WESTERN PLAINS ENERGY

FUELING THE FUTURE

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February 2019 Newsletter

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The Quarterly Update

I wish I had better news to share, but the truth of the matter is that the margins in our industry continue to remain under significant pressure.

The crush margin is the difference in the price of ethanol compared to the price of grain, with the price of grain converted into equitable ethanol units. This metric is a pretty good indicator of the economic condition of the industry and our business as roughly 75% of our revenue is ethanol and roughly 75% of our expenses are grain. The crush margin has been negative for four of the last five months, and unfortunately I don't see much relief in sight for the near-term.

The core issue remains the same, over-supply of ethanol on the market. Each week the US Energy Information Administration (EIA) publishes the previous week's production, demand, and stocks information (see www.eia.gov) for items such as gasoline demand, ethanol production, and ethanol stocks as well as various other petroleum based energy metrics. The recent reports have indicatied that gasoline demand, which is a direct indicator of ethanol demand, has been riding around the 5-year average. Ethanol production has remained fairly strong. Unfortunately, ethanol exports are not reported in the weekly reports, which makes it difficult to determine a true composite balance. However, the EIA reports show that ethanol stocks continue to hover near historical highs, which indicates that production continues to outpace demand putting downward pressure on ethanol values in the marketplace.

There have been some announced shutdowns in the industry, and there is market chatter about other plants that have slowed down. Yet, we still haven't seen enough supply come off to allow ethanol pricing to perk up. Cash flow values for most of the industry continue to hover around zero, which is stifling the industry from further production rate cuts. This is prolonging the current situation. I see potentially two paths forward for the next few months. First, margins further deteriorate pushing additional plants into negative cash flows positions which should incentivize a reduction in production rates. Second, we typically see gasoline demand, and subsequently ethanol demand, pick up as we return to summer driving season. The bad news is that neither option is likely an immediate solution.

One positive note is that President Trump directed the EPA back in October to begin the rulemaking process to allow E15 to be sold year-around. The intent of the process is to be complete before June 1, 2019, and the process is now underway. It doesn't sound like this past government shutdown had a large impact on the timing, but the threat of an additional government shutdown could impact the timing. Getting this process complete should add additional demand during the summer months.

Did You Know:

- Drivers across the US have driven 7 billion miles on E15
- The EPA has approved the use of E15 in all 2001 and newer vehicles
- E15 typically sells for $0.05 to $0.10 less than regular 87 octane gasoline

The Bored Secretary Report

Drinking the Kool-Aid. This common expression is rooted in the infamous Jonestown Massacre that occurred 40 years ago. Jim Jones, the cult leader, orchestrated the murder and suicide of over 900 people on November 18, 1978. Many died after consuming a sweet drink laced with poison. Hence, the phrase "Drinking the Kool-Aid."

We have all drank our share of Kool-Aid during our lives. We believe information that is misleading or false and then, based on that belief, act in ways that pose a threat to our health or well-being.

The tobacco industry is a good example. For many years, they fed the public their brand of Kool-Aid extolling the benefits and image of using tobacco products. They failed to disclose, and even denied, the additive properties of nicotine and the long-term health risks associated with tobacco use.

The current opioid crisis is another example. For years, drug makers and distributors promoted the pain-relieving benefits of opioid based drugs to doctors and patients. They downplayed the addictive potential of the drugs and the long-term health risks. Now hundreds of people are dying each day as a result.

The champion Kool-Aid distributor, though, has to be the oil industry. A hundred years ago, they began blending tetraethyl lead in their gasoline to increase the octane level. For fifty years, they promoted the benefits of this additive while denying the long-term health risks. Finally, enough of the public quit drinking their Kool-Aid and "unleaded" gas was born. However, the lead was replaced with other dangerous chemicals commonly referred to as BTX (Benzene, Toluene and Xylene).

A recent publication by the Urban Air Initiative (UAI) documents the many adverse long-term health risks associated with the use of BTX which now comprises more than 20% of gasoline. The publication is titled "Beyond a Reasonable Doubt" and is available on the UAI website. The public continues to drink this Kool-Aid. There are no warning labels about BTX on gas pumps. Maybe they will again wake up some day and we will see "unBTX" gasoline for sale.

As bad as the lead and BTX issues are, the oil industry produces Kool-Aid on many other issues as well. Rural America seems to be especially susceptible to drinking the oil industry Kool-Aid. Oil products have been instrumental in mechanizing agriculture and eliminating much of the manual labor that was once required to grow crops. As a result, farms got larger and small rural towns got smaller, along with the local rural economies.

The oil industry has also been very effective in getting rural groups and associations to help distribute their Kool-Aid. This just perpetuates the decline of small rural communities and their economies. Most of the products produced by the oil industry can now be replaced sustainably and economically by products produced in rural America. Biofuels are but one example. The economic opportunities for rural areas could be transformative, not just for the health of the people, but the rural economy as well.

Rural America needs to quit drinking the oil industry Kool-Aid. It is killing us, both physically and economically.

Ben Dickman, Board Secretary

What is Gasoline?

Gasoline is a colorless, pale brown or pink liquid, and is very flammable. Gasoline is a manufactured mixture that does not exist naturally in the environment. Gasoline is produced from petroleum in the refining process. Typically, gasoline contains more than 150 chemicals, including small amounts of benzene, toluene, xylene, and sometimes lead. How the gasoline is made determines which chemicals are present in the gasoline mixture and how much of each is present. The actual composition varies with the source of the crude petroleum, the manufacturer, and the time of year.

Source: https://www.atsdr.cdc.gov/substances/toxsubstance.asp?toxid=83

Financial Review

The unaudited financials for the quarter ended December 31 are included in this newsletter. For the quarter, we had a increase in ethanol production of 5.3% over the same quarter the year previous. Total grain grind saw a very similar increase, with essentially the same denatured ethanol yield for the two quarters.

Revenue from ethanol sales were up by 0.8% over the same quarter last fiscal year. The average Chicago cash price for ethanol was $1.25, and the average Los Angeles cash price for ethanol was $1.42 for the latest quarter. This is compared to $1.38 for Chicago and $1.53 for California for the same quarter last fiscal year. WPE ships most of our ethanol to California, Colorado, and Kansas. For the first quarter in this fiscal year, we shipped roughly 13% more ethanol to California than the previous year. Revenue for distiller products was up nearly $0.5 million, contributing to an overall increase in total revenue of more than $300 thousand.

Expenses toward the total cost of goods sold was up by 5.8%. Grain expenses were the largest contributor. CME grain costs for the first fiscal quarter of 2019 averaged $3.70 compared to $3.46 for the same quarter the previous fiscal year. Based on an average of 4.5 million bushels of grind per quarter, this $0.24 difference in CME market price equates to an increase in grain costs of just over $1 million. Energy expenses were also up for this past quarter compared to the previous year's quarter. CME natural gas costs averaged $3.72 per mmBTU compared to $2.91 per mmBTU for the first quarter for the previous fiscal year. WPE's energy costs were up 31% from the previous year, despite natural gas usage being slightly down.

EBIDTA for this fiscal quarter remained positive but was down by more than 70% from the previous year's first quarter. Net income for the quarter was a disappointing negative net income.

Important Information

The annual WPE shareholder meeting will be held March 28 at 6:30pm at the Oakley Country Club.

Proxy information about the meeting will be sent out February 15. The information will include a proxy ballot, which must be received back no later than March 25.