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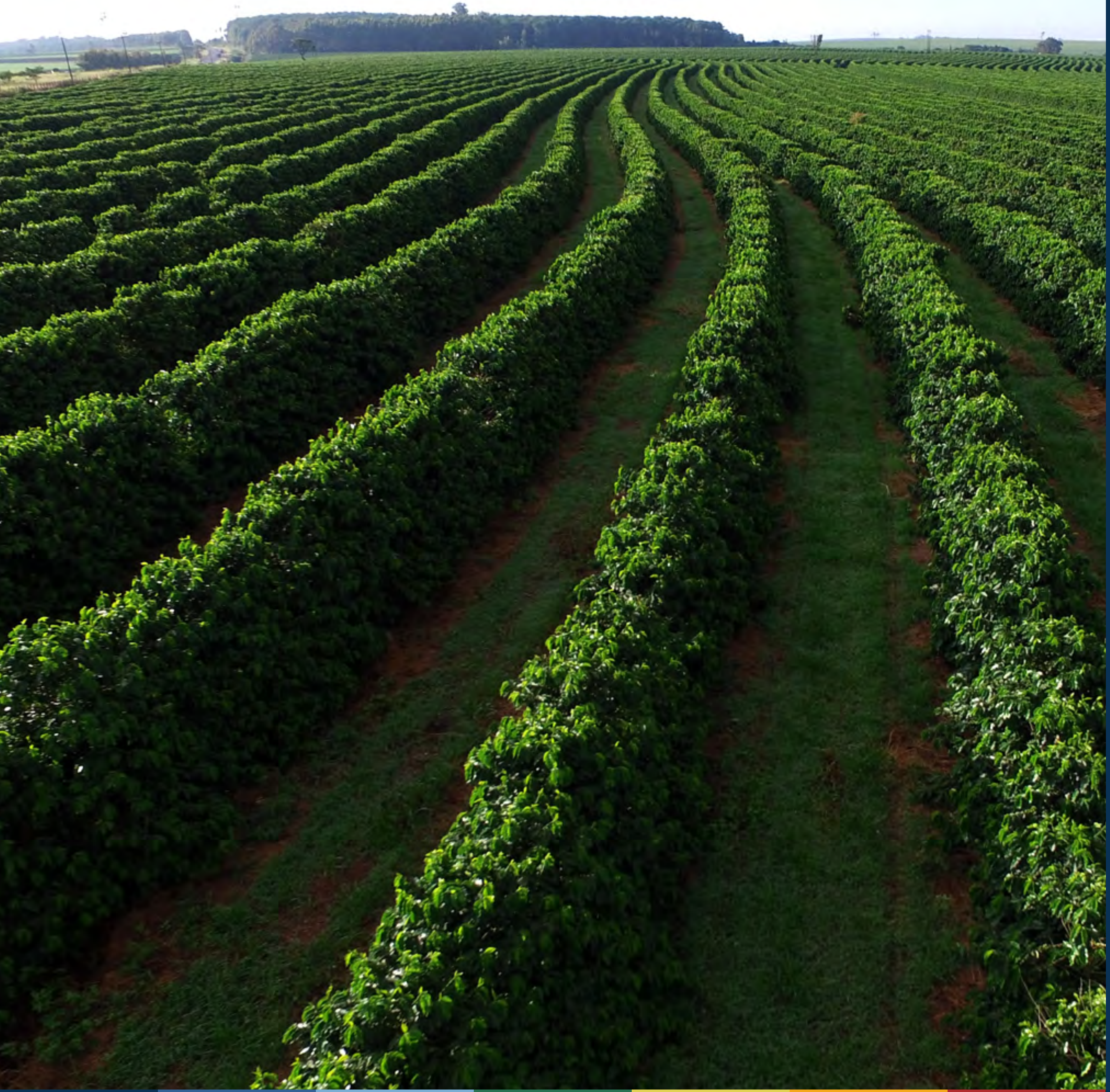
5 MYTHS ABOUT COFFEE PRICE RISK MANAGEMENT



Climate, regulation, fickle consumer demand all combine to make the coffee market one of the most volatile of all commodity markets. This volatility can eat up already-thin margins, frustrate long-term planning and hurt the bottom line.

Fortunately, an effective risk management strategy can provide companies with opportunities to manage their commodity price risk, as well as protect their margins and enhance their profits. Yet it seems like only a small handful of producers and consumers in the coffee industry take advantage of these opportunities.

Why so few? Much of the reluctance likely stems from some misconceptions, or myths, about commodities risk management that have arisen over the years.

The following is a list of the most common of these myths – and why companies should consider them “busted.”

1 RISK MANAGEMENT REQUIRES LEAVING THE SPOT MARKET.

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The spot market model remains the most prevalent trading strategy within the coffee industry. For many traders working within this model (and especially the successful ones), exposure to volatility is simply the price that must be paid for the freedom to read the market and secure good deals. Alternatively, these traders fear getting locked into pricing set by the futures markets or forward contracts – and locked out of a spot market that moves above or below those prices. What many don't understand is that a sound risk management strategy that incorporates exchange-traded options can enhance their success in the spot market model by adding protection and flexibility. In this way, participating in the spot market and pursuing risk management aren't "either or" propositions, but instead potentially a "win-win" scenario.

2 RISK MANAGEMENT IS ABOUT PREDICTING PRICES.

2

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From inside tips from trusted suppliers to proprietary commentaries by celebrated market gurus, coffee traders often find themselves inundated with information about where prices might be headed beyond the short-term. In the minds of some traders, successful risk management requires turning this information into a prediction that can form the basis of a forward purchasing strategy. The hard truth is that nobody knows for certain where prices are going in the long-term – not even the best risk managers. That's why sound risk management practices eschew price predictions in favor of establishing potential price ranges within which a company's strategy could be successful, and then developing programs that enable the company to make its purchases within those ranges.

3 RISK MANAGEMENT IS SPECULATION.

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Many coffee traders looking to limit their exposure to market volatility seem to view the options and futures markets for commodities as the province of speculators. They believe their companies operate at a disadvantage in these markets because – unlike speculators – their companies must, at some point, actually either have or will take possession of the physical commodity. If the objective of risk management was to secure the lowest possible price for an input, they'd have a point. However, the primary goal of risk management is to help increase the likelihood that the prices the company ultimately pays for its inputs do not exceed the prices required for the company to makes its target margins or achieve its larger strategic goals. In this sense, risk management is more akin to purchasing insurance than it is to engaging in speculation.

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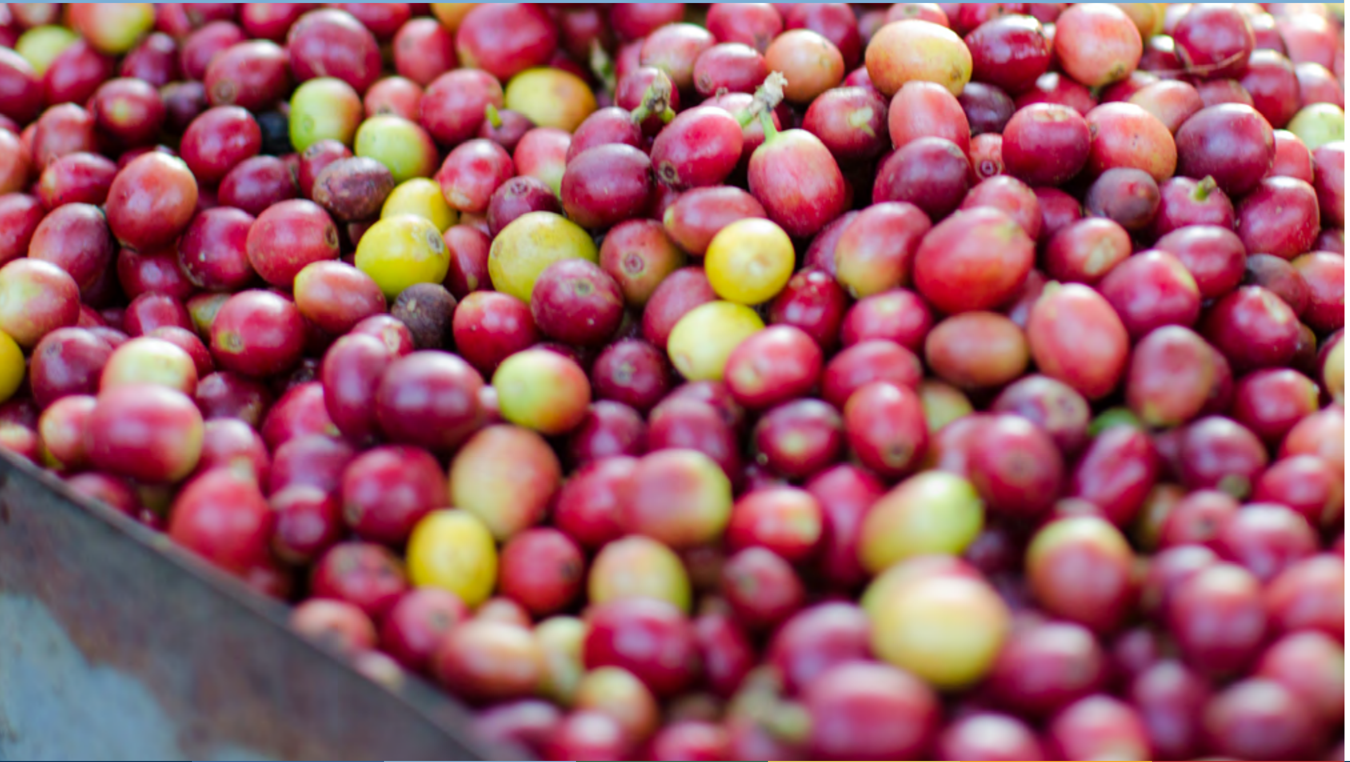

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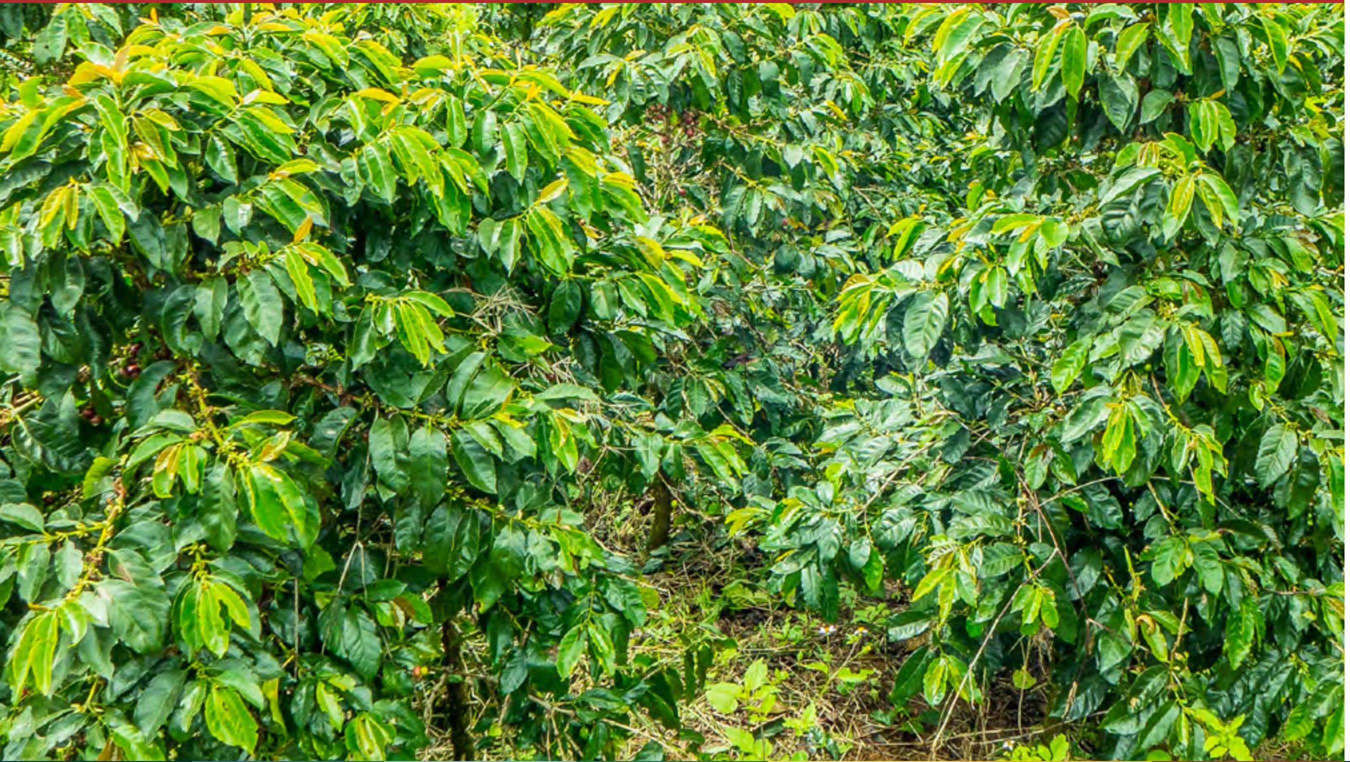
It is absolutely true that financial tools like futures and options involve risk – especially for speculative purposes. Fortunately, risk management is the opposite of speculation (please see Myth #3). For example, experienced risk managers use long options to protect their companies from the risk of rising prices. Companies pay a price, or premium, for that protection. In the end, market conditions may render that protection unnecessary – at which point the premium may be considered "lost." But that potential loss is defined at the beginning of the long option strategy and can be planned for by the company. Again, the process is akin to purchasing insurance to limit one's risk, as opposed to increasing it.

5 THE ONLY BENEFIT OF RISK MANAGEMENT IS PRICE PROTECTION.



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The natural inclination for managers when considering a risk management program is to boil it down to a single question: “Am I really going to do that much better on price?” As with nearly everything in business, there’s no guarantee. However, a properly designed risk management program can deliver significant benefits beyond just a flatter price curve. Companies with sound risk management principles in place can achieve better control of operating margins. They can dial in ingredient budgets months in advance. And they can develop customer-friendly sales programs long before competitors. These benefits, in turn, can lead to more consistent profit margins and the ability to make more accurate long-term projections and decisions regarding capital allocation – including for future growth.

Make no mistake: Pursuing a risk management strategy that realizes these benefits requires an organizational commitment that goes beyond simply finding the "right" purchasing manager or hiring the "right" consultant. It requires close coordination between upper management, the purchasing department and the accounting department. Fortunately, such coordination can result in improved operational integrity and enhanced collaboration across other facets of the business.

Myths aside, the question of whether to pursue the benefits of a sophisticated risk management program ultimately comes down to mindset. Is the purpose of the company to survive or to grow? Sustained growth requires more than good instincts and nimble responses to changing markets. It requires advance planning and forward-thinking allocation of capital. If your current purchasing strategy does not allow for these, then it may be time to consider supplementing it with a risk management program.

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