

Farmers fuel investment

The trend may be slowing as large companies expand capacity



Photograph: Ron Van Zee

Al-Corn Clean Fuel of Claremont, Minnesota, is one of the first farmer-owned ethanol dry mill plants, starting up in 1996. Board members and early investors include (from left to right) Lyle Borgschatz, Brian Peterson, Duane Klocke, Darrel Trom, Randall Doyal (CEO), Terry Ebeling, Rod Jorgenson, Brad Ahrens (board chairman), and Lou Kuhlman.

Sure, they've made money on their investments. But the farmers who have pioneered grower ownership of ethanol plants take pride in what it has done for their communities.

More than 10 years ago grain farmer Brad Ahrens helped start Al-Corn Clean Fuel near Claremont, Minnesota. Last June, Ahrens, who is board chairman, stopped by the plant and was asked to drop off a box of letters at the post office.

"In that box of envelopes was

over \$4 million that's going to 350 area families," he says. "When they get their dividend checks or distributions, it makes you feel good that you're helping the economy out."

Good-paying jobs

Near the small northern Iowa town of Lakota, Midwest Grain Processors (MGP) now processes 100 million gallons of ethanol annually after a \$50 million expansion that doubled its production. It's one of the first farmer-owned plants in the

state, and even before the expansion it had a \$2 million payroll.

"It's created a whole bunch of really good-paying jobs in the upper Midwest, which we haven't had before," says Dave Nelson, a Belmond, Iowa, farmer who is MGP's board chair. Starting pay at the plant is \$11 an hour. The average salary is between \$35,000 and \$40,000.

The original goals of plants like Al-Corn and MGP were modest. Farmers wanted to increase local corn prices. Ethanol plants often do.

"I sold some corn last spring for an 18¢ basis, which we never had here," says Nelson. The basis in his northern Iowa area used to be 25¢ to 35¢ a bushel under nearby futures prices.

Owning plants brings even more than a better basis. "If we can't get our profit out of the market, we can find profit through processing," explains Todd Sneller, administrator of the Nebraska Ethanol Board. Farmers realize that "they don't want to just be producers of the raw material anymore."

Paul Kenney, an Amherst, Nebraska, farmer who is president of KAAPA Ethanol, a 40-million-gallon plant, is amazed at almost 100% returns after the LLC's first full year of production in 2004. For each \$12,000 unit (or share), investors got a dividend of \$6,000, and the LLC retained the rest to retire debt. After 22 months, its \$33 million in start-up loans are paid off. "I wouldn't go into this with the expectations of the tremendous returns we had recently because I don't think it's going to continue," he adds.

Phenomenal growth

Rural revival, better cash prices, and profit potential are the main reasons farmers own ethanol plants. Another, says Sneller, is start-up incentives in some states that range from 5¢ to 20¢ a gallon of ethanol produced. They often target small- to medium-size plants and sunset after a few years. The 2002 Farm Bill also subsidizes expansion.

The result of all this has been an ethanol boom.

It took a dozen years for ethanol production to double, from 900 million gallons in 1990 to about 1.8 billion gallons in 2001. In just the last six years, industry capacity has doubled again, from 1.9 billion gallons at the start of 2001 to 4.3 billion gallons this year, says the Renewable Fuels Association (RFA). (Production lags capacity slightly, so the two numbers don't match for 2001.)

"The driving force over the past five to 10 years has been farmers," says Bob Dinneen, RFA president. "Today, ethanol is the single largest value-added market for farmers."

Last year it consumed about 1.5 billion bushels of corn and will soon



Photograph: Courtesy of Midwest Grain Processors

Iowan Dave Nelson is at the helm of Midwest Grain Processors as well as this fishing trip.

pass up the U.S. corn export market of 2 billion bushels.

Farmers produce almost half the nation's volume of ethanol, says the American Coalition for Ethanol.

Ethanol is a rare agribusiness market that has seen more competition, not less, in recent years. A University of Missouri study shows that Archer Daniels Midland (ADM), with more than 1 billion gallons of capacity,

is the industry leader. A recent Federal Trade Commission report says, "The largest producer's share of capacity is currently around 25%, down from over 40% in 2000."

Tough at first, easy now?

Don't think this has been easy for the farmers who organized early. Or that they aren't concerned about investor dollars that could swamp the industry with new capacity.

Paul Kenney and others in the Kearney Area Ag Producers Association needed two years to raise the money and to organize KAAPA Ethanol, LLC.

"Back then, ethanol wasn't popular," he says. "There were some bloody noses from ethanol earlier."

Some Nebraska farmers lost money in Minnesota Corn Processors, a Marshall, Minnesota, co-op that owned a plant at Columbus. MCP had nearly gone bankrupt and later was purchased by ADM, a sale that was challenged in a lawsuit by some farmers. To the west of Kearney, a smaller plant near Sutherland had been in and out of bankruptcy.

Conservatively managed Al-Corn has survived a marketing roller coaster in its first decade.

"We've seen \$5 corn. We've seen 70¢ ethanol. We've seen \$2 natural

A checklist for farmer investors

Here are eight financial and management benchmarks for new ethanol plants used by Shane Frahm and Jeremy Wilhelm, agribusiness lenders with Farm Credit Services of America in Omaha:

1. Equity-to-asset ratio of at least 40%. That means investors should own 40% of the total value of the plant and inventory, with no more than 60% financed by loans.
2. Working capital for buying and hedging inputs of at least 10¢ for every gallon of plant capacity.
3. Adequate corn supply. Ideally, a plant should use no more than 50% of the net exportable bushels of corn in a 35- to 50-mile radius.
4. Find management with industry experience, something that's difficult to do during fast expansion. Some plant builders/designers will

train staff and manage start-ups.

5. Have a risk management strategy. The goal is to lock in a margin by hedging inputs of corn and natural gas used in distilling. Plants hedge or contract outputs of ethanol and distillers' grains when possible.
6. Use technology. With high natural gas prices, some new plants are looking to coal or methane from manure. Capital costs for these energy sources can be higher.
7. Have a competitive break-even cost. Energy inputs are pushing that up. Typical breakevens currently run from \$1.10 to \$1.30 a gallon.
8. Use marketers. Many plants sell ethanol through Renewable Products Marketing Group, ADM, Cargill, Ethanol Products, Noble Americas Corporation, or United Bio Energy to name a few.

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gas, and this year it's \$13 plus" [per million Btu's], says board chairman Brad Ahrens.

Al-Corn owners watch prices for natural gas, the fuel that runs most plants, and the price of oil just like corn, he says. "It's been quite a learning experience for everyone."

Al-Corn is one of a dozen Minnesota plants forced by the EPA to clean emissions at great cost. Al-Corn did find a way to save energy, too. Through it all, it has averaged returns on investment between 20% and 30%, he says. Like KAAPA Ethanol, the plant is virtually debt-free.

Losing the lead?

Farmers are still investing in ethanol. And it's easier. "There's so much interest in ethanol, you see these equity drives completed in a shorter time, sometimes a month or so,"

says Brian Jennings of the American Coalition for Ethanol (ACE).

But for the first time in eight years, farmers aren't leading the growth. In 1999, they owned all of the new plant capacity under construction,

'It would be sad commentary if the industry went back to what it looked like 15 years ago'

—Brian Jennings, American Coalition for Ethanol

according to the Renewable Fuels Association. At the start of 2006, they owned just 19% of the 1.7 billion gallons that will flow from 29 new plants going up or expanding. With 95 plants already producing 4.3 bil-

lion gallons, the industry will be at 6 billion gallons by 2007. Farmers, investors, and big companies all are building nearly twice as many new plants this year as in 2005.

Cargill plans a new 110-million-gallon plant at Blair, Nebraska, to start up in 2007. It also will source corn for partners and investor groups that are building another 500 million gallons of capacity in Ohio, Indiana, Minnesota, and Nebraska. Industry-leader ADM plans to expand ethanol output by 500 million gallons at its existing plants by 2008.

At ACE, Jennings says he doesn't want to throw up barriers to this growth, but he'd like to see farmers and small towns keep most of the benefits. "It would be a sad commentary if the industry went back to what it looked like 15 years ago."

Different policy could help

Someone who wants new federal ethanol programs is David Morris of the Institute for Local Self Reliance. He recently told the Minnesota Corn Growers that farmers may miss out



Photograph: Ted Schlaebitz

Kearney, Nebraska, cattle feeders Steve Mercer and his son, Chad, feed wet cake from KAAPA Ethanol, LLC of Minden, Nebraska. Steve, the plant's treasurer, was one of the early organizers.

on the benefits of ethanol growth.

"The problem is the federal government is, at best, neutral on the issue of scale and, at worst, it encourages absentee investor ownership," he tells *Successful Farming* magazine. It's hard for farmers to raise capital for 100-million-gallon plants. Morris wants the 51¢-a-gallon federal fuel tax credit now given to gasoline blenders replaced by something like Minnesota's system.

Minnesota gives a 20¢-a-gallon subsidy directly to plants, not blenders. It applies only to the first 15 million gallons of production. And the subsidy ends after 10 years. This approach would be cheaper for taxpayers than the federal open-ended system. He concedes that oil company blenders might fight his idea.

Survival strategies

Meanwhile, farmer-owned plants aren't waiting for the federal government to level the playing field.

They're pursuing different ways to survive a shakeout some feel is inevitable. Consider these options:

● **Add value.** At this, Chippewa Valley Ethanol Company of Benson, Minnesota, excels. Located at the northern edge of the Corn Belt, the LLC has no plans to expand beyond its 45-million-gallon capacity.

Instead, it makes Shakers vodka. It makes organic alcohol from certified organic corn for use in organic herbal extracts and flavorings and hair sprays and colognes. It makes nonorganic food-grade alcohol, too. And it blends its own E-85 ethanol that it sells to 60 gas stations.

Selling ethanol to oil companies for conventional 10% blends is still 90% of Chippewa Valley's sales volume, says general manager Bill Lee, "but we like to create a little more value on ethanol when we can."

● **Expand.** The typical farmer-owned plant makes 40 to 50 million gallons, says Jeremy Wilhelm, an agribusiness loan officer for Farm Credit Services of America in Omaha, Nebraska. Expanding to 100 million gallons lowers costs, he says. "You can spread more gallons over fixed costs on a 100-million-

gallon plant." Availability of corn and markets for distillers' grains can limit expansion, though, he adds, and a tax credit for small plants stops at 60 million gallons.

Midwest Grain Processors is expanding. It doubled capacity to 100 million gallons at the end of 2005 and is partnering with Great Lakes Ethanol in Michigan to build a 57-million-gallon plant. "We will take care of our customers in the East from that plant. It will give us some more marketing opportunities," says MGP's board chair, Dave Nelson.

● **Get out of debt.** Some new plants are being built with only 30% equity, says ethanol pioneer Brad Ahrens. "We know some of these plants aren't going to make it with their heavy debt. Our board has always taken a conservative position from day one. We've paid down a lot of debt over the years."

● **Cut fuel costs.** Chippewa Valley is switching to biomass gasification to replace natural gas. A new fuel source is just one of the innovations in how ethanol plants work. □



Photograph: Ted Schlaebitz

Paul Kenney, president of KAAPA Ethanol, loads corn. At first, farmer-owners had to sell some corn to KAAPA at \$2 a bushel. Most have recently opted out, and the plant buys nearly all at market prices.