



November 5, 2008

Economy Shifts, and the Ethanol Industry Reels

By [KATE GALBRAITH](#)

As producers of ethanol navigate a triple whammy of falling prices for their product, credit woes and volatile costs for the corn from which ethanol is made, an economic version of “Survivor” is playing out in the industry.

Last week, VeraSun, one of the nation’s largest ethanol producers, announced that it had filed for bankruptcy protection after its bets on the price of corn turned out to be wrong — and costly.

Several other small producers have filed for bankruptcy this year, and construction plans for several Midwestern ethanol plants have been postponed or shelved. Shares in the handful of publicly owned ethanol companies have mostly been slumping all year. Aventine Renewable Energy and [Pacific Ethanol](#), for instance, have both lost more than 80 percent of their value since the beginning of the year.

While producers pin their hopes on rising government mandates for the use of ethanol, analysts who follow the industry voice concerns that more companies could go under. They expect a wave of consolidation to sweep the ethanol business once the [credit crisis](#) eases.

Ian Horowitz, an analyst with Soleil Securities, said that he was particularly worried about [BioFuel Energy](#), an ethanol maker. The company, based in Denver, is low on cash and has had problems similar to VeraSun’s, losing \$46 million when commodity-price hedges turned out badly.

“Like the airlines, sometimes one goes in, the others run to go in, too,” said Mr. Horowitz, speaking of bankruptcy protection.

BioFuel Energy’s shares have fallen to 57 cents, from a high of \$7.75 in January. The company did not respond to requests for comment.

[Archer Daniels Midland](#), the agribusiness giant that is one of the largest ethanol producers, reported higher overall profits on Tuesday — but recorded a sharp drop in operating profit for its corn processing unit, which includes ethanol production. The company, which also announced a new \$370 million investment in Brazilian ethanol made from sugar cane, is far more diversified than its smaller competitors who are focused on ethanol.

Nowadays, gasoline sold at many stations nationwide includes about 10 percent ethanol, with a few stations in the Midwest selling an 85 percent ethanol blend. Many politicians have embraced ethanol as a way to court farmers and because it is produced domestically. Most research suggests that corn ethanol offers modest benefits in lowering emissions of climate-altering greenhouse gases, though production of ethanol has contributed to rising [food prices](#).

The federal government began mandating the use of ethanol in a 2005 energy bill, setting off a building boom in ethanol plants. A 2007 energy bill substantially raised the quotas, which will require 10.5 billion gallons of ethanol next year and 12 billion gallons in 2010.

Energized by strong government support and a profitable year in 2006, the industry redoubled its building spree. High gasoline prices also encouraged refiners to use more of the cheaper ethanol over the past year. In August, nearly 50 percent more ethanol was produced than a year earlier, and many more plants were on the drawing boards.

But then ethanol companies got a rude shock: corn prices hit record highs this summer after the Midwestern floods. That made ethanol more expensive to produce. Fearing that prices would go even higher, some producers — including VeraSun, BioFuel Energy and Glacial Lakes Energy, a South Dakota farmers cooperative — entered into contracts intended to protect them if corn prices rose.

“We were hearing \$8, \$9, \$10” a bushel, said Jim Seurer, the interim chief executive of Glacial Lakes. “We sought protection from that.”

But after the fields dried and it became clear the nation would have a good corn harvest, the market turned again. Companies that had locked in around \$7 and above were stuck watching corn fall to \$4 a bushel.

In a statement last month, Mr. Seurer’s company reported “significant margin and hedging losses due to the sharp downturn in the price of corn.”

Fewer than 10 of the country’s ethanol plants have stopped operating, according to Matt Hartwig, a spokesman for the Renewable Fuels Association, an industry group. But construction times have slowed and some plants in the planning stage have been halted.

Falling ethanol prices have compounded the squeeze on producers. These roughly track gasoline prices, and are down by nearly 40 percent since June, despite a recent uptick.

On top of all that came the credit freeze, which hurt companies that needed operating loans. With companies’ share prices falling, it became difficult to raise investment capital, too. VeraSun, for example, sought to issue 20 million shares to raise money, but that failed and it was forced to file for bankruptcy protection.

A few months ago Glacial Lakes, the South Dakota cooperative, failed in its efforts to obtain financing from a group of banks, including some Wall Street lenders, Mr. Seurer said. It is asking its members — many of them farmers — for \$11.3 million more to cover operational costs.

Ethanol “has been hit much harder than most other industries,” said Kevin Calabrese, an analyst at Argus Research, citing the volatility in corn and natural gas prices, the two main inputs for making ethanol.

The credit crisis will also prevent consolidation that otherwise would be expected in a hobbled industry, experts say.

“The industry should be consolidated — I think everybody believes that,” said Mr. Horowitz of Soleil. “But who is going to finance anything right now, let alone a very low-margin business that doesn’t look like it’s going to get better in the near term?”

Some are more optimistic, in part because of lower corn prices.

“The future of the industry looks very bright,” said Ronald H. Miller, president and chief executive of Aventine, citing the rising federal quotas for producing ethanol.

But he characterized the current environment as “choppy.” Aventine lost about \$30 million earlier this year on certain securities, and recently delayed construction on a Nebraska plant to stretch its cash.

VeraSun, whose 14 operational plants account for 13 percent of the nation’s ethanol production capacity, announced on Tuesday that it was indefinitely delaying construction of a new plant in Minnesota, its second plant in that state to be delayed. VeraSun hopes to emerge from bankruptcy as an intact company, but it is possible the company will be sold off in pieces.

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