INNOVATIVE BUSINESS MODELS FOR RURAL AMERICA

Presented to:

Agricultural Outlook Forum 2008

February 21-22, 2008

Crystal Gateway Marriott
1700 Jefferson Davis Highway
Arlington, Virginia

Presented by:

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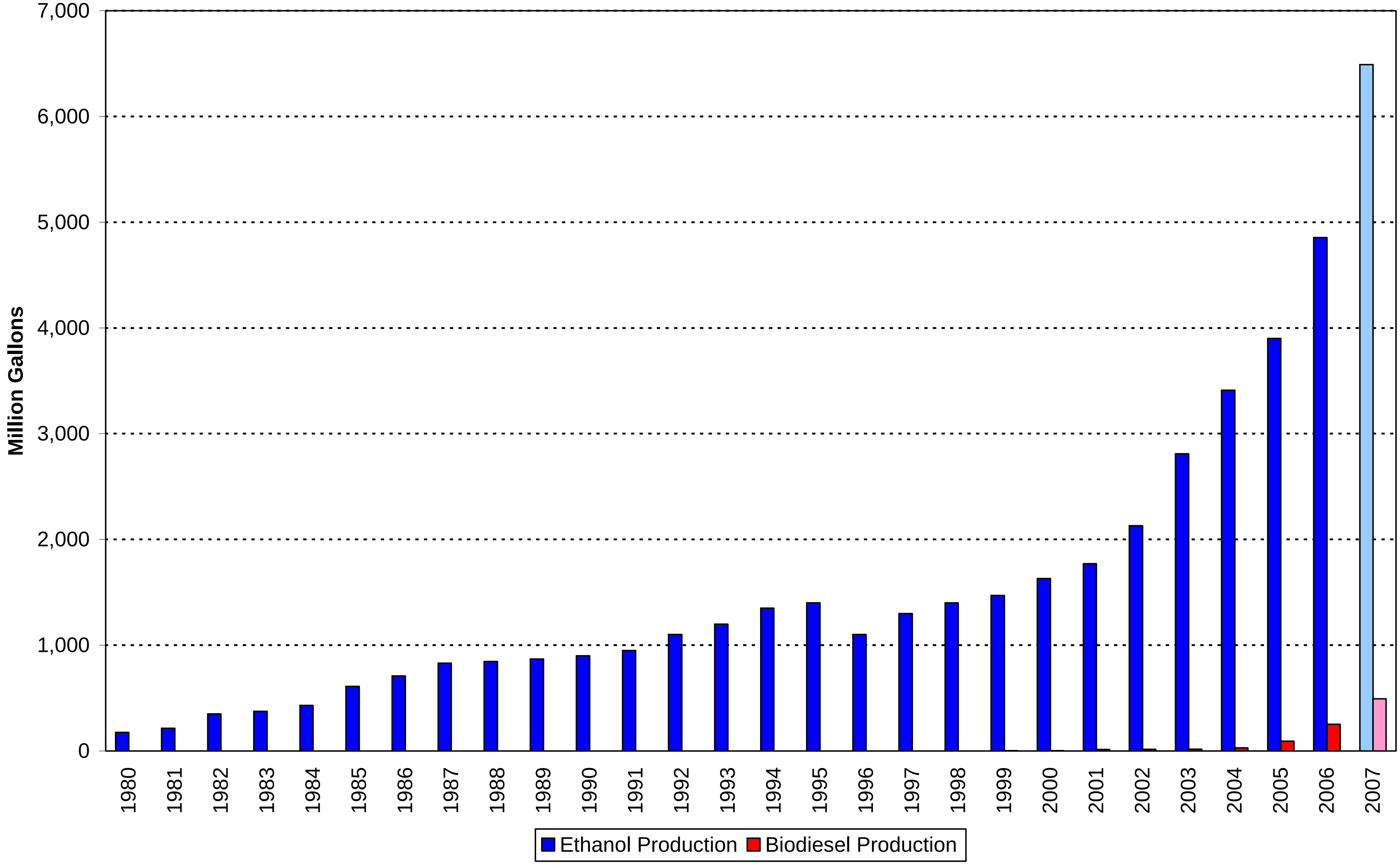
informa economics
an AGRA informa company

The Premise

- Growth of renewable fuels industry has been the most substantial change in agriculture/rural economy in at least a generation
  - Extensive participation by farmers and other rural investors
    - 37% of ethanol industry capacity in late 2006
    - Participated less in recent building boom
- Key Questions
  - What business models are in use in the renewable fuels industry?
  - What are their advantages and disadvantages?
  - What are the implications for other value-added agriculture industries, as well as other rural industries, especially emerging ones?

Growth of the U.S. Ethanol and Biodiesel Industries



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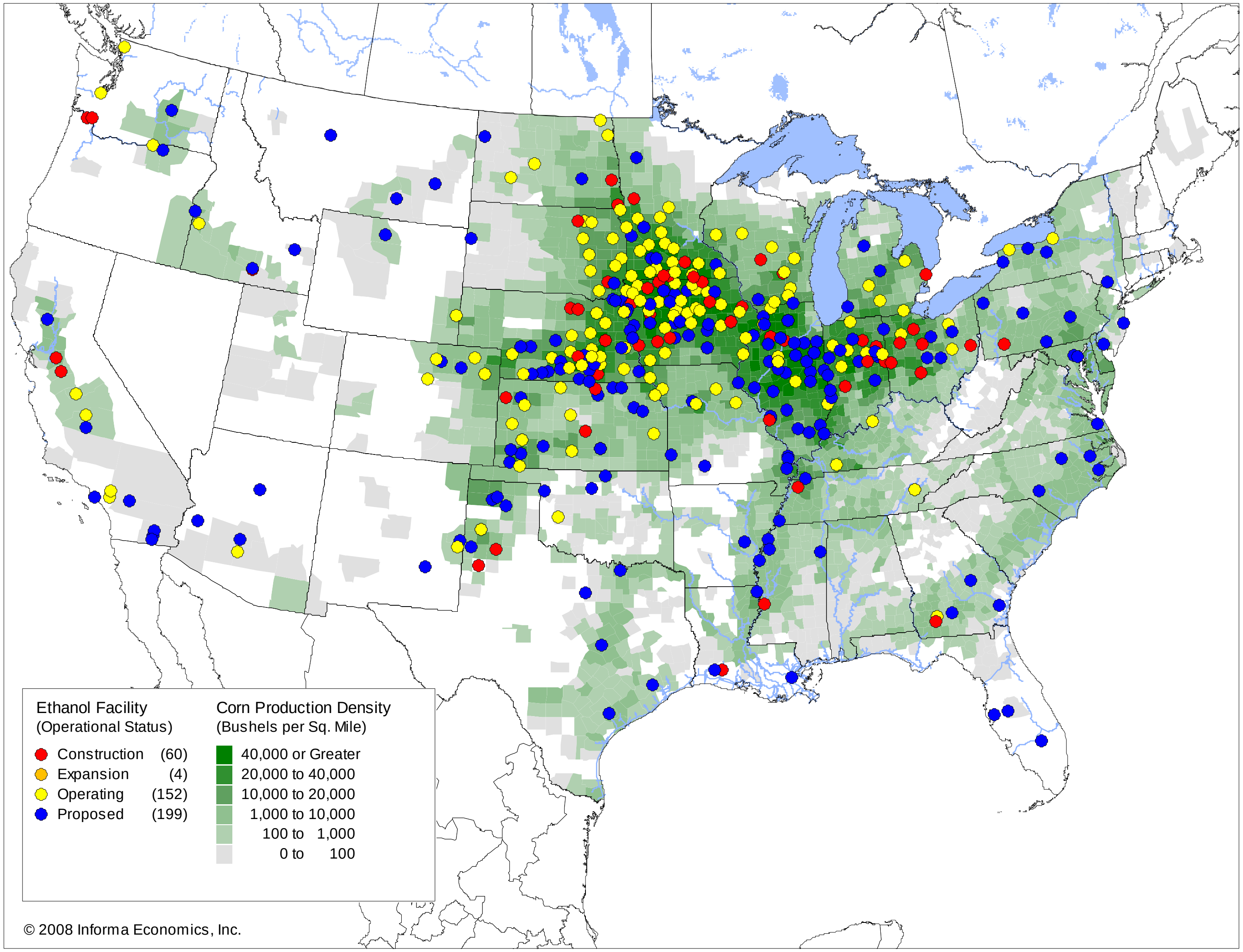
Sources: USDA & DOE (History); Informa Economics (2007 Estimate)

Geography of the U.S. Ethanol Industry



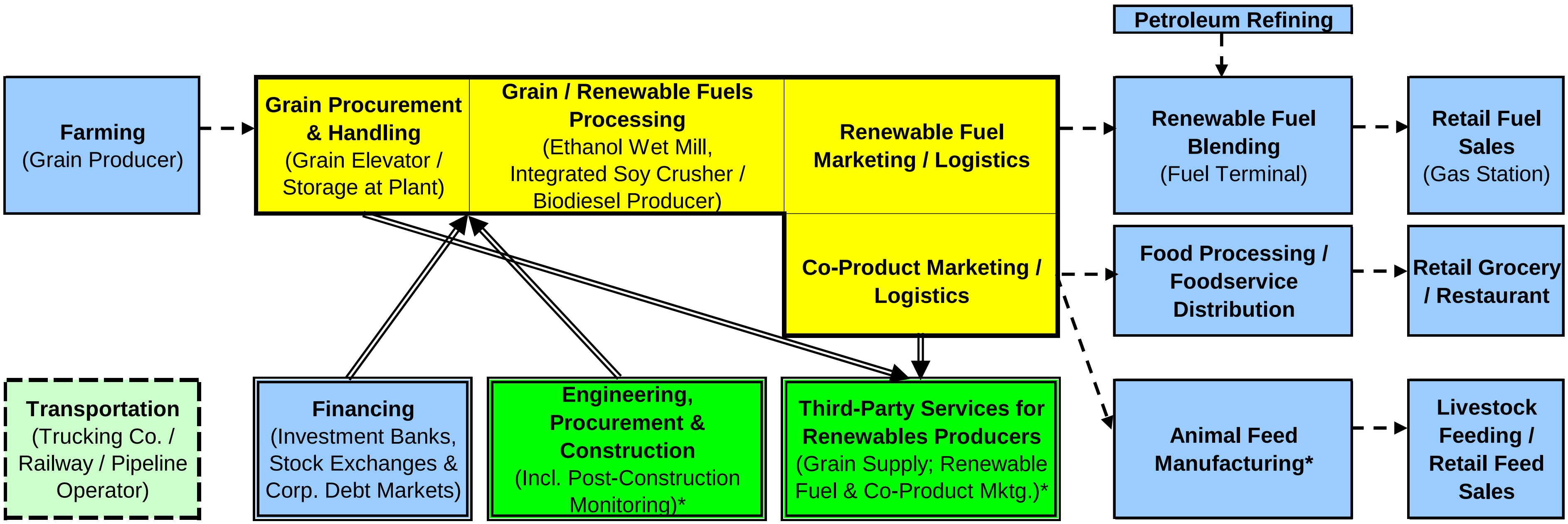
Sources: Renewable Fuels Association & Informa Economics (Current & Construction); Informa Economics (Proposed)

Four Main Business Models

- "Corporate" Business Model. Producer is a corporation or a subsidiary. Internal staff manages plant, feedstock procurement, renewable fuels marketing and co-product marketing.
- "Farmer-Owned" Business Model. Farmers have majority ownership in the facility and have feedstock delivery obligations (mainly corn for ethanol). Often, third-party service providers market the output.
- "Engineer/Builder-Owned" Business Model. Design/build firms own facilities or retain a significant ownership interest, allowing a degree of control over management. Ownership in multiple facilities gives scale to have internal staff procure feedstock and market output.
- "Franchise" Business Model. Organization is not vertically integrated; depends on service providers to link to other levels of the supply chain, including feedstock procurement and product marketing.

Corporate Business Model

(Wet-Mill Ethanol Producers, Biodiesel Producers with Integrated Crushing)



Key:

- Renewable Fuel Producer
- Transportation/Physical Commodity Flow
- Third Party
- Services Provided

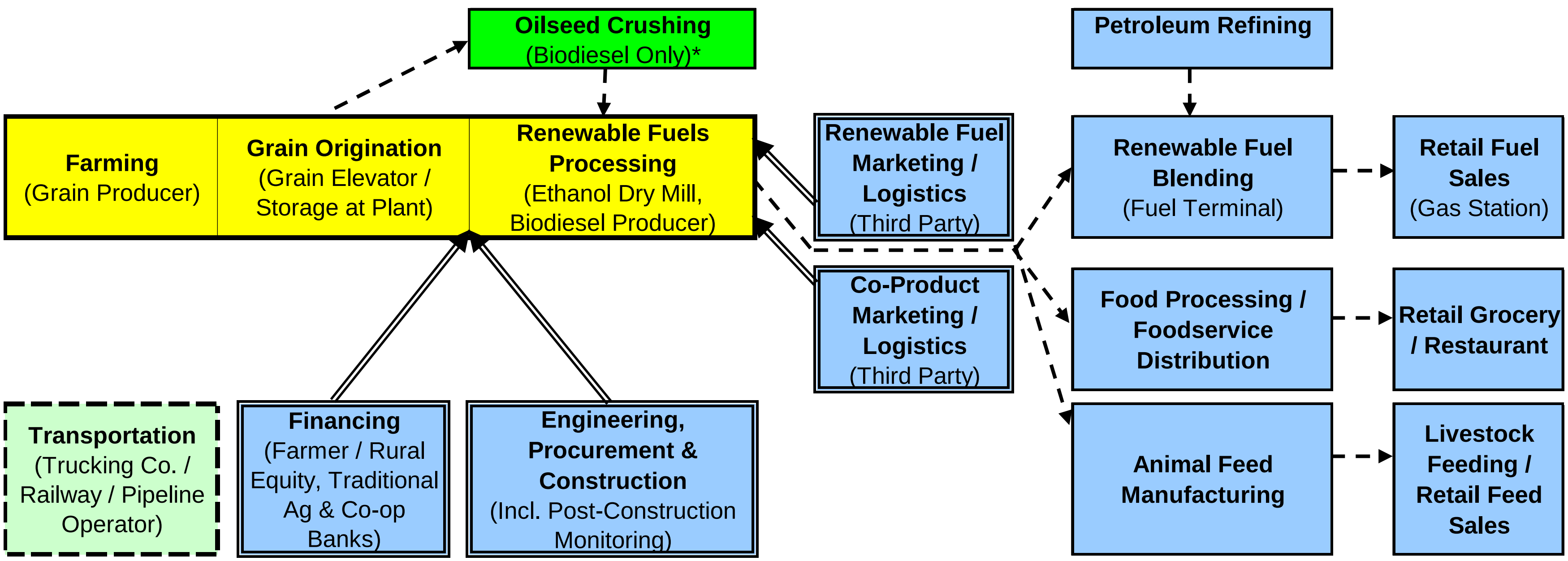
Notes:

* Indicates internal function at limited number of renewable fuel producers.

Glycerin not depicted since raw glycerin is a small part of the revenue stream for biodiesel producers.

Farmer-Owned Business Model

(Mainly Dry-Mill Ethanol Producers, Some Biodiesel Producers)



Key:

Renewable Fuel Producer

Transportation/Physical Commodity Flow

Third Party

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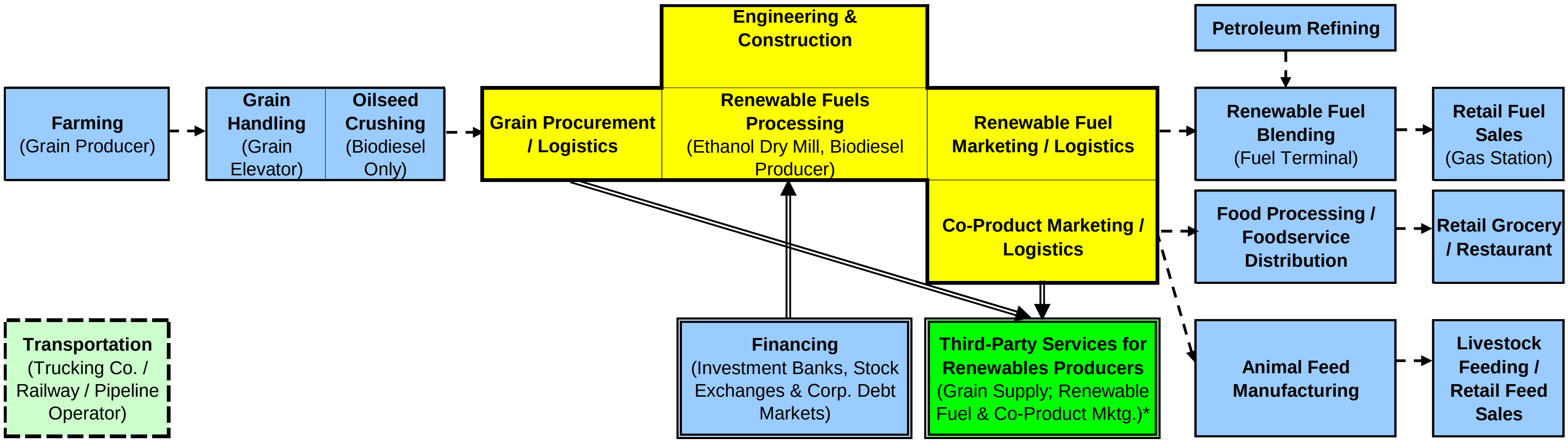
Engineer/Builder-Owned Business Model

(Mainly Dry-Mill Ethanol Producers, Biodiesel Consortium)



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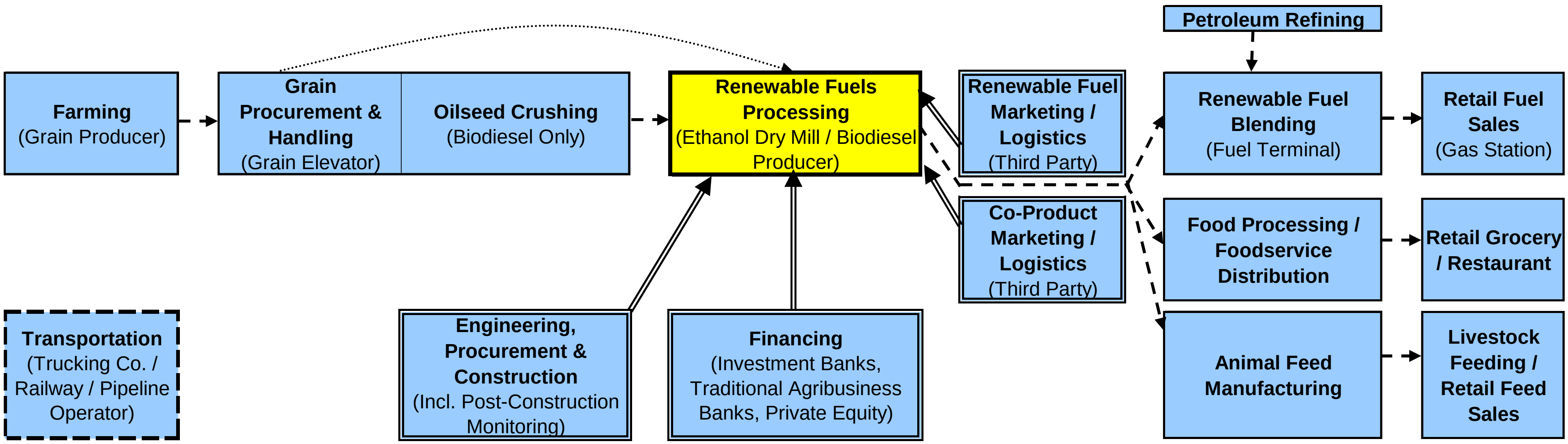
Franchise Business Model

(Dry-Mill Ethanol Producers and Biodiesel Producers, Especially Those Owned by Financial Investors)



Key:

Renewable Fuel Producer

Transportation/Physical Commodity Flow

Third Party

Services Provided

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Six Categories of Legal Structures

- Sole proprietorship (rare among renewable fuel producers, except perhaps small biodiesel companies)
- Partnership
  - General partnership
  - Limited partnership (LP)
- Corporation
  - Non-profit
  - For profit
    - C corporation
    - S corporation
- Traditional cooperative
  - Marketing
  - Supply
  - Service
  - Education
- New generation cooperative
- Limited liability company (LLC)

Advantages/Disadvantages

Structure	Main Advantages	Main Disadvantages
Cooperative	•Link to grain supplies •Earnings taxed once	•Might limit equity from non-farmers •Farmers have limited liquid assets; can require large number of members •Share illiquidity (closed co-op)
Limited Liability Company	•Flexible business structure •Equity from range of investors •Earnings taxed once •Limited legal liability	•Lacks link to grain supply, but can overcome by having co-op be investor •Costly compliance with reporting standards if >500 investors
Limited Partnership	•Equity from range of investors •Management via general partner can be streamlined •Earnings taxed once •Limited legal liability	•Lacks link to grain supply, but can overcome by having co-op be investor •Might be limited to accredited investors
C Corporation	•Main advantage: equity can be traded on public exchange •Tend to be large organizations with favorable access to capital •Can use equity for acquisitions	•Main disadvantage: earnings are taxed twice •Public reporting and compliance are costly

Which Business Model Is Right for a New Entrant to the Industry?

Right Model = ***f*** (Ownership, Size, Financing, Market Position)

- Examples
  - Ownership/legal structure
    - Co-op advisable only if significant proportion of equity is from farmers; otherwise a third-party feedstock supply agreement might be advisable
    - C corporation advisable only when the company has critical mass and reason to go public now or in the future
  - Size
    - In most cases, it would not be cost-efficient or effective for a new company with a single 50-million-gallon-per-year plant to market its own ethanol
  - Financing
    - Lenders & debt holders tend to prefer that new companies use third-party suppliers & marketers that have substantial market presence & balance sheets
  - Market position
    - New facility in the Corn Belt has higher probability of being able to hire an experienced grain buyer locally

Implications for Emerging Rural Industries

- For some industries, “virtual integration” is appropriate and is an alternative to vertical integration
- Legal structures have the same advantages and disadvantages in other industries as in biofuels
- Farmers and other rural investors have assets (*especially these days!*) and can contribute vital business inputs, but raising equity from them can take time and can involve a number of participants
  - Challenge: land accounts for large majority of an average farmer’s net worth
- There are still opportunities to succeed by having ingenuity in developing new business models and adapting them over time!

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