with a projection into 2009. While Food products have a growth of about 10% for the whole period, the Non Food sector grows seven times more!

(Slide 23) If we look at the price index chart, we can compare the price developments of the two sectors; it is rather clear how the Non-Food sector gains a larger share of Value and inevitably absorbs growing share of the consumers' disposable income.

Over again coffee proves to be a traditional, mature, low growth product, characterized by a moderate rate of innovation and a high geographical and market differentiation.

Such conditions favour consolidation and defence of positions, in some cases, even disinvestment, rather than growth and development strategies.

(Slide 24) Consolidation is, for instance, shown in the total market share of the first European roasters, where only small changes occurred in the last three years.

There are very positive signals, too.

(Slide 25) The success of coffee pods and capsules can be read as a sign that the market is revitalizing.

This segment reached during the 2005, in the first 6 EU countries, the level of 11.000 tons, equivalent to € 250 million, with a growth rate of 83%.

Another positive signal comes from the growth trend of consumption in new markets and producing countries.

(Slide 26) shows the worldwide consumption by geographical area: let's notice, as an example, that Latin America as a whole has almost the same share as North America; Africa and Middle East share is very close to the Eastern European one.

Forecasts of Retail market in 2008 **(Slide 27)** indicate a growth rate of 30% for Latin America and 62% for Middle East; **(Slide 28)** Asia Pacific and Australasia respectively 61% and 29% while **(Slide 29)** for East Europe the growth rate is expected to be a good 38%.

In terms of market segment the Away of Home seems to be even more significant and promising, reflecting a generalized evolution of life styles, an increase of occasions of consumption and a wider age range of consumers of coffee, mostly towards youngsters, thanks to the diffusion of espresso machines, new milk based products, ready to drink beverages and the spreading of coffee shops.

(Slide 30) In UK will have in 2006 about 2150 coffee shops; in 1997 they were 233 only. Ten times more in 10 years with a constant growth!

If we look at the forecasts for the A.F.H. markets in 2008 all geographical areas are showing interesting growth rates: **(Slide 31)** North America and East Europe at about 70%; **(Slide 32)** Australasia + 76%, Asia Pacific +55%; **(Slide 33)** Latin America + 39%, Africa and Middle East +33%.

(Slide 34) To summarize, there are some fundamental factors that are at the basis of those positive developments and can be considered the conditions for a sustainable growth in the medium-long term:

- Product innovation and launch of higher value added products;
- Increased activity in markets with higher growth potential;
- Search for new segments, within mature markets;
- Stimulate consumption for young consumers, also with sweet and milk based products,

with the objectives to modernize the traditional image of coffee and to search for new business models that allow sustainable profits.

Finally, there is another fundamental factor to add: stability.

The FMCG market is a very competitive one, for the benefit of the final consumer.

We have to notice though, that when the equilibrium condition is broken, due to, for instance, a substantial change in the cost of raw material or another factor of production, the system becomes unstable and enters in a state of discontinuity, before reaching another level of stability.

It is thanks to stability of the major economic factors: prices, supply and demand, disposable income, market conditions, and the most important political and fiscal factors, as well as stable and known regulations, that the system reaches the optimization of its performances in the medium-long term.

Lack of stability, therefore, means slowing down, and eventually, a new state of crisis, to be overcome again.

All this would be further more evident in light of the increasing integration of production and consumption, mostly in those countries that, once producers only, are developing a very important consuming sector.

We will go beyond the traditional roles of producer and consumer, as Countries and as companies. Growers and Roasters are the extremes of a chain that will be more and more integrated and transparent; new forms of commercial and industrial cooperation will grow.

In my opinion, the knowledge of the changes and the need for intellectual integrity of the many parties involved in scientifically handling these issues, avoiding ideological and political bias, is a great learning that we can take from the coffee crisis period.

In conclusion, the more the coffee market will offer growth and profitability chances, the more the people and companies involved will have the interest to foster its growth, evolution and development.

(Slide 35) Thanks for your kind attention.