

Summary and Analysis of Pro-Exporter Meeting in Chicago, IL – December 9, 2007 Rich Feltes – MF Global Research 12/12/07

Corn vs. Cellulosic ethanol: Hudson outlined flaws in landmark 2005 USDOE/USDA study promoting feasibility by 2050 of 1.364 mil tons of biomass for conversion to ethanol. Congressional preoccupation with cellulosic ethanol and their willingness to extend lavish incentives to this so called “next generation feedstock” for ethanol are clearly on shaky ground. Specifically, the DOE study assumes that switch grass and other cellulosic crops will be planted on 60 mil acres of US crop land already in use for food and feed crops. This is a laughable assumption given surge in grain/oilseed markets that will not relinquish acres to much lower returns from cellulosic crops. Hudson exposed additional absurdities in this largely engineer authored study while concluding that cellulosic crops over the long term will be relegated to niche market status at best in the lower latitudes of the US or in environmentally sensitive areas of the Midwest. Nonetheless, there are enough starry eyed members of Congress pushing for alternative feedstocks for ethanol that corn—for the time being—has lost the war to cellulosic feedstocks. Speakers urged USDA economists, who have historically been pre-occupied with Farm Bill analysis, to become more pro-active in generating ag oriented economic analysis to the cellulosic debate which has by default landed in the lap of the DOE. Hudson went on to outline a scenario wherein by 2015/16 US corn used for ethanol will advance to 5.5 bil bu producing 16 bil gal of ethanol and 36 mmt of DDGs. Hudson pegs ‘07/08 US corn ethanol use at 3.010 bil bu (190 mil bu below USDA) yielding 18.3 mmt of DDG. As a final note—Hudson demonstrated convincingly that if Congress mandates cellulosic ethanol that corn cobs offer the best potential for conversion to ethanol. But even corn cobs will have difficulty catching up with the enormous lead that corn grain alone has as the most economically viable US source for ethanol.

Production Talk: Hudson views practical top in combined US CN/BN acreage at 157 mil acres and termed it a “*constraint to production*”. ‘07 US combined acres of corn and soybeans were 157 mil acres—up over 7 mil from ‘06 and the highest combined US CN/BN total planted area since the mid 70’s. Thus row crop prices will be forced to advance further to draw acres away from cotton, pasture and other crops. Specifically, soybean prices in particular must achieve a price high enough to pull Brazilian acres away from sugar, cotton and corn over the next several years.. Additionally, despite increase in US corn planted to triple stack varieties, Hudson noted that Dakota/NE/KS corn yield trend growth since 1997 has fallen below 1973-2004 trend growth suggesting that rainfall (which is more variable across the plains) is still a key determinant of corn yield. Nonetheless, the aggregate US corn yield appears to be advancing at 1.86%/year which suggests a 2015 US corn yield in 176-178 BPA area vs. USDA’s Nov ‘07 yield of 153 BPA. Hudson cautiously embraces Monsanto expectations for a 289 US corn yield by 2030 which assumes a 2.5% annual growth in US corn yield driven by marker

assisted breeding. Interesting to note that Hudson's 10 year corn balance table projections indicate sub 1.0 bil bu US corn carry outs from Sept 2012 through Sept 2016 even with 90 mil plus corn acres—an item that will not be overlooked by index fund managers.

EPA as “Lead Dog” Recent Supreme Court ruling chiding EPA for not being pro active enough regulating air quality via regulation of pollutants that “*may contribute to pollution or endanger public health or welfare*” has effectively ended the debate on Global Warming. The Supreme Court has sided with the Greens! This landmark decision forced President Bush to issue an executive order directing US agencies to cooperate in the formulation and issuance of rules by late 2008 that will regulate fuel emissions and vehicle regulations. Hence, look for more active interest in E-15 and E-20 (possibly implemented by 2011), more emphasis on cellulose and carbon trading legislation. These initiatives will impact US production agriculture by 2012. Pro Exporter's lead Washington analyst underscored that EPA will lead the charge on lowering carbon emissions if the Congress fails to act via the energy bill.

Pro Exporter on Crude Prices: Hudson, while acknowledging unpredictable nature of price discovery process in crude oil, expressed bearish outlook given Oct/Nov decline in US gasoline use vs. '06, prospects for a Democratic US President in '09 and reduction of risk premium amid intelligence reports of Iran halting nuclear weapons development. Hudson's mid November '07 update of his 10 year “Blue Sky Model” assumes \$65-75 average crude oil prices and ethanol plant returns just above breakeven at 0-20 cents/gal or 0-56 cents/bu.

Tierney on Grain/Oilseed Outlook: Pro Exporter's top grain analyst a (former WASDE grain analyst) underscored high risk associate with upcoming Jan 11 crop report especially as it pertains to Sept-Nov US corn feeding (which he thinks USDA is understating) and US wheat feed and residual (which suggests that USDA must find back 162 mil bu of wheat in remaining 3 stocks reports vs. largest ever found in the past—75 mil bu). This largely overlooked item in an already tight '07/08 US wheat balance table has enormous price implications even at current lofty price levels. Pro Exporter's '08 CN/BN/WHT area changes vs. '07 are -6.6/+4.2/+3.2 mil acres respectively prompting '06 carry over stocks of 1.624/0.228/0.419 bil bu respectively. Tierney underscored advanced pace of US corn, soybean and wheat export sales which as of mid Nov as a % of total '07/08 exports were the 3rd highest ever for corn, the 2nd highest ever for soybeans and the highest ever for wheat. He went on to emphasize importance of domestic PRC corn prices (currently trading near all time highs) as an indicator of PRC's corn export surplus which may be overstated (USDA indicated '07/08 PRC corn exports at 1.5 mmt). Hazards for corn bears include possibility of Brazilian corn imports, larger than expected global corn trade due to reduced wheat feeding and even larger US corn exports to Mexico. He views PRC corn auctions as indication that their corn stocks are shrinking while recognizing that neither Washington nor Beijing have an accurate reading on internal Chinese corn stocks. Tierney has a \$5.00 upside objective on July corn but noted likelihood that WN will gravitate to corn values next summer if 40 mmt plus increase in '08/09 world wheat production materializes prompting WH '08 to track WH '74 analog which rallied into the winter months, peaked in March and then traded lower.

Tierney on Ethanol demand: USDA won't publish their first '08/09 US corn ethanol demand forecast until Feb 22, 2008 but Pro Exporter is using 3.871 bil bu—up 860 mil bu from Pro Exporter's '07/08 US corn ethanol usage forecast. And although 6 US ethanol projects under construction with combined production capacity of 700 mil gallons (250 mil bu) have halted construction due to shrinking ROI, there are still 7.9 bil gallons of on-line US operating capacity and another 7.7 bil gallons under construction for a combined total of 15.6 bil gallons. Additionally, there are a whopping 457 US ethanol projects totaling 31 bil gallons being considered although many will never break ground unless ethanol plant ROI improves substantially. Pro Exporter estimates “probable” US

ethanol production capacity by Aug 2009 at 18.7 bil gallons (6.68 bil bu or corn or 236% of 12/07 US ethanol operating capacity). If Pro Exporter assumptions about Aug '09 US ethanol capacity are correct, it would imply that all US ethanol plants during '09/10 will operate at only 70% of capacity given Pro Exporter's '09/10 US corn ethanol usage forecast of 4.666 bil bu. Bottom line—prospects for near breakeven returns on ethanol plants over next decade will not only increase importance of active risk management of corn, DDG's, Nat Gas and cash ethanol but in addition act as a speed break to long list of new ethanol plants under consideration.

Comment on Global Soybean Demand: Pro Exporter cited USDA data on percent change over last decade in global grain/oilseed consumption with soybeans leading the pack (up 70%) vs. corn (up 37%) and wheat up (12.5%). Pro Exporter has global soybean demand over next 10 years up 73 mmt (2.68 bil bu) which will require Brazil to increase soybean area 28 mil acres (53%). Pro Exporter assumes that US soybean area, due to rising ethanol demand, will stagnate in 60 mil acre level over long term vs. the 63.7 mil acres planted in '07.

Wrap Up: The approximately 125 attendees at this late Sunday night session (comprised largely of participants from the National Grain and Feed Convention and assorted CGO based FCM analysts and brokers) could not help but walk away with a price positive bias. Tierney statement that "*we don't have enough US soybeans to get to the end of the marketing year*" (based on strong US soybean export sales pace, a larger US crush forecast and a possible contraction in '07 US soybean production on the January 11 crop report) was particularly compelling. It is increasingly apparent that prospects for continuation of tight ethanol crush margins will regulate both the growth in new US ethanol capacity and how high corn futures can go. Regrettably, zeal of greens and misinformed Congress in promoting cellulosic ethanol is pushing US bio-fuel policy down a dead end road that will ultimately impact corn positively. In the meantime—big US corn yield gains promised by Monsanto--due to triple stack varieties--have failed to occur over the last 3 years on a national basis suggesting that weather still matters. And for soybeans—with PRC/India GDP growth at 15 year highs and an over doubling of PRC meat consumption since 1985—it is apparent that global soybean prices must advance to a level that spurs a rapid expansion in Brazilian soybean acreage. In other words, a soybean price that is high enough to overcome strong domestic Brazilian corn prices, their firm Real and their sub-par domestic road network.