

# Ethanol

PRODUCER MAGAZINE

The World of Ethanol at Your Fingertips

From the December 2009 Issue

## Putting it Back Together

**As the industry begins to re-build after its bust, plant ownership could be evolving into a new shape. How much consolidation should we expect in 2010 and what types of companies will lead the acquisitions?**

by Kris Bevill

If the state of the ethanol industry in 2009 leading into 2010 had to be summed up in two words, they might be "recovery" and "consolidation." The painful shake-out of 2008 followed by a difficult economic period has left only the strong standing, but those remaining are gearing up for greater production in 2010 and possible expansions to take on more facilities. That's an easy prediction to make. More difficult to forecast, however, is what form of company will emerge as the most able to survive in a commodity/energy hybrid industry.

### Who's Who

According to EPM's plant list, 184 U.S. plants are currently producing ethanol. For the purpose of this article, EPM separated its list of active producers into two categories: corporations and cooperatives. Some plants were obvious fits for a single category—Archer Daniels Midland Co., for instance, or Central Minnesota Ethanol Co-op. Others blur the lines between small, locally owned operations and large, publicly traded companies and were placed in either category for a number of reasons. For example, Poet LLC prides itself in having up to 49 percent local ownership at each of its 26 production facilities. Because it is such a large producer, however, it has financing and distribution opportunities that small co-ops do not. Therefore, Poet was classified as a corporation. Generally, plants that were categorized as cooperatives are either true co-ops or fit the description of being small, locally owned and operated facilities that own a total of no more than two plants. Multi-location companies with greater access to capital were deemed corporations.

Based on these criteria, EPM estimates that only about one-third of the U.S. ethanol facilities currently producing ethanol operate as co-ops. The remaining ethanol plants are run by large companies and/or are publicly traded. This could be an indicator of the future of ownership in the ethanol industry. As some of the smaller producers succumbed to funding difficulties and tight operating margins, large companies with access to adequate capital have stepped in to purchase most of them, however, there are also instances of regional co-ops banding together to purchase facilities by combining their equity. A brief look at some of the more notorious acquisitions of 2009 serves as a snapshot of the larger acquisition picture.

### Taking Over

VeraSun Energy Corp.'s bankruptcy filing and consequential sale of its production facilities provided ample opportunities for companies to add to their ethanol portfolios or to get into the game. Power shifts have already taken place as a result of the redistribution of a significant portion of U.S. production capacity. Valero Renewable Fuels made international news in the spring when it purchased seven VeraSun facilities, making it the first petroleum blender to own and operate ethanol production facilities. Its parent company, Valero Energy Corp., is a Fortune 500 firm could easily afford to enter the ethanol production market, so it's easy to imagine how a local co-op interested in one of the plants wouldn't stand a chance at the negotiating table. As a result of its acquisition, Valero controls 760 million gallons of the nation's ethanol production capacity.

Green Plains Renewable Energy Inc. also made a strategic move to purchase former VeraSun facilities and acquired plants in Central City and Ord, Neb., in May. Like Valero, the acquisitions provided the company entrance into the Top 5 list of producers. In its annual report for investors, GPRE stated specifically that bankruptcies and plant closures were to be viewed as opportunities for company growth and could affect the pace of industry consolidation.

Co-ops were smaller players in the redistribution of VeraSun's properties, but managed to acquire a few of the facilities. Central Farmers Co-op in South Dakota reclaimed the Marion, S.D., production facility it had established in 2008. Guardian Energy LLC, a collaboration of six locally owned ethanol companies (four of them co-ops), purchased the never-operated Janesville, Minn., facility and began operating the plant in late October. The purchase was made by combining funds from all six of the companies' members.

### A Difference of Philosophies

Randall Doyal, president of Guardian Energy, says the Janesville plant was in a good location and had good rail access, which made it an attractive property even though its production capabilities hadn't been proven. Doyal is also the CEO of Al-Corn Clean Fuel, a co-op which is located less than 50 miles from Janesville. The plant's proximity to the other facilities owned by Guardian Energy members was attractive to Doyal, who doesn't deny that location played significantly into their decision to purchase it. "For some of us, this was a defensive move rather than an offensive move," he says. "We'd like to have somebody [in Janesville] that we can work with rather than somebody we can't. We saw this as an opportunity to help move that idea down the field, where we could have someone that we could cooperate with rather than someone outside of our group."

The Guardian Energy group, which is composed of mainly cooperatives, is not technically a co-op itself, but operates under the cooperative philosophy, says Doyal. "The idea that you can work together to accomplish more is the co-op way," he explains. "The co-op model works really well for those of us who are true co-ops. We were formed to process our members' corn. That was really our goal. The guys who set it up were trying to create their own local market and that's what they did."

Developing a market for local corn farmers may have been the initial goal of the ethanol industry, but it didn't take long for profit-driven corporations to realize a good investment. For some, the goal is not about local corn markets at all, but about the bottom line.

Becker says GPRE's business is focused on risk management, and that requires cash. "To really effectively manage risk, you need to have a balance sheet, you need to have the ability to raise cash," he says. "You need to have a balance sheet that is strong enough to manage the risk."

Publicly traded companies simply have more access to cash than locally owned cooperatives, which has proven to be both the rise and demise of facilities throughout the industry. Becker says liquidity and the ability to raise capital through the public markets is the main advantage corporations have over co-ops. And access to capital could prove to be the reason the industry experiences more mergers and acquisitions of smaller producers by large companies in 2010. "Because we have a public currency, when we're looking for acquisitions we can oftentimes use our stock to do that," Becker explains. "Three years ago you could go public, [but] today there really is no path to public liquidity in corn-based ethanol. So if a plant has a bunch of owners but is not public, your exit is to either sell for cash or sell for stock and continue to stay in the game. You can often do that by merging with a company like [GPRE] for a stock-for-stock transaction. Then you have the ability to monetize your investment."

That may be true, but for companies such as Guardian Energy, monetizing investments is not necessarily the top priority. Doyal says the exit strategy for locally owned companies is different. "We're not looking to make a fortune and get out," he says. "We care about what we're doing and who we're doing it with. [Share value] is really not what farmer-owned or locally owned facilities are all about. We're about trying to return to good, constant, steady value over years and not being a flash in the pan."

Whether it's a "mom and pop" co-op or a large, publicly traded corporation, the ups and downs of operating a successful ethanol production company boil down to who is at the helm of the operation, as evidenced multiple times recently. As Becker says, "I've worked for co-ops, I've worked for publics and I've worked for privates, and my philosophy has always been the same: it's a commodity risk business and you've got to set yourself up so that you never have an event that will take you down because of a pricing decision that you made. This is an agriculture/energy business. It's a hybrid. So as long as you understand processing and refining [and] as long as you understand trading and risk management, you have a great opportunity to succeed and be successful in this industry."

#### **Consolidation Continues**

Doyal sees long-term staying power for the co-op model of business, partially due to the willingness of individual cooperatives to work together. "Because we're working together and helping each other out, if one of us screws up we tell the others what we did that was wrong so they don't make the same mistake," he says. "On top of that, if you hit a homerun you let people know how you did that. I think we gained a lot from our experiences and our association that makes us much stronger not only individually but especially as we work together."

Doyal has no doubt there will be consolidation in the long-term. "We prefer to see that happen as individual plants finding ways to join forces and work together rather than some corporate giant snarfing them up," he says. Becker says GPRE is done with its acquisitions for now, but the company is not done growing and he agrees that the industry will experience more consolidation in 2010.

"There are a lot of independent players, and I think consolidation comes when they have the ability to get a good value for their asset and get liquidity for their investors," he says. "That's key, because a lot of people invested in ethanol because they wanted to get a return on their investment. They didn't want to be in it forever. Some people have a longer timeline than others, but everybody thinks about the path to liquidity." EP

Kris Beville is the editor of *Ethanol Producer Magazine*. Reach her at (701) 373-8044 or [kbevill@bbiinternational.com](mailto:kbevill@bbiinternational.com).

© 2009 BBI International