

Ethanol

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BUSINESS

How Deals Square UP

After a long stretch of profitability, there are few U.S. ethanol producers "approaching the table" to sell. But that could change.

By Tom Bryan



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Like golf, ethanol mergers and acquisitions (M&A) is game of opposites. A golfer swings right to draw the ball left, left to cut it right, down to send it up. Ethanol M&A, too, work on ironic inverse relationships. Transaction numbers spike after bad times and dip during good times. High margins work against deals. Low margins produce them. Simply put, when profitability goes up, ethanol M&A activity generally goes down.

After the 2008 downturn, for example, 29 ethanol plants traded hands in 18 transactions before the end of 2010, according to Mark Fisler, managing director at Los Angeles-based investment banking firm Ocean Park Advisors. “That was a huge amount of volume over a two-year stretch,” Fisler says, explaining that improved margins, starting in 2010, yielded only five ethanol plant acquisitions in four deals in 2011. Then low M&A activity continued through the first half of 2012 following a generally profitable 2011.

Production margins sagged in 2012, spurring the sale of six ethanol plants late in the year and setting the stage for double-digit transactions in 2013. “We saw 13 ethanol plants acquired in 10 transactions that year,” Fisler says. “It was driven mostly by weak balance sheets and distress coming off 2012. “Clearly, the industry sees more transactions on the heels of distressed cycles than it does during or after good times.”

That last big M&A run ended when the ethanol industry cycled into an epic 18-month stretch of record margins from mid-2013 through late 2014. “I would characterize the last year and a half as a period of low M&A activity, but it depends on what you compare it to,” Fisler says, explaining that there were five ethanol asset transactions completed in 2014. “There are a lot of reasons for that, including the fact that ethanol margins were so good through most of 2013 and 2014.”

Most but not all M&A activity in the ethanol industry since 2008 has been a story of leaders acquiring laggards. A vast majority of the deals were financially distressed independent plants acquired by large, integrated ethanol producers. Today, Fisler says, “strategic producers” remain interested in acquiring ethanol plants, but sellers are scarce. “We’re four months into the year and there really isn’t an announced 2015 deal at this point,” he says. “There are whispers about deals—and we are in talks with

various people—but ethanol producers just aren’t approaching the table. So there’s a lot of interest in transactions but very few producers looking at a sale.”

Fisler continues, “When you talk to a producer who just made 60, 70, 80 cents a gallon last year, it’s pretty hard for them to get excited about where plants are trading. Ethanol plants are [selling for] roughly \$1.60 per gallon on name-plate capacity or around \$1.30 per gallon on their operating rate. So if you made 70 or 80 cents a gallon last year, that’s not very interesting. Shareholders remember the last dividend check they made, and most of them don’t want to let go of an asset for that low a number right now.”

Notably, M&A activity in the ethanol sector doesn’t follow industrial M&A activity in general. “The ethanol industry is characterized by single-purpose assets at location,” Fisler says, explaining how some industries offer more opportunities for transactions than others. “There are a limited number of reasons for ethanol plant acquisitions.”

The fact that this year’s lower-margin environment has not spurred appreciable M&A activity could be the result of two things. First, it’s early and transaction activity generally lags behind prevailing market conditions by several months. Second, many U.S. ethanol producers were able to strengthen their balance sheets and reduce their debt last year. “The massive run up in crush spreads provided meaningful liquidity to producers and gave them a number of capital market solutions for the first time in a while,” says Scott Chabina, director at Carl Marks Advisors, a New York-based investment banking firm. Chabina cites three high-profile loans secured by producers in 2014, including a \$66 million senior credit agreement completed by Southwest Iowa Renewable Energy, a \$225 million senior secured credit facility completed by Green Plains Renewable Energy, and a \$40 million loan and security agreement secured by Aventine Renewable Energy before the company moved ahead with its pending merger with Pacific Ethanol. “This was a great time to provide optionality, which is king in the world of ethanol. It’s defensive. It’s strategic.



Fisler

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SELLING AN ETHANOL PLANT 101

Although each sale is unique, most transactions can be completed in less than six months. Here's a simplified look at how it works:



1. Gain Consensus: After an ethanol plant's board of directors makes a decision to explore a sale, an investment banking firm is retained to meet with the board and plant management. Expectations are discussed. Visions are aligned. The investment banker establishes a basic understanding with the board about what the market will support. Board consensus on the sale is achieved. In some cases, a shareholder vote is conducted. Financial advisors begin a "stem to stern" review of the asset and begin to clearly define the producer's value proposition and how the asset, or assets, stack up to other companies.



3. Solicit, Host Suitors: The team builds a list of potential suitors and establishes a game plan before buyer solicitation begins in earnest. The investment banker communicates with all potential buyers. Interested parties sign nondisclosure agreements. Nonbinding solicitations are secured for screening and evaluation. Site tours take place.



2. Market Asset Sale: After assembling the necessary legal, accounting and financial advisory team, the investment banker works with plant management on initial due diligence, populating a "virtual data room" containing all relevant financial, operational and legal information about the plant. Marketing materials are developed in order to position the asset appropriately.



4. Narrow In, Get Binding Bids: The buyer search is narrowed to select suitors. Second-round seller due diligence is conducted as buyers' due diligence begins. Binding bids are requested as the team works toward a deal. Prospective buyers are invited to meet with management in person. More confidential information may be added to the data room.



5. Select Buyer, Close: Purchase and sale agreements are collected and a final evaluation of the offers is conducted. A third-party fairness opinion of one or more offers is completed and the winning bidder is selected. Additional shareholder votes may be conducted. The team moves forward with final documentation and sets expectations for closing. Multiple rounds of funding may be necessary. Shareholders are partially paid out. The remaining funds are held in escrow and paid out later. Shareholder retention of shares is sometimes an option.

You need to be a low-cost producer and take advantage of the margins when the margins are there.”

Chabina says ethanol producers, big and small, are still in good positions and able to act on strategic activities including M&A, refinancing and inside-the-fence capital projects. “Producers are looking at projects,” he says. “In many cases, they’re dusting off the CapEx books that have been on the shelf for a while because they’re in a position to take advantage of having liquidity.”

Nondistress Deals

While financial distress may be the surest expediter of ethanol plant transactions, it is not the only thing that makes deals occur. Fisler says multiple ethanol plants have been sold in recent years by what he calls nonlong-term investors. “These are your pure-play investor groups that see an opportunity in ethanol, put dollars into a plant, achieve good returns and want to exit their investment,” he says, citing CHS’s acquisition of Illinois River Energy LLC last April. “That’s a perfect example of a plant that was

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2013-2014 U.S. Ethanol Plant Transactions

There have been 22 plants acquired totaling 1,617 MMgy

Aquirer	Target	Plants Acquired	MMgy Acquired	Txn. Value (\$M)	\$/Gallon
Pending - Pacific Ethanol	Aventine Renewable Energy	4 ⁽¹⁾	315	\$325.00	\$1.03
2014 Flint Hills Resources	Southwest Georgia Ethanol	1	100	NA	NA
2014 Green Biologics	Central MN Ethanol Co-op	1	21	NA	NA
2014 CHS	Illinois River Energy	1	133	\$160.00	\$1.20
2014 Tyton BioEnergy	Clean Burn Fuels	1	60	\$12.20	\$0.21
2014 Valero	Aventine Renewable Energy	1	110	\$34.00	\$0.31
2013 Guardian Energy	Hankinson Renewable Energy	1	130	\$170.00	\$1.29
2013 Green Plains	BioFuel Energy	2	220	\$101.00	\$0.46
2013 Flint Hills Resources	Platinum Ethanol	1	110	NA	NA
2013 West Ventures	Purified Renewable Energy	1	18	\$5.00	\$0.28
2013 Marathon Petroleum	The Andersons	3	86	\$75.00 ⁽²⁾	\$0.87
2013 Global Partners	Columbia Pacific Bio-Refinery	1	107	\$95.50	\$0.89 ⁽³⁾
2013 Granite Falls Energy	Heron Lake BioEnergy	1	32 ⁽⁴⁾	\$62.50	\$1.08
2013 Ace Ethanol	Utica Energy - Oshkosh	1	60	\$16.50	\$0.28
2013 Green Plains	Choice Ethanol Holdings	1	50	\$15.00	\$0.30
2013 Future Fuels	Osage Bio Energy	1	65	\$13.00	\$0.20
	TOTAL	22	1,617 (5)	\$1,085.30	\$0.65(6)

SOURCES: PUBLIC FILINGS AND OCEAN PARK ADVISORS DATABASE.

(1) Aventine Renewable Energy is comprised of two facilities each in Pekin, Ill., and Aurora, Neb. (2) Represents an acquisition of minority stakes in three ethanol plants from Mitsui. (3) Transaction based on marine terminal value. (4) 32 MMgy of capacity acquired by Granite Falls is pro-rata for its 63.3% ownership stake in Heron Lake BioEnergy. (5) Based on announced capacity. (6) Average of transactions.

owned by an offshore investor that didn't see the asset as strategic to retain. That deal was not driven by distress."

At the other end of the seller spectrum are farmer-owned ethanol plants, arguably the most unlikely transaction participants. Fislser says that about a third of U.S. ethanol plants can still be characterized as "steadfastly independent," and not interested in giving up control, regardless of margins. "Those types of ethanol plants are usually not going to trade. Even though there might be a real opportunity to merge four or five smaller plants together in a way that creates a greater internal balance sheet, better cash

flows, greater ability to invest and grab new technology, they may not necessarily be interested in hearing that because they just want to keep what they've got."

Chabina says some near-term ethanol plant transactions could involve middle-of-the-road producers who have "earned their way out of trouble" and are considering selling while they're in a strong position. "Against the outlook of a more moderate 2015, it might make sense for some of these guys to explore their options and look at a sale," Chabina says, explaining that nondistressed facilities can command a premium from buyers seeking

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U.S. Ethanol Plant Acquirers (2009 –2014)

Seven buyers have bought 64 percent of plants and 68 percent of capacity since 2009. In all there have been 28 buyers in five years.

Top Seven Buyers

Flint Hills

- 6 Acquisitions in 2010–2014
- 7 plants and 760 MMgy capacity

Green Plains

- 5 Acquisitions in 2009–2013
- 8 plants and 632 MMgy capacity

Valero

- 4 Acquisitions in 2009, 2010 and 2014
- 12 plants and 1,220 MMgy capacity

Guardian Energy

- 3 Acquisitions in 2009, 2010 and 2013
- 3 plants and 304 MMgy capacity

Pacific Ethanol

- 2 Acquisitions in 2014 and 2010
- 5 plants and 335 MMgy capacity

Murphy Oil

- 2 Acquisitions in 2009 and 2010
- 2 plants and 225 MMgy capacity

Big River

- 2 Acquisitions in 2009 and 2012
- 2 plants and 155 MMgy capacity

(1) Going private transaction.

Single Acquisition Buyers

Green Biologics / 21 MMgy - 2014

CHS / 133 MMgy - 2014

Global LP / 107 MMgy - 2013

Central Farmers Co-op / 100 MMgy - 2009

Poet / 90 MMgy - 2010

SiemKapital & North Atlantic Value⁽¹⁾ /87 MMgy - 2011

Marathon Petroleum /86 MMgy - 2013

Future Fuels / 65 MMgy - 2013

TytonBioEnergy / 60 MMgy - 2014

Ace Ethanol / 60 MMgy - 2013

Aemetis / 55 MMgy - 2012

Pratt Biofuel / 55 MMgy - 2012

The Andersons / 55 MMgy - 2012

Carbon Green / 50 MMgy - 2009

REX / 50 MMgy - 2011

Nebraska Corn Processing / 44 MMgy - 2009

Palmer Energy / 40 MMgy - 2012

Aventine / 38 MMgy - 2010

Granite Falls / 32 MMgy - 2013

Gevo /22 MGPY - 2010

West Ventures /18 MMgy - 2013

SOURCE: OCEAN PARK ADVISORS

assets with specific attributes. “Many producers wanted to acquire gallons for scale a few years ago. Now, buyers are more disciplined and seeking assets that fill out their respective network for a number of reasons. Flint Hills’ acquisition of Southwest Georgia Ethanol is a great example of that sort of approach. It was strategic purchase and it made sense for them given their existing resources.”

Chabina adds, “The appetite from buyers is still there, but they are more discerning. They know what they want, and it’s often not just a matter of gallons. Buyers are looking at the specific

production history of a facility, its transportation and logistics situation, its management team, third parties services, grain storage and more. The attractiveness of each plant is unique to each prospective buyer. That’s always been true, but today’s buyers are more disciplined and won’t simply stretch for gallons alone.”

A new X-factor in ethanol M&A is the potential for more transactions to be driven by strategies to convert existing ethanol plants into facilities that can produce nonethanol fuels and chemicals. “We’re seeing the emergence of companies interested in buying and retrofitting ethanol plants for other purposes, one being

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the possibility of producing higher-value, higher-margin specialty chemicals,” Chabina says. “That tends to lead toward the discussion of the diversified, integrated biorefinery concept against the backdrop of the big second-generation ethanol plants that are coming online.”

Having spearheaded the sale of the Central Minnesota Ethanol Co-op to Green Biologics last year (see “Back to the Future with N-butanol” on page 46), Fisler knows firsthand what the value proposition is, for both buyers and sellers, in transactions based on plant conversions. Green Biologics purchased CMEC in a creatively structured deal that gained a lot of attention in the biofuels M&A space. When completed, the reconfigured plant will have the capability to produce acetone, normal butanol and ethanol. “I’d be surprised if we don’t see more deals like that in the future,” he says.

Clear Signals Help

At press time, the ethanol industry was awaiting the U.S. EPA’s final 2014 and proposed 2015 and 2016 renewable volume obligation (RVO) numbers, which instruct oil companies on their mandated biofuels blending obligations. Fisler doesn’t expect the RVOs to have a major impact on ethanol plant M&A, but he does think improved policy certainty will invite more capital to the biofuels sector. “The type of improvement projects that a number of producers are looking at are quite large and would require the support of the lender community,” Fisler says. “Better policy certainty might help facilitate that process, particularly if it gives the industry a runway for cellulosic ethanol or plant upgrades.”

Chabina agrees that a stable regulatory and policy environment is key for biofuels finance markets. “It’s critical to stay the course and send a clear signal that encourages companies to invest the time and capital in next-generation biofuels and, more broadly, biorefining,” he says, adding that he believes M&A activity will pick up regardless of where the EPA lands on its RVOs. “Absent any truly adverse changes to the RFS or major weather events, margins are largely expected to be moderate. We’re not expecting to see a lot of plants with their backs against the wall. There will still be some distressed asset sales, but they will be less a function of pure crush spreads and more a function of not being the low-cost producers in a normalized market.”

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