



Ethanol's popularity wanes amid rising food prices

By David Mercer, The Associated Press

CHAMPAIGN, Ill. — Not long ago, the fledgling ethanol industry was the darling of investors, farmers, the federal government and a lot of Americans who liked the idea of turning corn into fuel.

Suddenly, it doesn't have nearly as many friends.

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Rising global food prices and shortages have spurred calls in Congress to roll back the federal mandate to blend more ethanol and other biofuels with the gasoline supply. Critics say so much corn is being used for ethanol that there's less available for people and animals to eat, raising prices of everything from tortillas to meat.

What's more, investors aren't seeing the returns they'd hoped for as once-record profits began to fall.

"Consumers are starting to get restless, and Washington is starting to listen," said Morningstar analyst Ann Gilpin, who follows Decatur, Ill.-based Archer Daniels Midland ([ADM](#)), the No. 2 U.S. ethanol producer.

The ethanol market would be severely limited if Congress rolled back the mandate for annual increases in the amount of biofuels added to the fuel supply — 9 billion gallons by the end of this year, increasing to 36 billion by 2022.

That would most hurt companies that rely exclusively or primarily on ethanol, which include small, often locally owned distillers — already under pressure since ethanol prices fell and corn prices rose sharply — as well as larger publicly traded firms such as VeraSun Energy ([VSE](#)), the largest ethanol producer.

"If you sell one product and the only reason there's a market for it is because the government makes a law requiring consumption — if that law goes away, obviously you're in trouble," Gilpin said.

The odds of Congress changing that mandate this year are slim because the 10 states that produce more than 80% of U.S. ethanol have almost half of the 270 electoral votes needed to win a presidential election, said analyst Kevin Book of Friedman Billings Ramsey.

After the election, sentiment may change. Congress took a mild swipe at ethanol in the new farm bill, shaving a tax credit for refiners that blend ethanol into gasoline from 51 cents to 45 cents. President Bush vetoed the bill Wednesday but the House already voted to override the veto and the Senate is expected to do so Thursday.

Ethanol loses market favor

Investor disappointment also is weighing on ethanol-only companies, particularly smaller and privately held businesses, says Rick Kment, an ethanol-industry analyst for agricultural data company DTN.

He said much of the public and private investment was made when profits were as high as \$2 a gallon. "It is very unlikely we will see that kind of profit again."

Shares of Brookings, S.D.-based VeraSun have fallen more than 15% since April 1, and Pacific Ethanol ([PEIX](#)), another major maker, has fallen about 30% in the same period.

After VeraSun posted first-quarter profits last week that fell short of expectations, some analysts raised worries about the industry.

"We remain cautious on the entire sector as we expect sustained higher corn and natural gas prices with little relief in sight," Calyon Securities' George Kotzias wrote in a note to investors.

VeraSun officials did not return a call seeking comment.

On the other hand, analysts say ethanol producers such as ADM, which distill it as one of many businesses, appear better positioned.

ADM doesn't break out the profit it makes from ethanol, but the unit that includes those operations accounted for about 20% of earnings last year. In the most recent quarter, when profit in that unit fell by almost a third, companywide profit increased 42%. At the time, ADM called the volatility in the quarter "unprecedented" as corn prices set a record above \$6 a bushel. But CEO Patricia Woertz said retreating from biofuels would be a mistake. ADM said Tuesday that the company had no further comment.

Ironically, the turmoil about ethanol has grown even as some industry vital signs have stabilized.

Corn has eased back a bit. Ethanol sells for more than it did last year, but at 60 cents to 70 cents a gallon less than wholesale gas, it's still cheap enough to be an attractive option for refiners looking to make oil go further, Kment says. And demand is steady.

Food price drop would help

ADM Executive Vice President John Rice believes pressure on the industry would ease with a drop in food prices.

"I think globally, it'd be very good to have a large corn crop and a large oil seed crop," he told analysts at a conference last week. "I think it would eliminate some of this debate, the food vs. fuel."

Ethanol companies have gone on a public relations campaign the past few weeks, citing studies that raise doubts about the degree to which ethanol is affecting food prices. They also argue that gasoline blended with a small amount of ethanol is saving drivers money.

"Consumers today who are filling up with the blended fuel are saving somewhere around a dime (a gallon)," said Matt Hartwig, a spokesman for the Renewable Fuels Association, an industry lobbying group.

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