

MAY 15, 2006

FINANCE

Drunk On Ethanol

Producers are riding a boom, but the market may be as tricky as oil

Andersons Inc. ([ANDE](#)) used to manage grain silos, lease rail cars, and run a few home stores from its rural Ohio headquarters. Now it's an ethanol play. In the past year it has invested \$36 million for minority stakes in three plants that will produce the fuel, which can be made from a variety of plant materials including corn, Andersons' speciality. Its share price has shot up from 30 to 122 during that time, adding more than \$700 million to the company's market value.

Welcome to the ethanol boom, the closest America's farmers may get to an investment bubble. Since the pro-ethanol State of the Union address in January, shares of Fresno-based Pacific Ethanol Inc. ([PEIX](#)) have doubled, to 37. Green Plains Renewable Energy has risen 40%, to 46, since it began trading in March.

But ethanol is far from the sure moneymaker its boosters say it is. In fact, some of the very forces behind the boom might undermine ethanol's prospects as an investment over the next few years.

The fuel, renewable and more environmentally friendly than gasoline, is already being used as a gas additive, replacing another additive that was found to pollute groundwater. The result: a squeeze on supplies that has doubled ethanol's wholesale price, to \$2.75 a gallon, about what gasoline costs at wholesale. With corn prices low and gas prices high, ethanol's profit margin per gallon is at a record of more than \$1. "You don't need Willie Nelson organizing concerts for these farmers," jokes Tom Kloza, an analyst for the Oil Price Information Service.

Last year's energy bill requires gas marketers to sell at least 4 billion gallons of ethanol-blended fuel this year, rising to 7.5 billion gallons by 2012. That sparked a surge of investment. In April, Goldman Sachs ([GS](#)) Group took a \$26.8 million stake in Canadian outfit Iogen Corp. Archer Daniels Midland Co. ([ADM](#)), meanwhile, tapped Patricia Woertz, a career oil woman (page 38), as its new CEO. Two U.S. companies recently filed for initial public offerings to finance more plants, while Spanish energy company Abengoa and Connecticut private-equity firm J.H. Whitney & Co. raised almost \$300 million to do so.

SURPLUS AHEAD?

But all the new money might create an ethanol glut. On Apr. 11, California projected that U.S. capacity required by 2009 would be online in under a year. Since that projection, at least four more companies have announced plans to build plants. That's because a typical 50-million-gallon-a-year plant costs just \$75 million or so to build, with banks willing to lend up to 70% of the cost, says Tom Murray, co-head of loan and debt capital markets at German bank WestLB. A new gasoline refinery costs \$1 billion or more.

Investors in ethanol plants will find themselves at the mercy of two commodity cycles: corn and gas. According to simulations run by the University of Missouri's Food & Agriculture Policy Research Institute, corn prices over the next six years are likely to rise and ethanol prices to fall, resulting in a 25% or more drop in producers' profits. "The industry has outstripped our expectations and grown a lot faster than we thought," says institute program director Patrick Westhoff.

What of the promise of ethanol replacing gas? Don't count on it. General Motors Corp. ([GM](#)) and Ford Motor Co. ([F](#)) have made a push this year to promote vehicles that can run on gas or E85, a fuel that's 85% ethanol and 15% gasoline. But E85 gets worse mileage than gas, a problem if ethanol is costlier. And right now there are only about 600 E85 pumps nationwide.

Ethanol's fans say the fuel is a blessing in this time of high gas prices and global warming. But energy is a cyclical business. Prospecting in the cornfield might prove as risky as prospecting in an oil field.

By Christopher Palmeri and Aaron Pressman

[Advertising](#) | [Special Sections](#) | [MarketPlace](#) | [Knowledge Centers](#)

[Terms of Use](#) | [Privacy Notice](#) | [Ethics Code](#) | [Contact Us](#)

The McGraw-Hill Companies

Copyright 2000- 2006 by The McGraw-Hill Companies Inc.
All rights reserved.