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## **As industry branches out, outside investment flows in**

**The future could bring consolidation along with farmer-owned plants**

**Does it matter who owns Iowa's ethanol?**

FUELING IOWA'S FUTURE

By PAULA **LAVIGNE**

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Iowa may be the nation's renewable fuels leader, but Iowans won't see most of the profits from the state's biofuel plants.

Out-of-state investors already own a majority of projected ethanol and biodiesel production in Iowa, and they're likely to acquire more.

Though farmers triggered much of the state's ethanol boom, plants primarily controlled by out-of-state or foreign investors account for at least 57 percent of Iowa's renewable fuels, an analysis by the Des Moines Sunday Register shows.

"Big money wants to own ethanol because it's liquid fuel," said Barry Ellsworth, the Las Vegas investor who founded Green Plains Renewable Energy. The company is building ethanol plants in Shenandoah and Superior. "I looked at it and said, 'Where can I make the most money?' Iowa was the best state to work with, and they had the cheapest corn."

Iowa leads the nation in renewable fuels production with a capacity soon to reach 3.2 billion gallons of ethanol and biodiesel combined.

Outside investment is likely to grow even if the industry consolidates - and many believe that is a good thing.

Iowa can remain the leader in renewable fuels, "but it'll take a lot of cash to do that," said Dave Nelson, an Iowa farmer who is chairman of the Midwest Grain Processors cooperative. Last year, the cooperative sold 60 percent of its Lakota ethanol plant to Global Ethanol, an Australian company backed by a bank founded in South Africa, for \$100 million.

Does it matter who owns Iowa's biofuels?

Studies show local ownership ensures that more dollars churn through Iowa communities. A plant with 75 percent local ownership pumps three times more money into area household incomes as a plant with 25 percent local ownership, according to a 2006 study by Iowa State University economists.

"Instead of the one guy who works at the ethanol plant going to the hardware store or the lumber store, you'll have a bunch of people who have money to spend at the hardware store, and the car dealership, and for putting up a new house," said Chris Petersen, president of the Iowa Farmers Union.

In addition, experts and advocates say local investors who resist the temptation to sell might fare better in the long term. More young people may be drawn into farming and reap the benefits of their families' investments over time.

All plants, regardless of ownership, will put money into the community through payroll, supplies, taxes and buying farmers' grain. Profits vary, as do payments to investors.

At Lincolnway Energy in Nevada, Ia., annual payroll is \$2 million, and last year's investor returns totaled about \$6.4 million. Lincolnway is owned primarily by Iowans.

The argument for outside ownership?

An Iowa-owned plant may put more dollars into local pockets, but the state will have more plants overall if it draws investors from other states and nations.

The change in ownership of many Iowa biofuels plants is a switch from a few years ago. Cargill and Archer Daniels Midland built the first ethanol plants in the 1980s, then farmers were largely responsible for growth in the late 1990s and early 2000s. That's when farmer cooperatives, such as Quad County Corn Processors in Galva and Little Sioux Corn Processors in Marcus, built plants, in part to secure a market for Iowa grain.

Then investments reached beyond farmers to local business owners, retirees and wealthy individuals, but remained mostly Iowan.

The ownership base shifted again when Wall Street stepped in with interest from private equity groups, venture capitalists, hedge funds and other public companies. Foreign firms with ties to Australia, India and Israel also are buying into Iowa.

Recent drops in ethanol profits - far from last summer's highs - slowed investment and made some speculators more selective. But industry experts say the money is still coming in.

Local plant leaders prefer Iowa ownership

Of the 52 Iowa biofuels plants in operation or under construction at the beginning of 2007, 26 were under the control of primarily local owners. Most leaders of those plants say they'd like to keep Iowans at the helm, but they can't offer a guarantee.

One way ownership transfers from Main Street to Wall Street is when an outside company makes shareholders an offer, and they to vote whether to sell. That's how Global Ethanol took over the Midwest Grain Processors plant.

"They dangled those dollars," said Dennis Barnes, a fourth-generation farmer in Britt. "They all jumped at it."

An original investor with 6,600 shares in Midwest Grain Processors worth \$10,000 would have made \$32,000 after the sale. Shareholders kept their same number of shares, and more shares were issued to give Global Ethanol its 60 percent ownership.

The value of the original shares has increased from \$1.50 to almost \$4, Nelson said. But Barnes, who was among the 33 percent of voters who didn't want to sell to Global Ethanol, believes investors could have reached bigger profits had they done it themselves.

Jeff Altena, chief financial officer for Siouxland Energy & Livestock Cooperative, which owns an ethanol plant in Sioux Center, also believes that if investors are patient, they likely will realize a larger return on their investment than if they sell now.

"Our theory has been ... to remain a producer-owned cooperative, to make that money, and have that money stay on the farm instead of getting sent to New York," Altena said.

The Siouxland plant's original debt is paid off, and investors have received a nearly 200 percent return on their initial \$3,350-per-share investment, Altena said. Those returns add up to millions of dollars in the local economy.

Barnes bought grain bins with the money he earned from the stock sale and dividends, he said.

Dale Swanson, a Nevada farmer who invested in Lincolnway with his two sons, said their returns have gone back into the community. They buy groceries in Nevada and they patronize the local John Deere dealership.

"Lincolnway's a good deal. It's a very good deal for the community, and it's a very good deal for the farmers, and ... it's a very good deal for the people who invested in it," he said.

Swanson said he believes Iowans should own their ethanol plants. "I would not want to see somebody else get control of them."

Share the risk, share the profits

Monte Shaw, executive director of the Iowa Renewable Fuels Association, doesn't worry about who owns the plants, as long as the plants remain profitable.

"Every ethanol plant chews up Iowa corn, and that helps the entire economy," Shaw said.

"Is there any sign out there that locally owned plants can't make it? There's absolutely no sign of that. Given that, am I going to be upset if ADM adds capacity? It's a great investment for Iowa."

Nelson, chairman of Midwest Grain Processors, which sold to Global Ethanol, said Iowans lack the money needed to fulfill the state's ethanol potential. As the industry tests new methods of producing renewable fuels, taking that financial gamble alone would be unwise, he said.

In addition, lenders have been less willing to support plants with unproven technology.

"To share the risk, we're going to have to share the profits," Nelson said.

Larger investors bring with them leverage that translates into savings, Nelson said. For example, joining Global Ethanol let the plant buy corn well into 2008 at prices far below \$4 a bushel.

"Our senators, governors and legislators have been crying for decades that we need to get outside investment," he said. "Now ... we're getting criticized for it, and that's not fair."

Private equity investing in Iowa went from \$185 million in 2002 to \$1.1 billion in 2006, much of that a result of renewable fuels. But Iowa still ranks near the bottom for overall venture capital funds.

Erik Straser, a venture capitalist with Mohr Davidow Ventures in Menlo Park, Calif., has made several trips to the Midwest recently.

"This is the chance for the agrarian heart of the country to recapture a lost significance," he said. "If your No. 1 goal is to impact 100 square miles, that's something that could be accomplished on a regional basis.

"If your mission is to have one in every five pumps in America be E85, the partners that will help you do that will be national-scale partners."

Currently, fewer than 1 percent of gas stations in America offer E85, a blend of 15 percent gasoline and 85 percent ethanol.

Volatile industry yields short-term pains

Companies that want to be ethanol partners have pulled back some since last summer's gold rush, when profits were sky-high by the Fourth of July.

It's been volatile in the industry since then. Ethanol profits peaked at \$2.50 a gallon on June 20. In February, they had dropped as low as 1.3 cents per gallon. As of mid-April, they rose to 45 cents, said Rick Kment, an analyst at DTN, a market research firm in Omaha. Corn, the main ingredient in ethanol, rose from \$2.29 a bushel June 20 to \$3.60 on April 11, and was nearly \$4 earlier this year.

Two companies - Hawkeye Renewables and Global Ethanol - tried to go public last year, but pulled their offerings after a rise in corn prices and a drop in fuel prices made ethanol less attractive. Stocks in existing public companies, such as VeraSun Energy, Xethanol, and Green Plains Renewable Energy are priced significantly lower than what they were last summer.

Some analysts have downgraded the outlook for renewable fuels because of concerns about oversupply.

"Over time, it will wash out, as do a lot of oversupply situations," said Brian Allingham, an associate with Norwest Equity Partners of Minneapolis, which invested \$31 million in two Iowa plants built and operated by Broin Cos., now known as Poet. "We're still positive on the long-term aspect. There will be some short-term pain as that oversupply issue comes online and the demands are not there."

At the same time, as investors seek new projects, some existing plants are exploring ways to make themselves more attractive to buyers, either by expanding, taking over a smaller plant, adding new technologies, or offering different types of byproducts, such as using corn oil extracted from ethanol to make biodiesel.

Stephanie Moline, executive vice president of corporate banking at First National Bank of Omaha, said some smaller plants are selling shares and talking about pooling ethanol so they can obtain better prices from buyers. They're also considering selling land that's ready for construction.

Cash in now or hold for the long term?

Moline is among the many experts who predict the industry will consolidate in the next year or two, possibly through a mix of publicly traded companies and private equity investors.

A few larger existing ethanol companies are already "lining up the war chest on the acquisition trail," she said.

Bruce Rastetter, CEO of Hawkeye Renewables, said consolidation and transition to a publicly traded company gives shareholders a great opportunity to turn their investment into cash that "they won't have today in a single plant."

Hawkeye's two plants in Fairbank and Iowa Falls annually produce 215 million gallons of ethanol. The company's output could double when plants in Menlo and Shell Rock are built. The company is interested in acquiring more plants someday, Rastetter said.

Thomas H. Lee Partners, a private equity firm in Boston, owns a majority of the shares in the Iowa-based company.

It's common for investment groups such as Thomas H. Lee Partners and Goldman Sachs & Co. - which made news last summer when it invested in a Canadian ethanol company - to buy out or invest heavily into companies and then take them public.

That's also the plan for Iowa venture capitalist and philanthropist John Pappajohn, who is trying to raise \$800 million from Wall Street to fund Countryside Renewable Energy. Countryside plans to buy existing ethanol plants in Iowa and other Midwestern states, then take the company public, said David Kolsrud, a Minnesota consultant working with Pappajohn.

Board members of several plants say they routinely get offers from investors, larger companies, hedge funds and others. Shareholders have rejected some offers because they just weren't lucrative, but good offers got canned as well because owners didn't want to sell.

"Over time, the companies that desire to be larger will be larger, either by acquisition or by construction," said Rick Brehm, general manager of Lincolnway Energy.

"Who are the companies who may be consolidating? Who knows who might come out of the blue and be a consolidator in this industry?"

The industry still has room for the traditional farmer-owned cooperatives producing 50 million gallons, despite the move to larger companies and bigger plants, according to Moline.

Farmers benefit from selling both corn and ethanol because if corn prices fall, ethanol profits might go up. Farmer-owned plants also will stick around because most farmers, unlike hedge funds or other Wall Street dealers, won't bail if their earnings drop from 40 percent to 7 percent.

Long term to a hedge fund is five years. Long term to a farmer is generations.

THE OUTSIDE INVESTORS  
REGISTER PHOTO BY JUSTIN HAYWORTH

Mark Beemer, second from left, and Lee Blank, center, want to raise \$750 million this spring so they can build three 100 million-gallon ethanol plants. The native Iowans - Beemer grew up in Webster City, Blank in Garner - founded Alternative Energy Sources Inc., based in Kansas City, Mo. One of the plants is to be built on 625 acres three miles west of Ogden. Beemer and Blank are on a quest to raise money, meeting with investment bankers and others in Europe, Toronto, Houston, New York, Denver, Chicago and San Diego. While investors have become

more selective, Beemer said the environment has improved slightly in the past two months as crude oil prices have risen and corn prices have moderated. Also pictured: At right, Verlin Friedly, director of engineering; second from right, J.B. Voss, vice president of business development; and at left, John Holland, executive vice president and chief financial officer.

FARMER INVESTOR  
REGISTER PHOTO BY DOUG WELLS

Who he is: Loren Book of Nevada, Ia., owns shares in both Lincolnway Energy ethanol plant in Nevada and Western Iowa Energy biodiesel plant in Wall Lake. He's a farmer in his 60s who sees wisdom in diversifying his investments, especially as he nears retirement. Book also belongs to the Heart of Iowa Cooperative and sells corn to Lincolnway.

Why he invests: "Owning something like this is just owning one step beyond the production phase," he said. "That's important because you're producing a product and generally when you sell it your interest stops." Shares in an ethanol plant allow a farmer's interest to continue, and "you can garner some of that value-added productivity," Book said.

How he did it: He took out a loan at the local bank to pay for his investment, and he plans to hang on to his shares. His children will have to decide if they're sold.

CASHING IN: Midwest Grain Processors sold a 60 percent stake in its Lakota ethanol plant last year to an Australian company, Global Ethanol, for \$100 million.

MONEY FLOWING IN: Private equity investing in Iowa went from \$185 million in 2002 to \$1.1 billion in 2006, much of it as a result of renewable fuels.

Graphic: Renewable energy plants  
Graphic: who owns Iowa's renewable energy?

**Caption:**