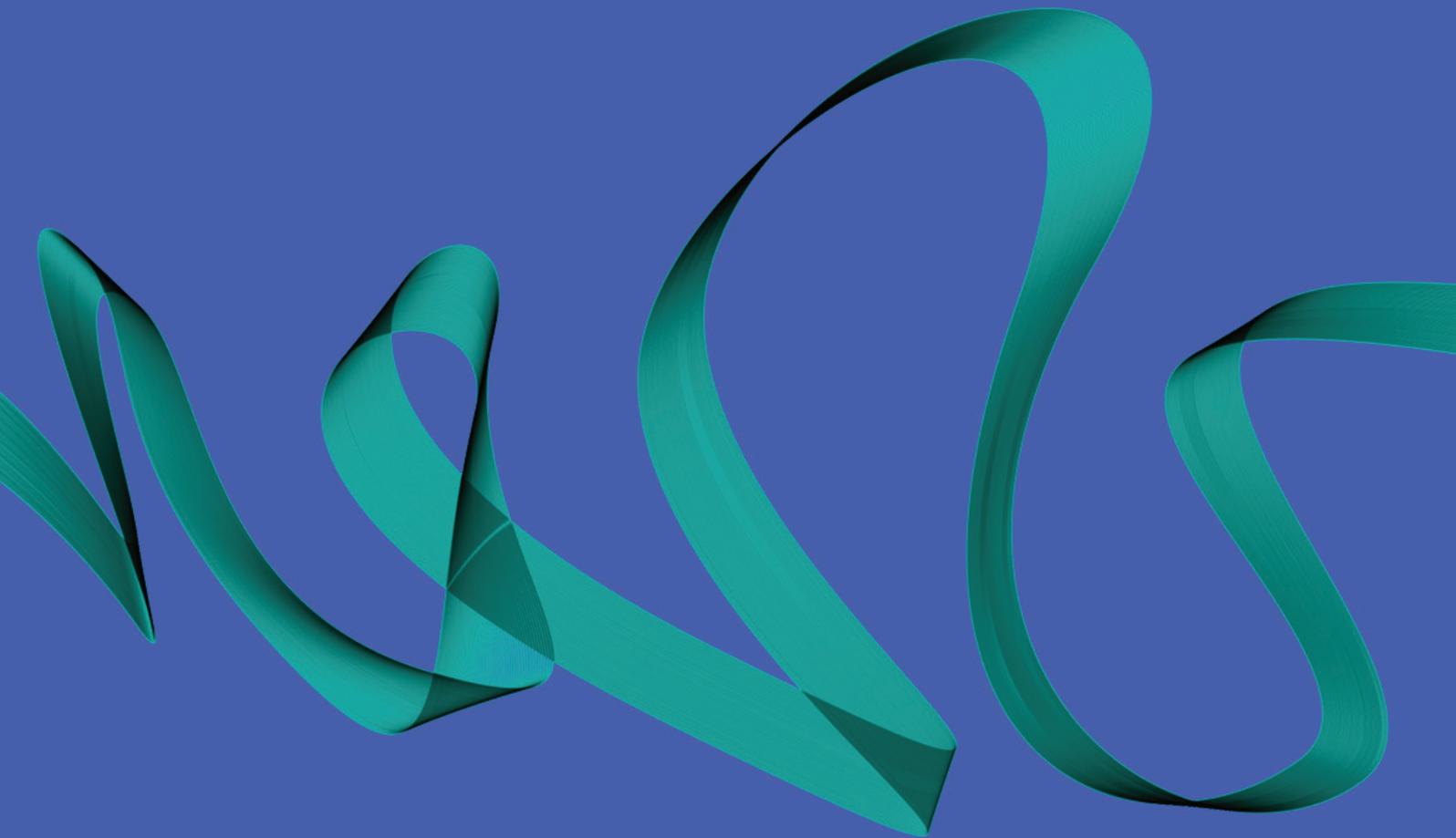




Vietnam's Coffee Industry



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July 2013

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Background

French colonists first introduced coffee to Vietnam in 1857. It has become embedded in the local culture ever since. The country is currently the world's second largest producer and exporter of coffee, after Brazil.

Most coffee-producing countries export the vast majority of their output with only a relatively small proportion being consumed domestically. World coffee exports totalled 113.1 million 60kg bags in 2012, an increase of 8.2 per cent over the previous year. Robusta exports reached a record 46.61 million bags, up from 37.53 million bags in 2011. Arabica shipments fell slightly from 67.04 million bags in 2011 to 66.52 million bags.

Despite a decline in exports of more than 15 per cent from the previous year, Brazil maintained its position as the world's top coffee exporter in 2012 with shipments totalling 28.26 million bags, followed by Vietnam (25.47 million) and Indonesia (10.62 million).

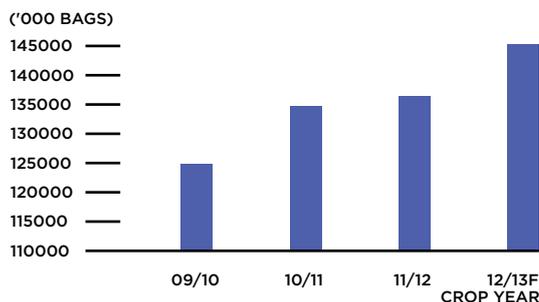


Figure 1. Total coffee production (2009-12) (source: ICO)

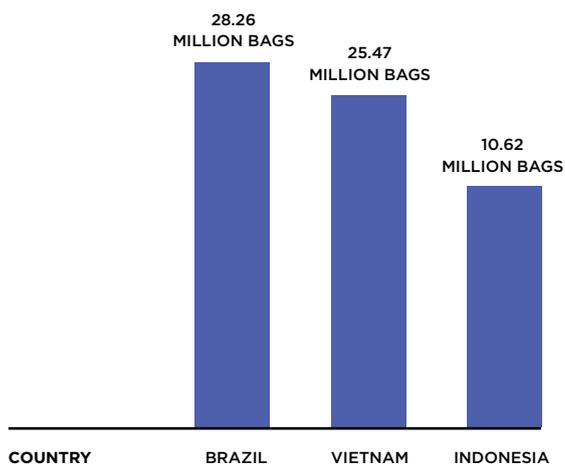


Figure 2. Top three coffee exporters (2012) (source: ICO)

Overview: Vietnam's coffee industry

Vietnam's coffee industry is expected to grow strongly in the coming years as the population continues to expand at a rate of about one million people a year and the tastes of its people become more sophisticated. Increased activity at both consumer and trade levels from local and international players is another factor that is expected to fuel the industry's growth.

Vietnam's government in 2012 set out a master direction for the coffee industry up to 2030. The plan set to maintain the country's total coffee growing area at 500,000 hectares, with high-yield production centres for high-quality coffee focused in four key provinces –DakLak, Lam Dong, DakNong and Gia Lai. Despite the government's efforts, however, the plantation area has continued to expand with many small, mostly family owned and run coffee farms dispersed over a wide area. According to the Ministry of Agriculture and Rural Development (MARD), during the 2011/12 crop year some 614,500 hectares were used for the cultivation of coffee, of which 549,100 hectares were directly involved in production, generating an average yield of about 2.4 tons per hectare.

NO.	PROVINCE	PRODUCTION AREA ('000 HA)	PRODUCTION ('000 TONS)
1	DAKLAK	190.3	487.7
2	LAM DONG	140.0	343.4
3	DAKNONG	81.0	179.7
4	GIA LAI	75.6	151.8
5	DONG NAI	17.0	30.3
	TOTAL	503.9	1192.9

Figure 3. Coffee production by province, 2011/12 crop year (source: MARD)

Robusta coffee accounts for more than 95 per cent of total output, with Arabica making up most of the remaining 5 per cent. As part of the strategy to produce higher-quality coffee, the industry is promoting the adoption of Arabica, with a target for the bean to account for 8 per cent of the total coffee growing area by 2020.

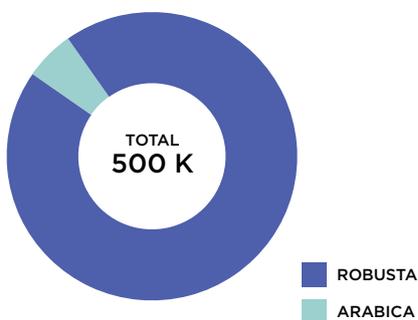


Figure 4. Coffee production plan by area (hectare), up until 2020 (source: MARD)

About 6 per cent of Vietnam's total production is currently consumed domestically, the rest is sold internationally making coffee one of the country's key export commodities. Even though domestic consumption has grown significantly in recent years, Vietnam's thirst for the bean remains relatively moderate when compared to other countries.

In 2012, Vietnam exported 1.7 million tons of coffee valued at a record US\$3.7 billion. This was an increase of 23 per cent in volume and 24 per cent in value over the previous year.



Figure 5. Vietnam versus top 5 coffee-consuming countries, 2012 est. (source: ICO, Ipsos)

The domestic price of coffee averaged US\$1.89 per kilo during 2012, while the average export price was slightly higher at US\$1,986 per million tons (about US\$1.99 per kilo), down 8.4 per cent from the previous year. However, this still marks a 34 per cent increase in the export price per kilo of Vietnamese coffee since 2010, a trend which provides a strong incentive for farmers to expand their cultivation of coffee.

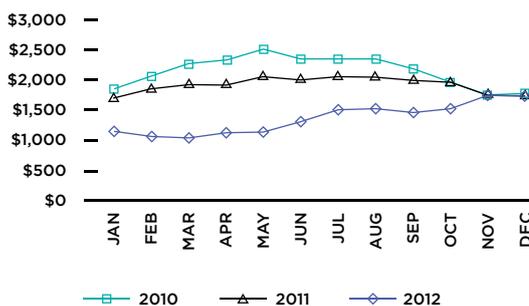
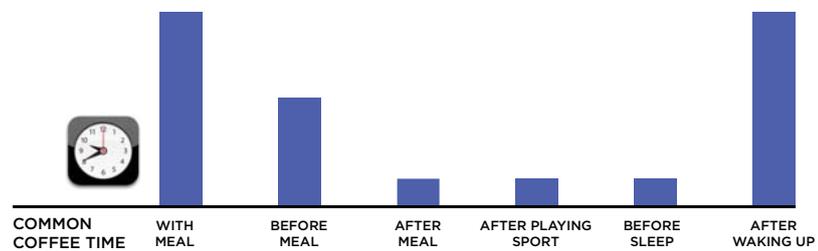
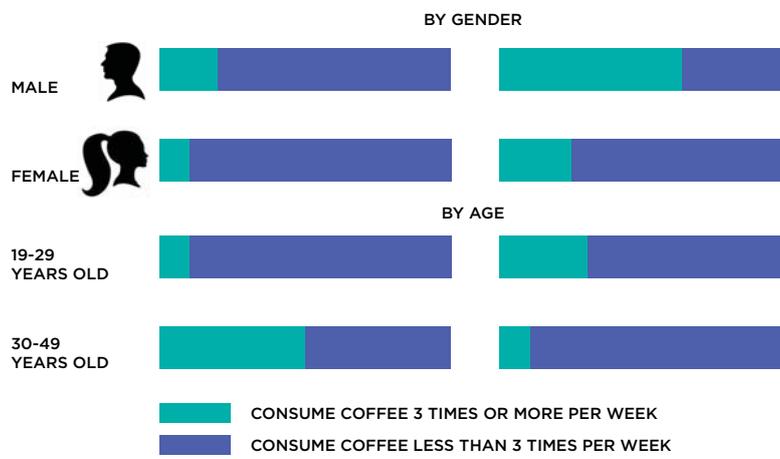
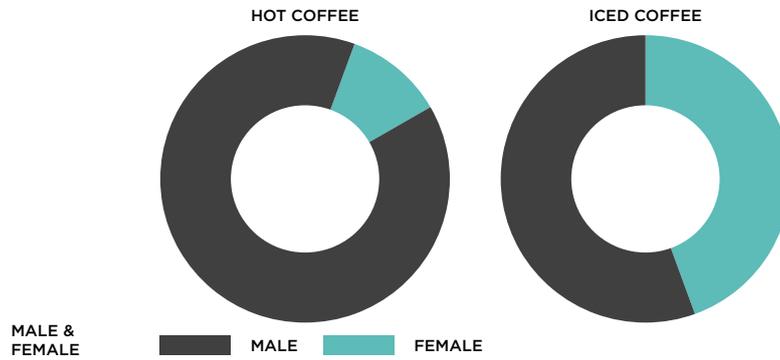


Figure 6. Export price for Robusta common ungraded coffee beans (US\$/ton) (source: ICO)

Vietnamese coffee drinking habits

PREFERENCE TOWARDS COFFEE TYPE AND DRINKING FREQUENCY



PREFERENCE TOWARDS COFFEE DRINKING PLACE



REASON FOR DRINKING COFFEE



Figure 8. Why Vietnamese consumers drink coffee (source: Ipsos)

Vietnam's coffee value chain

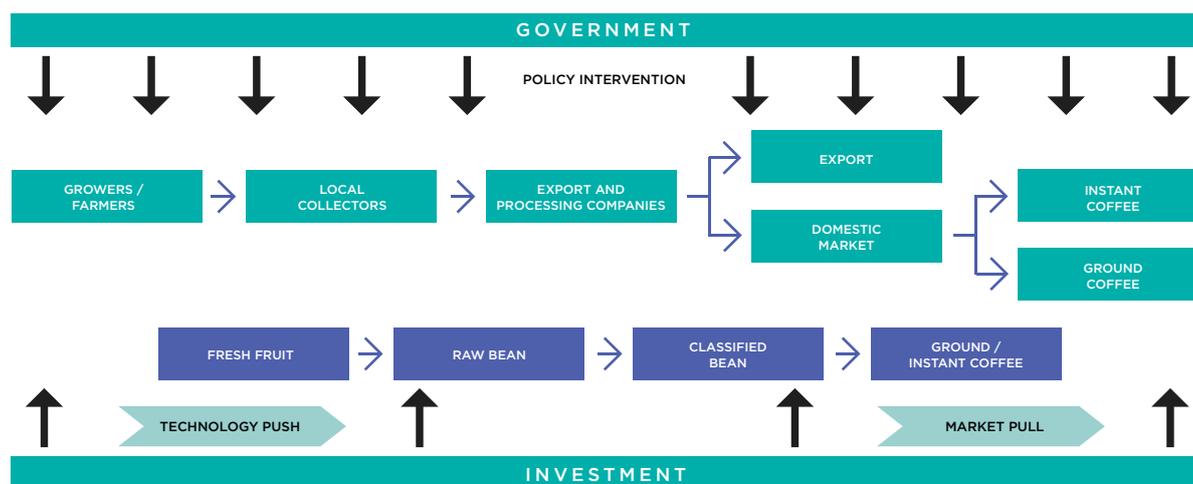


Figure 9. Vietnam's coffee value chain (source: Ipsos)

In the coffee value chain for Vietnamese farmers, supporting industries participate as input providers, including coffee seedling providers, fertiliser sellers and plant protection sellers.

On average, each coffee seedling costs 2,000-3,000 dong (US\$0.094-US\$0.141), while farmers spend about 15 million dong per hectare on fertiliser (about 2.5 tons/ha). Higher demand for better quality coffee products requires input providers and growers to increase the standard of their qualified inputs by using better seeds, fertilisers and other farming elements.

Plant protection substances help sustain production

More than 60,000 hectares of coffee plantations in the Central Highland were hit by early falling berries in 2011, causing losses of tens of millions of US dollars to coffee growers. A key factor in this phenomenon was the drop in usage of fertiliser and crop protection products by farmers due to a significant increase in the price of these commodities.

Disease can often be treated within three or four days by using plant protection substances. However, inadequate use of such products can have devastating results, such as those described above.

Most coffee in Vietnam – about 95 per cent of the total growing area – is cultivated on small private farms. More than 85 per cent of these private farms are less than one hectare with only one per cent being larger than 5 hectares.

Once the coffee is harvested, collectors go directly to farmers' warehouses to purchase cherry coffee and/or coffee beans, which they then sell on to larger coffee processors. The buying process between growers and collectors relies heavily on developing mutual trust and fostering long-term relationships. Coffee beans are selected according to a given collector's criteria, which typically include smell, moisture level and physical appearance. Before selling to processing companies, collectors may dry and grade the beans to ensure standard moisture content and bean size.

Processors and exporters are the next stakeholders in the value chain. Currently, Vietnam has about 150 registered coffee processors and exporters, which include a number of joint ventures with international partners, as well as thousands of small and unregistered local businesses. Leading players are Vinacafe, Nestle and Trung Nguyen.

Do foreign firms dominate the industry?

While the proportion of enterprises with foreign investors or owners specialising in coffee exports is relatively small compared to the hundreds of local industry players, the market share of foreign entities has surged over the past three to four years. Enterprises with some level of foreign investment now account for 60-65 per cent of the total coffee exported each year. This dynamic poses a potential threat to domestic coffee producers, who will require more government support to remain competitive with foreign players.

In fact, the Ministry of Industry and Trade on 7 June 2012 banned foreign entities from directly purchasing coffee from farmers and establishing coffee buying networks in Vietnam.

Domestic competing forces

Market studies on Vietnam's coffee industry project strong growth in domestic consumption. Double-digit annual growth in sales of Vietnamese instant coffee paints a favourable picture for the future of the industry as a whole.

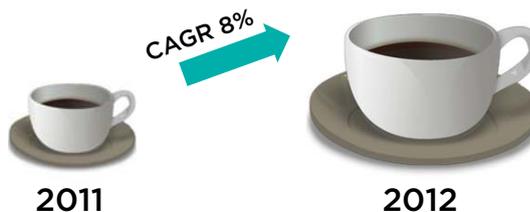


Figure 10. Forecast retail sales of coffee (Volume growth – tonnes) (source: Euromonitor, Ipsos)

Rising demand for instant coffee, mainly from teenagers and young adults who prefer the convenience of instant products over ground coffee, has seen coffee manufacturers diversify their offering to include 2-in-1, 3-in-1 and 4-in-1 instant products.



Figure 11. Domestic market share of instant coffee by type (source: Euromonitor, Ipsos)

The 3-in-1 instant formula is the most popular type of instant coffee product for local consumers. Leading brands in this sector are G7 from Trung Nguyen Coffee Corporation, Vinacafe from Vinacafe Bien Hoa and Nescafe from Nestle Vietnam. G7 has more than 38 per cent of the 3-in-1 instant coffee market, followed by Vinacafe (31 per cent) and Nescafe (27 per cent), according to a market survey published in 2011. The sharp growth in Vietnam's coffee industry in recent years should make it increasingly attractive to both local and foreign investors despite the new law banning foreigners from certain parts of the trade.

In 2011, Masan Consumer Corporation, a unit of Vietnam's biggest publicly traded group, acquired Vinacafe Bien Hoa Joint Stock Company in a move which benefited both parties. Vinacafe has improved its market position thanks to Masan's extensive distribution channels and retail experience. Vinacafe now has over 180,000 points of sales, up from 45,000 points, an increase which contributed to the 30 per cent growth in sales volume and 14 per cent growth in profit during 2012.

Such positive industry trends are spurring greater interest from foreign parties. Investment will clearly play a defining role in the development of the industry. Much attention has also been paid to processing and exporting coffee. However, more needs to be done in other core areas, such as research and development, if Vietnam's industry wants to sustain its growth trends and be able to punch above its weight in the global market.

Gearing up for sustainable growth

Vietnam's arrival to the world coffee market and its exceptional growth, which has seen it rapidly rise to become the second largest producer after Brazil, paints an optimistic picture for the future of the industry. However, a number of challenges must be overcome to make that outlook reality.

Challenges loom on the horizon

Aging coffee trees are affecting quality

Currently up to 30 per cent of Vietnam's coffee trees are more than 20 years old. While they can live for 40 years, yield diminishes significantly once the trees reach 15 years. This poses a major threat to the entire industry. Given that it takes coffee trees about six years to start producing at full yield, replanting initiatives need to be implemented immediately if Vietnam does not want to see the volume and quality of its coffee production and exports severely affected.

Replanting one hectare of coffee trees costs approximately 100-120 million dong (US\$4,710-US\$5,652). A recent report published by the Western Highlands Agriculture & Forestry Science Institute shows how the absence of a structured replanting strategy has seen many farmers use coffee seedlings from unverified origins.

This resulted in only 12-14 per cent of the replanted crops surviving until the second year. In an attempt to resolve this problem during the 2012-13 crop year, WASI provided farmers with nearly 300,000 seedlings free of charge which were used to replant some 270 hectares. Funding for the initiative was provided by the Vietnam Coffee Association (VICOFA) and Nestle Vietnam.

These high quality seedlings are expected to more than double the annual yield of beans per hectare.

Another major issue is the fact that most Vietnamese coffee beans are exported without being fully processed. Despite there being about 150 coffee processors and exporters, quality assurance remains a real challenge for every player in the value chain. These days the term "quality" has been expanded to cover a far broader range of issues than simple product quality. It now includes the production system as a whole, as well as an operator's impact on the environment.

More integrated support needed to overcome challenges

Actors in the value chains are still not provided with sufficient government support to enable them to understand the nature of the industry, the risks they face and how best to manage those risks. The fact that coffee producing areas are widely dispersed creates additional problems in educating farmers about appropriate planting and processing techniques. Most solutions to existing bottle necks require improved integration and cooperation between the public and private sectors. The greatest challenges for exports – traceability, food safety and sustainability, which are monitored by authorities in export markets such as the US Food and Drug Administration (FDA), the European Food Safety Authority (EFSA), the Netherlands Food and Consumer Product Safety Authority (VWA) - can be overcome by increasing the control and influence of lead firms over the value chain. Contrary to problems at the primary production level, such as productivity and high input costs, these issues are directly related to exports, as non-compliance with traceability and food safety regulations will create entry barriers to key markets.

The bottom line...

Achieving sustainable growth across the coffee industry requires timely and effective action from the government, related institutions and all stakeholders in the value chain.

This means there will need to be better integration and long-term sustainable relationships not only between farmers and exporters, but also between value chain actors and business support organisations. This can only be achieved by improving the capacity and capabilities of coffee farmers, either through organising farmers horizontally or by increasing the formal relationships between farmers and processors, which should encourage more processors to invest in coffee farms.

While the role of government policies is to confront challenging issues and provide overall leadership for the sector, higher competition in the global coffee market means Hanoi will need to renew its focus on forging stronger links between actors in the value chain and promoting the further investment needed to leverage the production of sustainably produced coffee in order to secure a sound future for the industry.

“It is crucial that governments, coffee research institutes, VICOFA, international and local exporters and NGOs continue to unite their efforts, share their knowledge and work together to increase farmers’ access to capacity building and training. It has been proved that it works so it is time to bring public-private cooperation to the next level. This will be the only way to scale up the production of sustainably produced coffee and secure the future of the sector.”

Robert Waggwa Nsibirwa, Chairman of the 4C Council and Board Member of the African Fine Coffees Association (AFCA) (2013)

COFFEE PRODUCTION CYCLE

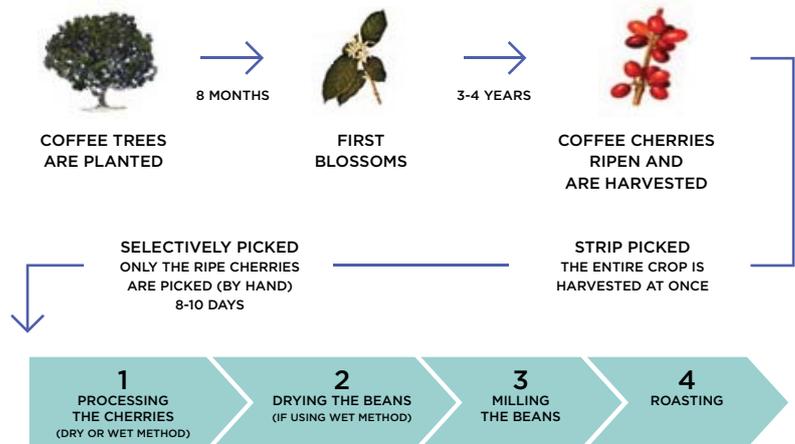


Figure 12. Coffee production cycle (source: Ipsos)

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