Summary & Analysis of March 17 & 18, 2008
Pro Exporter Outlook Meeting in Kansas City, MO

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PRC Update: Pro Exporter's lead feed grain analyst expects China to import corn during '08/09 amid dwindling grain stocks, increasing livestock production and belief that large gains in feed efficiency through greater use of protein will require proportional gains in grain feeding to sustain gains in domestic meat production. PRC milk consumption, which from 2002 to 2006 increased 160%, continues to expand rapidly along with demand for eggs and aquatic foods. Widening gap between urban and rural incomes is forcing leadership (who are well aware that government overthrows are historically driven by rural interests) to be more proactive in promoting rural infrastructure and development. And while approval of new ethanol plants has stopped, PRC analysts noted that a large portion of China's ethanol output is being converted into drinking alcohol. Pro Exporter's PRC expert noted that pace of PRC food imports is unlikely to subside either before or after the Olympics. Additionally, environment problems are worsening amid rapid urban/industrial development with top leadership worried about impact of climate change on China's capacity to product food. And finally, Pro Exporter analysts are optimistic on long term outlook for further gains in PRC per capita veg oil consumption which in 2007 is still 34% less than Taiwan's. Pro Exporter expects a nearly 12% gain in '08 PRC veg oil consumption.

Keith Collins: In his 1st public appearance since retiring as USDA's chief economist, Mr. Collins told the nearly 400 attendees that the US livestock sector will bear the brunt of cutting corn usage. Look for US food industry to join forces with livestock feeders in applying more pressure on Congress to roll back the ethanol mandate. Regarding '08 US crop area, Collins noted that '07 US all crop area was 13 mil acres less than '96 total crop area of 333 mil acres. With '08 net returns/acre over variable costs $75/$145/$150 acre above '07 for corn/soybeans/wheat respectively it is reasonable to assume that at least a portion of this 13 mil acres will be pulled back into production. Collins further noted that between 2008 and 2012, another 19.7 mil acres of CRP ground (on top of the 2.6 mil expiring acres in the fall of '07) will become available if no new signups are offered. USDA, which has underestimated US food inflation in each of the four years, is likely to do so again in '08 (their current forecast is only 3.5% with actual Jan '08 US food inflation up 4.9%.) Collins expects per capita meat consumption to decline as meat prices advance although total US food consumption will continue to advance given its low income elasticity of demand. Nonetheless, high consumer debt, higher energy costs, mortgage refis, and limited use of home equity will collectively dampen growth in US meat consumption helping to bring use in line with lower meat supplies. On the export front, Collins remains optimistic that strong income growth in developing countries will fuel ongoing gains in US meat and corn exports while Brazil captures majority of gain soy complex trade. There is a risk that a protracted slowdown in OECD GDP will impact emerging nation growth in high protein foods. Remember that emerging nations GDP is small relative to the US. Nonetheless, Collins is optimistic about continued growth in US grain exports amid shortage of arable land in production and the growing interdependence of developing countries among themselves.

Cellulosic perspective: Collins, along with the EIA, does not believe the 16 bil gallon cellulosic mandate by 2022 will be met. He notes that to do so would require 640 plants with annual capacity of 25 mgy (DOE's optimal plant size). There are only 135 US corn ethanol plants today. Pro Exporter concurred by noting that there is not enough US crop land for both cellulosic and food/feed crops as all land will compete with other land for the best economic return. The market knows that the world does not have enough oilseeds or wheat to burn for fuel (witness recent record soybean/wheat prices) and that only a limited amount of US land exists for converting corn to ethanol (with 15 bil gallons viewed as current upside limit). Hudson used the word **"myth"** to characterize Washington/Green view that cellulosic ethanol is independent of food and the sooner our nation's leaders level with the American people on this reality the better. Additionally, Hudson stated that "*food and feed will outbid fuel for land"*! Nonetheless, pressure on Washington to "do something" on both climate change and energy independence is enormous given 6 fold revenue gain flowing to OPEC coffers from early in decade to 2007 ('07 OPEC revenue averaged $490 bil/quarter vs. only $70 bil/quarter from 2000-2003).

Hudson talking points: In a marked change from prior meetings, Pro Exporter's founder raised possibility that 160 years of relatively cheap food prices is over. Linkage of fuel and food markets raises odds that gains in crop land and productivity may not keep pace with demand. Clearly, in the short term, corn supply will be challenged to match ethanol demand growth with US ethanol capacity reaching 11.5 bil gallons on the end of August vs. approximately 8 bil gallons today. Even Dr. Collins noted that the US is in the steepest part of the demand growth curve for ethanol with little price relief until expanding crop area and yields pushes production higher than gains in ethanol usage several years out. Hudson supported Collin's observation by stating that the current ramp-up in US fuel ethanol use (25%/year) is faster in slope than the ramp up in US corn exports in the 70's with total US corn demand for ethanol about to exceed the demand for global trade in corn. Meanwhile, the topping out of US soybean planted area since 2002 along with an average gain in global soybean use of 10 mmt/year is in Hudson's words "*making the US soybean balance table unsolvable"*. Growth in global oilseed demand was characterized by Dr. Collins as "*amazing*" (global soybean use has expanded 156% since 1998) with strong soybean demand growth "*likely to continue"*. Pro Exporter forecasts a 70 mmt gain in global soybean demand over the next decade that will require Brazil to increase soybean planted area 55% (30 mmt) to offset the likely 10 mil acre loss in US soybean area due to increasing ethanol mandates. High producer debt, lack of credit, poor transportation infrastructure and a strong Real will collectively limit Brazil's ability to expand into the 338 mil acres of potential crop area increasingly under the eye of environmentalists.

Long term S/D: Hudson's **"Blue Sky"** 10 year model which cranks in a host of assumptions on US corn supply/demand, energy prices and other variables, concludes that with typical yield variability that US corn prices will average between $5.00 and $6.00 through 2018. US corn used for ethanol will advance from 3.981 bil bu in '08/09 (vs. USDA's 4.100 bil bu forecast) to nearly 5.6 bil bu by 2017/2018 under the assumption that ethanol plant returns (including debt service) are only 9-15 cents/gallon—essentially a break even proposition that will act as a break on expanding corn use for ethanol. Pro Exporter's long term soybean balance tables—like USDA's baseline forecasts, keep ending US soybean stocks at 150 mil bu through 9/2018 with the pressing need to export more meal and import soy oil amid steadily increasing bio-diesel mandate. Bio-diesel characterized as a "*bad story getting worse"* with need for 30 cent soy oil before industry returns to profitability. Pro Exporter expects most of gain in US DDG production to be fed with corn displaced by DDG for feeding swelling to 1.7 bil bu by 2018 vs. 750 mil bu during ‘07/08.

Ethanol plant construction update: Pro Exporter notes that only 10 additional ethanol plants with 100 mgy capacities are needed to meet the 15 mil gallon corn ethanol mandate. They note that project equity is harder to source although foreign based capital is still looking for attractive US ethanol plant investments. There are nine US projects on hold but another 140 products that are in initial sages of securing permits. An incredible 5 bil gallons of ethanol capacity will be added in ’08 although most projects are running 30-60 days late on completion. The US ethanol industry will be more prone to mergers as high corn prices squeeze margins, which makes risk management and procurement execution even more critical. Older ethanol plants that have paid down debt are putting up more storage ($4.00/bu) or buying up neighboring country elevators to enhance grain origination capabilities. With attractive margins—many plants capable of operating at 110% of broiler plate capacity although long term outlook for tight ethanol margins appears likely amid enormous job over next year of absorbing higher US ethanol production via greater penetration of US gasoline market.

Carbon becoming King: Pro exporter warned clients to expect more regulation and higher taxes for energy users/producers and farmers. Large bureaucracy to calculate green house emissions and impact of land use conversion on global warming via life cycle analysis is virtually assured. Trade off between Greens focused on green house gasses and global warming skeptics more concerned about strategic competitiveness will set off a vigorous national debate. Democrats, for starters, in the next Congress will insist that polluters buy carbon credits. Look for more proposals to estimate carbon stocks on various types of land—especially in developing countries that continue to place development priorities ahead of environmental concerns.

Pro Exporter ’08/09 US S/D: Pro Exporters lead grain analyst projected ’08 US acreage for CN/BN/WHT at 89.040/69.0/61.4 mil acres respectively prompting ’09 carryouts of 1.3/0.155/0.369 bil bu respectively. Pro Exporter noted that USDA’s Outlook forum understated March corn intentions in 5 of the last 7 years with ’07 being an obvious exception as USDA’s 3/30/07 crop report reported US corn area nearly 3.5 mil acres over the Feb Forum forecast. Weather will be a key driver on final corn area given strong relationship between early planting and gains in March to Final US corn acres. Nitrogen fertilizer, of which 62% was imported into the US in 2006, was repeatedly mentioned by attendees in fringe areas as a catalyst for switching back to soybeans in ’08. Both Tierney and Hudson believe that it will be difficult for soybean production growth globally over next 5 years to match demand thus putting soy complex a lead market that will influence everything from corn prices to ethanol margins. And although Tierney could accept unprecedented risk premium in current corn price on historic price vs. stocks scatter charts, he was adamant that nothing could justify new crop CGO wheat over $10.00 given prospects for modest rebound in ‘08/09 US and world wheat stocks.

Wrap Up: This highly respected analytical team, which was spot- on at their 12/07 outlook meeting in Chicago, conveyed a decidedly bullish outlook for row crop prices. We don’t know where commodity fund liquidation will bottom out, but the bullish backdrop of corn ethanol demand growth over-running supply gains, ongoing strong growth in global protein demand and Washington’s blind eye to escalating food inflation to save the planet will once again resonate with specs and end users after the spec bubble has eased. The importance of trend or higher ’08 US/PRC yields was repeatedly mentioned as a wild card with Washington policy makers apparently unaware that 6-8% (and climbing) of the nations fuel supply will be dependent on corn belt weather. Skepticism over cellulosic ethanol is building at each winter outlook meeting I attend which simply places more burden on corn ethanol as the poster child for Washington’s drive to energy independence. Beware of high risk associated with the March 31 crop report which along with outside financial pressures could spark additional liquidation before weather assumes center stage early next month.