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FOLLOW THE MONEY

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DRIVING SUCCESS THROUGH
CHANGE AND GROWTH

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After a period of incredible profitability, leaders in the ethanol industry are better positioned for thinner margins.

In an industry ruled by volatility, it's important for producers to position themselves to take advantage of favorable market conditions. "You've got to get it while the getting is good," says Scott Chabina, director at Carl Marks Advisors.

The ethanol industry is now on the other side of exactly that type of scenario. In March, University of Illinois economist Scott Irwin pointed out that 2014 was the most profitable on record, in his FarmDocDaily analysis. Looking at a model 100 MMgy Iowa ethanol plant, it lasted 22 months with an average profit of 43 cents per gallon, more than 10 times the average 4-cent-per-gallon profit earned in the previous seven years. Driven by relatively high ethanol prices and relatively low corn prices, the record profits went from March 15, 2013, and ended on Jan. 2, 2015, representing the longest run of uninterrupted profits since the university started keeping records in 2007.

With that strong profitability now in the rear view mirror, Ethanol Producer Magazine is taking time to reflect on what savvy companies did to prepare for the new normal. "The more sophisticated, strategic producers that were able utilize that window, from September '13 to September '14, are the ones that have optionality to explore the capital solutions or capital projects, in house," says Chabina. "That can really position them for a better day in an environment with thinner margins."

As a result, some companies were able to pay down debt while others were given the opportunity to refinance outstanding loans. Lenders haven't always been receptive to that but, for a period of time, deals were being made. "That window opens and closes pretty frequently, given the margin environment,"Chabina says.

Mike Jerke, CEO of Guardian Energy Management LLC, says he heard one particular remark repeated several times at annual meetings. "We can't expect this to happen with any frequency because it was so unprecedented," he says.

As a result, Guardian Energy, and the ethanol industry as a whole, is set up to better handle the normal volatility that comes with being an agricultural industry. Besides paying down debt or refinancing, Jerke added that putting together a rainy day fund was also a move some producers were making, to prepare for leaner times.

Chabina agrees. For those producers able to build up cash, some are thinking about consolidation. "There are definitely producers out there looking for additional gallons," he says. "We are aware of people on the hunt for assets at the 100 million gallon level and the 50 million gallon level." (See "How Deals Square Up" for more information about mergers and acquisitions.) Others are looking at "inside the fence," toward operational improvement projects or even moving to the true biorefinery model, he adds.

Mick Miller, president of NuVu Fuels LLC, which has management contracts with Carbon Green BioEnergy LLC, Iroquois Bio-Energy Co. LLC and DENCO II LLC, says in times of profitability the emphasis is on continued investment, including equipment upgrades, debottlenecking projects and potential technology improvements. "These investments are usually focused on increasing plant efficiencies, throughput and shareholder return," he says.

Of course, not every producer is in the same favorable position. Some face operational impediments or are located in less desirable geographic areas, Chabina says. The reality is, when times are tough, those plants may idle and come back online depending on the margin environment.

Farmer Roots

When asked what Big River Resources did with the profits the company brought in, Ray Defenbaugh, president, CEO and chairman, says the answer is closely tied to the company's original goals in entering the ethanol industry. "Those goals were to provide good jobs for people in the community and, secondly, to preserve the community—and you have to have good jobs to preserve rural communities—and the third is to provide good returns to our investors," he tells EPM. "Of course, our subgoals are that we are people of our word—you can take it to the bank if we tell you something—and, secondly, we treat people like we'd like to be treated, so fairness is an important concept."

Looking at the first and second goals, Big River continued to pay good salaries for the people who helped the company reach success and, on top of that, paid out extra bonuses during the time of profitability. Big River also paid local farmers generously for their crops. "Our goal never was for cheap grain, we were put into existence to build up the price of grain, to build up the local farmer," he says. In reference to the third and final goal, the company paid good dividends to its shareholders. In 2014, return on investment was 126.8 percent and return on equity was 45 percent.

The strategy is working for Big River. "We've been in existence over 10 years and we've never had a loss year and we've never failed to pay a dividend," Defenbaugh says, adding that the company has no debt and more than adequate cash reserves on hand to weather any unexpected downturns or capital requirements.

The period of profitability also allowed Big River to put money back into its facilities, with several capital investment projects. One example is improvements being made into the company's grain procurement infrastructure, which includes six elevators. "We've upgraded them with large capacity dryers and bin storage and so forth," he says. Then there's the zein production plant currently under construction at Big River's Galva facility. "It will be finalized and we will have product for sale this early summer, late spring," he says.

Last but not least, Big River contributes heavily to organizations and causes that support the growth of the ethanol industry, as well as local groups, such as clubs for children and local parks. "When we have a good year like last year, we put even more into those areas," he says.

On Big River's list is Prime the Pump, a nonprofit group formed to expand the availability of E15 and higher blends, American Ethanol, the group that partners with NASCAR and others to put ethanol on the racetrack, and more. The company is also a member of the Renewable Fuels Association, Growth Energy, the American Coalition for Ethanol and the U.S. Grains Council, to support U.S. and global markets for ethanol and distillers grains. "We think that whatever benefits the industry, will lift everybody up," he says.

Alternative Viewpoint

Eric McAfee, chairman and CEO of Aemetis Inc., which operates a 60 MMgy corn-ethanol plant in Keyes, California, and a 50 MMgy distilled biodiesel plant in India, sees things a bit differently. Aemetis' goal has long been to convert corn ethanol plants to advanced biofuels. In 2013, the EPA approved the company's pathway to produce D5 advanced biofuel RINs using sorghum in combination with biogas and the plant's existing combined heat and power system. However, the plans for are on hold due to the high price of sorghum.

Policy certainty is needed in order for the industry to invest in next generation biofuels. The profits brought in during 2014 didn't significantly change lenders' willingness to increase their exposure to the ethanol industry, McAfee says, at least not at levels that support $20 million to $40 million projects to upgrade or build plants for advanced biofuels production. "Are biofuel producers making a crazy amount of money, rolling in cash and just can't wait to throw money

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at the next advanced biofuels technology, or are biofuels producers mostly saying to the EPA and others seeking advanced biofuels, 'Oh my gosh, stop beating me up, I'm dying here','" he asks. "I hate to tell you, but the industry is closer to the latter."

For example, there's the incremental step that corn-ethanol producers could take to convert corn fiber to cellulosic ethanol. It would allow for production of an extra two to three million gallons of ethanol yearly, bringing in $6 million to $7 million in revenue and cost about $10 million to implement. The industry isn't doing it, he says, because it doesn't have bank financing or access to equity. "They are struggling to survive," he says.

What looks like big numbers in the 2014 profit column, actually aren't sustained enough to provide access to growth funding, McAfee says. For example, Aemetis brought in $30 million in positive cash flow last year. While that's a good number, he points to the fact that the company applied 100 percent of its cash flow to debt reduction, adding that it's more the rule than the exception in the biofuels industry.

He believes the biofuels industry has a curable illness. The cause, he says, is the U.S. EPA's failure to enforce the renewable volume requirements as required by the renewable fuel standard (RFS). It's making the industry anemic. "There is no lender in their right mind that would expose itself to additional funding of ethanol businesses when you don't have the faintest idea whether federal law is going to be enforced," he says, adding that because lenders and investors can't depend on the law being enforced, it's preventing investment, job creation and strengthening dependence on foreign oil.

He called it a "complete screw up" by the EPA and Office of Management and Budget and compared the situation since November 2013 to the repeated robbery of a federal bank, after which law enforcement doesn't even bother to investigate. The oil industry is stealing about 50 cents a gallon from Aemetis every day, he says, due to surplus inventories caused by lower biofuels demand than the RFS requires. The EPA's failure to enforce the RFS has cost the company at least $30 million in cash in the last year.

McAfee believes a lawsuit for declaratory relief should have been filed against the EPA 18 months ago by biofuels and corn industry associations. "How can you ever run an industry when federal law is not being enforced?" he asks. "I personally think there should be riots in the streets in Iowa."

The question then becomes, is the ethanol industry well-positioned to produce the next 16 billion gallons of cellulosic ethanol and up to 5 billion gallons of advanced biofuels? "Is this industry ready for that?" he asks. "The answer is, yes, if you just enforce federal law."

Financial Highlights

Although far from a complete list, here are some examples of refinancing deals and record profits announced by ethanol production companies in 2014 and early 2015.

Refinancing Deals: Green Plains Inc. announced June 10, 2014, that a $225 million senior secured credit facility due 2020 was complete and that the proceeds would be used to refinance outstanding debt.

On Sept. 17, 2014, Aventine Renewable Energy said it had secured a $40 million loan and security agreement in partnership with AloStar Bank of Commerce in Birmingham, Alabama, and MidCap Financial LLC in Bethesda, Maryland. Aventine used proceeds from the refinancing and its existing stockpile of cash to fully repay debt early, before it matured in 2016.

Southwest Iowa Renewable Energy LLC announced that, during its fiscal year 2014, the company paid off $96 million in net debt reduction. In June 2014, the company completed debt refinancing, with a $66 million senior credit agreement and a $26.2 million subordinated term loan.

Record Profits: On Feb. 4, Green Plains announced record operating income of $286 million for 2014. The company produced a record 966 million gallons of ethanol, earned more than $100 million in nonethanol operating income and was close to achieving its goal of zero net term debt.

Aemetis Inc. said March 12 that it had achieved record revenues of $208 million, up from $178 the previous year, and record gross profit of $37 million, up from $18 million. The company also made term debt net cash payments of $29.6 million.

On March 30, Rex American Resources Corp. released its fiscal year 2014 results, which revealed gross profits more than doubled to $141.9 million, up from $64.3 million the previous year. The company also said its net sales of $572.2 million were down from $666 million in 2013.

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