December 2018 Newsletter

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General Manager

From the General Manager

WPE finished another fiscal year in September, and we have included a copy of the audited financials with this newsletter. As you will see from the numbers, it has been a tough year.

One bright spot for the year was that we had a strong corn and sorghum crop this year. According to the latest USDA crop data, we set a new record with a national corn yield of 178.9 bushels per acre, compared to the previous record set last year at 176.6 bushels per acre. The record yield produced 14.626 billion bushels of corn, which an estimated carry-out of 1.739 billion bushels. The sorghum crop was also a solid crop this year with a national average of 71 bushels per acre and production totaling 364 million bushels, which is equivalent with last year's sorghum crop. Breaking the data down to a state level, Kansas produced 663 million bushels of corn with an average yield of 130bpa and 201 million bushels of sorghum with an average yield of 82bpa.

Even with the strong production, harvest has been a little slow and drawn out this year. Just as harvest was approaching Mother Nature decided to bless us with moisture, and she continued to bless us with additional moisture every few days making it difficult for the grain to dry down and for producers to get into the fields. Nonetheless, we are finally nearing the end of the harvest season.

One of the big challenges for the industry is over-supply of ethanol into the marketplace. The industry continues to produce at record levels, reaching equivalent production rates nearing 17 billion gallons per year this summer. Most recently, the industry has been running at a production rate equivalent to 16.3 billion gallons per year. Based on recent gasoline demand, the domestic demand for ethanol has been around 14.5-14.8 billion gallons. The industry has put a lot of focus this year on exports in an effort to balance out the supply and demand, and we are on pace for a record year of exports of 1.7-1.8 billion gallons. Unfortunately, even the strong export program hasn't been quite enough, and profit margins have slipped to negative values for the majority of the industry. Thus far, two fringe plants have announced that they are permanently closing, and other plants have slowed production. Based on the rumored numbers, it looks like we could be getting close to a more balanced supply and demand situation. I don't look for this to change overnight, but I am hopeful that this will help to put some value back into the profit margin equation.

Another challenge for our industry resides on the policy side. For years our industry has lobbied to allow for E15 (i.e. 15% ethanol mixed with 85% gasoline) to be able to sold as a regular fuel year-around. Today, E15 can be sold only as a flex-fuel during the summer months and can only be sold a regular fuel from September 16 through May 31. This rule stems back to the 1990 Clean Air Act, whereby E10 was provided a waiver around evaporative emissions to be able to meet the special emission requirements during the hotter summer days. The waiver was only applied to E10 fuels as E15 had never been considered as an option at that time. E15 provides a better evaporative emission profile over E10, and there is simply no scientific reasoning to not apply the same waiver for E15 as is applied to E10. Again, our industry has been making this argument for a number of years, and over the last several months President Trump has become personally involved in the discussions. In October, the President directed the EPA to begin the rulemaking process to allow E15 to be sold year around. This is fantastic news for our industry as it will create additional domestic demand for our product. However, the rulemaking will take some time, and it will include a public comment period and likely legal challenges. The goal is to have the new rule in place by June 1.

A more recent policy challenge is centered around the Renewable Fuels Standard (RFS). Congressman John Shimkus (R-IL) and Congressman Bill Flores (R-TX) recently released a “draft discussion” for legislation to reform the RFS and establish a new octane standard for gasoline. The draft proposal contains some positive items and some negative items for our industry. The draft is not likely to get traction for this lame duck congressional session, and I wouldn’t expect a lot of traction for it in next year’s Congress with the change in control from the Republicans to the Democrats. Regardless, it serves as a reminder that we need to continue to be active with our Congressional members.

The final political item that I wanted to share is also in regards to the RFS. The RFS prescribes specific volume amounts of renewable fuel that is to be blended into our national transportation fuel each year through 2022. Compliance for the system is managed at the petroleum refinery level. So each refinery is obligated to blend a specific percentage of renewable fuel based on their gasoline and diesel sales. Built into the RFS is a protection for the small refineries. Refineries with a capacity of less than 75,000 barrels-per-day can receive waivers from the RFS if they prove compliance would cause them “disproportionate hardship”. The trouble with these exemptions is that Congress prescribed that a specific amount of renewable fuel be blended, yet when the EPA provides an exemption that volume of renewable fuel is not reallocated back to the other refineries. Thus, the overall volume mandated by Congress is not met. In early 2018 it was revealed that Scott Pruitt, the then Administrator of the EPA, provided over 2 billion gallons of waivers to various refineries. One of the refineries that received the waiver was Chevron. That same year, Chevron reported a net income of $9.2 billion. $9.2 billion hardly seems like a hardship to me.

So what does all of this mean for WPE? There is no doubt that times are tough in the industry. Margins are as low today as they have been in several years...in part, due to our own oversupply. However, WPE has been able to withstand similar conditions in the past, and I believe that we are positioned to again weather the storm.

Thank you for you continued trust and support, and may each of you have a blessed and joyous holiday season!

The Bored Secretary Report

Is it time to remove the word “ethanol” from our collective vocabularies? That would seem to be the message from a recent presentation at the Iowa Renewable Fuels Association convention. The presentation was made by Dave DenHerder from FP1 Strategies, a public relations firm from Washington D.C. which has done considerable consumer research into the subject.

The most important aspect is the dinosaur fuel industry understands it needs to eliminate the free market to whatever extent possible, in order to make huge profits. The production of biofuels is still a mostly competitive market, and as such, represents a threat to the highly concentrated and controlled dinosaur fuel industry. So, they have spent many millions of dollars and much time and effort into spreading lies and misstatements about the ethanol industry in order to influence consumer, regulatory and political actions favorable to their anticompetitive practices and unfavorable to the ethanol industry.

As a result of these efforts, the term “ethanol” is now viewed less favorably by the people of this country than even the term “big oil,” which has long been the most unfavorably viewed industry.

So what options does the biofuel industry have? We do not have the wealth to compete with the massive public relations budgets of the dinosaur fuel industry. According to Mr. DenHerder, we can, however, learn how to more effectively communicate our wonderful story to our friends and neighbors as well as other consumers. While many consumers view the term “ethanol” unfavorably, they still view the term “biofuel” favorably, so we need to emphasize the fact that our product is a “biofuel.”

We also need to emphasize other attributes of our product that are important to the consumer. Highest on that list is that our biofuel can save them money. Typically, it can save them 30 to 40 cents per gallon. Claims that biofuels help rural economies doesn’t mean much to most consumers who live in urban areas. Consumers also respond well to the fact that our biofuel is also better for their lungs, their health and the environment.

Historically, the biggest problem with gasoline has been the lack of octane, which can cause damage to engines and also results in inefficient combustion and dirty exhausts. That is why all gas pumps are required to list the octane rating of the fuel. The dinosaur fuel industry has tried one toxic, dangerous compound after another. First it was a compound containing lead. Then it was MTBE. Now it is a combination of dangerous chemicals referred to as BTEX.

So, we also need to emphasize that our biofuel is also high octane and as such, is better for engines. Terms like BioOctane Fuel, Healthy Octane Fuel, Better Octane Fuel, or Safe Octane Fuel would be important to most consumers.

While the production of biofuels is vital in the reduction of terrorism, and the many ongoing conflicts associated with the control of oil supplies, that aspect doesn’t seem to be very important to most consumers. Emphasizing the fact that our biofuel is domestically produced seems to be much more effective.

Ben Dickman, Board Secretary

Production and Financial Information

The plant continues to operate well as we continue to improve upon efficiencies. We used 17.4 million bushels of grain (a decrease of 0.9% from the previous fiscal year) to produce 50.9 million gallons (an increase in 0.25% from the previous fiscal year). This resulted in a ethanol conversion yield of 2.92 gallons per bushel, which is an increase of 1.1%. For the fiscal year, we also had a sharp change in the percentage of corn versus sorghum that we used. Roughly 80% of our grain purchased for FY2017 was milo, and for FY2018 about 75% was corn. The difference was driven mainly by China's willingness to purchase a high proportion of the US sorghum crop at a premium to corn. This past fiscal year we also sold just over 340 thousand tons of wet distiller grains and 12 million pounds of distiller oil.

This year, we completed two projects that are key to keeping the plant operating well. This past spring we replaced our Distributed Control System (DCS). This is the "computer" system and related components that automates our process and allows us to operate the system via a computer. The major components of this system were original from when the plant started up in 2004, and the system was outdated and no longer supported by the manufacturer. The second project was to replace the three molecular sieve reactor bottles (see picture to the right). These reactors were also original equipment, and they are the key equipment required in the last step in dehydrating the ethanol. The new sieve bottles have a little higher capacity than the old system, which will give us a little more room for capacity increases with that part of the process. The operations group completed both projects on time, on budget, and with no unplanned impact to operations. Great job to all involved!

As I mentioned on the front page of the newsletter, the financial performance for this fiscal year was down considerably. This was mainly driven by over-supply of ethanol into the market, and higher than historical grain prices. Ethanol prices average \$0.135 per gallon lower than the previous year resulting in a reduction in revenue of \$6 million, while revenue from the other co-products was up \$1.25 million. Grain prices averaged \$0.42 per bushel higher, increasing grain expense by \$6.7 million. Ingredient costs and energy costs were both down by just over \$0.75 million for this fiscal over the previous fiscal year. Repair and maintenance expenses and administrative expenses were flat. The net of lower ethanol sales and higher grain expenses pushed EBIDTA values down by nearly 300%. Net income for the year was down by nearly \$12 million.

A copy of the audited financials in included on the following pages. In addition, the portion of the packet includes information regarding the estimated tax information for the calendar year 2018.