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GPRE - Q2 2019 Green Plains Inc and Green Plains Partners LP Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Green Plains Inc. and Green Plains Partners Second Quarter 2019 Results Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded. I would now like to introduce your host for today's conference, Jim Stark. Jim, you may begin.

Jim Stark - *Green Plains Inc. - VP of Investor & Media Relations*

Thanks, Joelle. Welcome to the Green Plains Inc. and Green Plains Partners Second Quarter 2019 Earnings Call. Participants on today's call are Todd Becker, our President and Chief Executive Officer; and Patrich Simpkins, our Chief Financial Officer.

There is a slide presentation available, and you can find that presentation on the Investor page under the Events and Presentations link on both corporate websites.

During this call, we will be making forward-looking statements, which are predictions, projections or other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could materially differ because of factors discussed in yesterday's press releases and the comments made during this conference call and in the Risk Factors section of our Form 10-K, Form 10-Q and other reports and filings with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statement.

Now I'd like to turn the call over to Todd Becker.

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Thanks, Jim, and good morning, everyone, and thanks for joining our call today. As we indicated on the last call, the second quarter would be similar to the first quarter, and it was.

We reported a net loss of $45.3 million or $1.13 a diluted share. Because of our planned slowdown due to market conditions in the first quarter, we slowly started off during the second quarter as well. With that said, we produced approximately 224 million gallons of ethanol, which put us at an 80% utilization rate for the quarter.

Madison did not restart as we had planned as the upgrades took longer than expected but we wanted to get it all done at once. Madison was restarted last week, and we anticipate achieving a 90% run rate in the coming weeks, which will get our ethanol production back to a minimum of 90% utilization rate for the rest of 2019 across the platform, which will also be positive for the partnership but it will also continue to drive down our operating cost per gallon.

Because of the slow start, Madison's fixed cost absorption and market conditions, the consolidated crush margin was negative $0.09 per gallon for the second quarter. The ethanol industry continue to be impacted by overproduction versus current demand, and overzealous EPA that issued a ridiculous amount of small refinery exemptions and a trade war that has dragged on too long for this industry. Even with all of these negative influences, we are seeing about a breakeven EBITDA ethanol margin in the first part of the fourth quarter coming up of the year, and I'll have more to say on this later in the call.

Project 24 is progressing. We achieved an average of $0.2930 with the plants operating in the second quarter even with the slowdown in Madison's absorption. I will discuss this in more detail a little later in the call as well but you will see why we continue to produce at, at least 90% going forward, and we will get better from here on improving costs.

As we expected, our cattle feeding segment showed significant improvement in the second quarter of 2019 compared to the breakeven first quarter of the year. We generated $8.9 million of EBITDA or about $54 EBITDA per head for the second quarter. We expect cattle's financial performance to remain strong for the rest of 2019, and it could be a record half for the business.

As we did mention in the press release yesterday, we have signed a letter of intent to sell 50% of this business to a group of investors, including pension funds. We believe we will have a definitive agreement signed, and we'll be able to announce that milestone within the next 2 weeks. We are on a path to close this transaction by the end of August or early September. This transaction will have a significant impact on our balance sheet as we expect to sell half the business for approximately $75 million in cash and removing $335 million of debt finance working capital from our balance sheet. This is over a $10 a share positive impact to our shareholders through this change on the balance sheet. We have an additional interest to purchase more than 50% of this business, and we may sell down further in a second close later this year.

Our intent is to grow the business off the balance sheet, and we will always have the option to buy back to 50% in the future if we sell down more today, which will happen through future acquisitions if we so desire. This will always keep the business off balance sheet, and that is a critical component of this transaction structure.

As I said, this transaction will have over a $400 million positive swing to our balance sheet when it is completed, but it will also illustrate our low debt levels that remains on the balance sheet and should put us back to at least a net debt 0 position against the convertible debt, which is our only non-working capital financing left on the balance sheet.

We exported approximately 75 million gallons of ethanol for the second quarter, which was 33% of our total production. The top destinations were Brazil, India, Canada, Saudi Arabia and Korea. Green Plains Partners reported $13.8 million to adjusted EBITDA and a coverage ratio of 1.04x for the second quarter. We continue to meet our stated goal of maintaining the distribution for our partners as Green Plains Inc.'s planned production level is expected to remain strong for the remainder of the year.

Our SG&A expense was down for a consecutive quarter by over $8 million year-over-year. Year-to-date is down 24% or approximately $13.5 million versus 2018.

Now I'm going to turn the call over to Patrich to review both Green Plains Inc. and Green Plains Partners financial performance, and then I'll come back later on the call to discuss the rest of the year outlook, provide more details on Project 24 and our protein technology initiatives.

George Patrich Simpkins - *Green Plains Inc. - CFO*

Thank you, Todd. Green Plains Inc. consolidated revenues were $895.9 million in the second quarter, down $91 million or 9% from the second quarter a year ago. The decrease in revenue was driven primarily by disposition of 3 ethanol plants and the sale of Fleischmann's Vinegar during the fourth quarter of 2018 along with lower run rates at our remaining plants.

Our consolidated net loss for the quarter was $45.3 million versus a net loss of $1 million a year ago. As Todd mentioned earlier, our Q2 financial performance continue to be impacted by weak ethanol margins. We recognized a tax benefit of $14.6 million in the second quarter of 2019, resulting in an effective tax rates of about 27%.

Interest expense decreased $6 million to $15.9 million in the quarter compared to last year. The change is driven primarily by lower debt overall debt balances compared to last year, offset in part by a charge of $1.6 million interest expense in Q2 related to early extinguishment of our 2019 3.25% convertible notes.

EBITDA for the second quarter was a negative $19.8 million compared to the positive EBITDA of $41.8 million for the second quarter last year. SG&A of $21.6 million decreased $8.1 million or about 27% from 2018 primarily due to the reduction of controllable expenses and the asset sales completed in the fourth quarter 2018.

During the quarter, we issued a $105 million 4% senior convertible note due 2024 and used approximately $40 million of the proceeds from the convertible note offering to repurchase 3.2 million shares of stock and repay the outstanding $56.8 million balance of our 2019 convertible notes due October 1. In July, the 2024 note issue was upsized $10 million to $115 million, bringing our total net proceeds from the offering to approximately $13 million net of fees.

Since the Board authorized our $100 million stock buyback plan in August of 2014, we have repurchased approximately 4.3 million shares of common stock for approximately $59.6 million under the program at an average cost of $13.78 per common share.

CapEx for the first half of 2019 was about $23.5 million with approximately $7 million of maintenance CapEx for ethanol production and an additional $12 million of growth capital primarily for high protein feed project in Shenandoah, Iowa and our Project 24 initiative.

On Slide 8 of the investor deck, you will see our balance sheet highlights. We had $387 million in cash and working capital net of working capital financing at the end of the second quarter compared to $427 million at the end of 2018.

Our liquidity position at the end of the quarter remained strong with $234 million in total cash along with approximately $459 million available under our working capital revolvers. This amount does not include availability of $68 million under credit facility of the partnership.

For Green Plains Partners, we had 225.1 million gallons of throughput volume at our ethanol storage assets, which was down 89 million gallons or 28.4% from the second quarter of 2018, again as a result of the Green Plains plant sales in Q4 of 2018. The partnership reported adjusted EBITDA of $13.9 million for the quarter, which included $500,000 of minimum volume commitment payments from Green Plains Trade. The adjusted EBITDA was $3 million lower than the second quarter of 2018 as a result of low throughput volumes.

Distributable cash flow was $11.7 million for the quarter, $3.4 million lower than same quarter of 2018, again reflecting the sale of the 3 plant assets in the fourth quarter of last year and slightly lower ethanol production at Green Plains in the second quarter versus the prior year. The distribution, $0.4750 per unit declared on July 18, resulted in coverage ratio of 1.04 for the second quarter.

On the last 12-month basis, adjusted EBITDA was $59.4 million. Distributable cash flow was $51.1 million, and declared distributions were $49.3 million resulting in a 1.04 coverage ratio.

Now I'd like to turn the call back over to Todd.

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Thanks, Patrich. We continue to be in a strong financial and strategic position as a result of executing our portfolio optimization plan launched in May of 2018. We eliminated a $0.5 billion of term debt, unencumbering our ethanol assets for the first time in our history, and as I said earlier, should work back to a net debt 0 position, excluding any working capital lines left after the cattle sale.

We have significantly reduced our controllable expenses. We sold assets, proving the value of our business. And with the recent financing, we repurchased almost 10% of our shares outstanding, which was another commitment we made to our shareholders as part of the portfolio optimization plan.

We do continue to work with interested parties on monetizing additional production assets and hopefully can achieve this before the end of 2019. Margins are improving in the fourth quarter, but we still have corn basis risk depending on what we see from the USDA in August.

As I said earlier in the call, the first part of the fourth quarter has turned slightly positive EBITDA across the whole platform average. Based on this, we should return to a more neutral free cash flow situation and have little or no cash burn.

More interesting is Q4 2020, a year from now, where the returns are also positive although down from high single digits we saw a few weeks ago without any benefit from protein but inclusive of Project 24. This shows how crucial it is to complete our initiatives.

The one overriding thing that has muted the work we have done for the benefit our shareholders is the impact of the negative ethanol margin curve. We knew that could be a risk for the program, but without all we have done over the last 18 months, we would be having a very different discussion about the future of the company.

As we discussed in October last year, we wanted to see the margin improvement -- margin curve improve before we allocate the significant capital of buying back stock, but we still delivered on our commitment in June although it is part of our ability to get that convertible debt financing on and keep the company from having any near-term maturities.

We're developing a plan concerning additional allocation of capital with the Board of Directors, and we believe the stock is significantly undervalued based on the results of the portfolio optimization plan and the continued interest in our assets at higher equivalent value to where the stock is trading, and we know our assets are turnkey for any purchaser.

Green Plains and the ethanol industry have been hit hard by both policy and geopolitics. While the RVP waiver for E15 was a victory that was long overdue, higher blends is the long-term solution for ethanol demand growth. The small refinery exemption issued by the EPA have absolutely hurt this industry as domestic blending is lower than last year. While the EPA said blending is not being impacted, they are dead wrong and are not doing their work while obviously being influenced by the oil industry.

So here's the quick math. The oil industry, refining industry obligated parties are not being held accountable by this administration to the 15 billion gallon renewable volume obligation. The benefit of the 2,000 or so stations which sell E15 has been lost in the 2 billion gallons of refinery exemptions given over the last few years.

So with blending down year-over-year by 0.01, which will equate to 145 million gallons annually, the fact that E15 sales are tracking towards 200 million gallons for the year and with the rest from not needing to comply with the RVO, you can find over 1 billion gallons of real demand loss, and we're just getting started.

It is dumbfounding that the EPA who is responsible for clean air favors oil over biofuels. Ethanol's proven time and time again to reduce greenhouse gas emissions by 59% versus gasoline.

Exports have weakened over the last 90 days, and we anticipate the U.S. ethanol industry will export approximately 1.5 billion gallons in 2019, down from our previous estimate of 1.7 billion gallons. The softness is in Brazil, the Middle East and we had believe that the EU would take more ethanol this year yet they are still tracking a little bit lower currently. There had been positive comments reported out of Brazil as of yesterday so we will wait to make a final call on 2019 exports, which could end up closer to our original number.

But make no mistake. The industry's negatively impacted by this administration's trade policies, and the EPA is distained for biofuels in general. The president needs to understand that the RVP was a long-term need, and we appreciate this, but his EPA needs to be reined in and held accountable for short-term problems in agriculture.

I wanted to give you some clarity to the information we also talked about in our last call concerning Project 24. We want to be clear on what we include and not include in this calculation. Our goal for Project 24 is to achieve an operating expense of $0.24 per gallon. The chart on Page 10 of the deck gives you the breakdown of our Q2 ethanol EBITDA crush margin as an example. The chart takes you through the calculation to arrive at EBITDA per gallon. The only thing we include in the calculation before the $0.24 of operating cost is ethanol and distillers grains revenues and corn and natural gas expenses. There is a corn oil credit as well, but that is not included in the $0.24, but it is included in the final EBITDA.

If we would have had Project 24 done and protein across our whole platform, we would have earned $0.11 a gallon EBITDA instead of a negative $0.09. This shows you the pent up value of our company especially as the stock price when these initiatives can bring another $0.20 a gallon to the bottom line.

As I mentioned earlier, we were at $0.2930 a gallon of OpEx per gallon for the second quarter. More importantly though, is we are tracking below $0.28 for July and August before any of the capital projects associated with this initiative had even ever begun. We're very confident we will hit our targeted of $0.24 a gallon.

The most interesting thing of this project is our ability to equalize expenses of our ICM and Delta-T plants. Basically, we have found a bottleneck or could ICM to fix it and now can expect the market value of our different technologies to narrow between the 2.

One thing not even included in this calculation is the fact that energy cost will come down on our non-ICM plants, and that increases the gross margin before OpEx as well. So the benefit is even greater than illustrated in the chart. The capital investment for Project 24 is approximately $55 million to $60 million with less than a 1-year payback. We're working to have this completed within the next 12 months.

Remember, we have exclusive use of this improvement for 1 year following the completion of our final plant upgrade.

High protein feed technology capital investment will approximately be $300 million to $350 million for the whole platform, and we currently anticipate payment of this investment over a 2- to 3-year time horizon. Over the last 4 months, we have been working hard to reduce the capital required to build this technology out with our providers and expect to announce additional projects in the future.

Our goal is to significantly reduce our dependent ethanol margins and transition to predictable cash flow streams. We plan to use the current cash and cash generated from additional asset sales to provide liquidity we need to manage through the current environment, provide capital to fund Project 24, and high protein feed technology installations. And finally, invest in reducing our share count as our per gallon valuation is well below the results from our recent asset sales and is just too low. We believe our initiatives are the best pathway to control our destiny in an industry that lacks the ability to show discipline when needed.

Thanks for calling in today, and I'll ask Joelle to start the question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Adam Samuelson with Goldman Sachs.

Adam L. Samuelson - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

So Todd, I was first hoping to dig a little bit more into the ethanol kind of margin dynamics today and thinking about between corn basis and cash breakeven and marginal variable costs for single operator plants, I mean, how -- I guess I've been surprised at how resilient production has proven to be over the past 2 to 3 months, and just would love to get your take and just your expectations and view on industry production through the end of the year given the margin environment we're in.

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Yes. I think even some of the best plants today are starting to finally feel the negative EBITDA environment. People that we talk to, some of our -- even our best plants saw some of that. And a lot of it was driven last quarter by the strength in the cash market around corn. The corn basis moved significantly, which then reduced margins overall late in the quarter and going into Q3. And so what we've seen is with the lack of information and knowledge that we have around next year's crop, the farmer has basically taken control of the remaining stocks, which then drove margins, especially in the eastern corn belt, into a significant negative position. I think we've seen some plants slow down. We've seen some plants shut down. We've seen some plants close forever. While not always been reflected in some of the data, I think we're -- maybe this is the week we finally see it. The cash market in ethanol still remains firm. The index value still remain firm. So I think there's a disconnect between what we're seeing in the EIA data and actually what's happening out there. So I think hopefully, this is the week we finally start to see that some of the marginal plants have slowed down. There has been plants in the industry that have had trouble buying corn to run their plants and haven't had the slowdown as well or have the shutdowns. So I think overall, everything -- the EIA is a lagging indicator. It's not a leading indicator, but it's treated as a leading indicator. And so we see a lot of noise and movement in those numbers, and maybe this will be the week that we finally start to see the reality of what we've been experiencing in the industry.

Adam L. Samuelson - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

And with that, I mean, and especially where maybe there is a more subdued export kind of environment over the balance of the year, just the total year-to-date number, I mean, how long do you think it might take before we start getting the industry stocks to back to a more appropriate and balanced level?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Yes. I mean the last week was a bit of a gut punch with the bill that we had towards almost a record. I mean we really need to get our stocks back down into the high teens, very low 20s in terms of million barrels, and so that's about -- we're probably 4 to 5 days of overproduction. And that could take -- we could wait to see -- it could be another 4 to 6 weeks before I still think we start to see even the end of some of these contracts that plants have on that have to deliver against. And maybe we start to see draws at that point, but I still think that EIA, as I said, is a lagging indicator and it still can take some time before we start to see draws. Although it doesn't feel like from the demand side domestically, that is a lot of -- that this excess that the EIA has reported is out there because there's a lot of markets that are still firm. There's a lot of markets that still has struggled buying some of the ethanol that they need. It's not like we are sitting on ethanol that can't get sold whenever we produce it. And so we're in a unique situation where the physical market in ethanol isn't really matching up with what we're seeing in the inventory levels. And I think that's -- because we would see much, much weaker physical market and a much weaker financial spread in terms of the curve on the forward curve in the financial market and swap markets and that's not representative of the stocks that we have as well. So it's just one of the things. I think the biggest driver that we still come back to has been this firm corn basis. When we are paying -- when the Eastern corn belt was paying 75 over for corn coming from the Western corn belt and Nebraska is paying 20 over in a normal 20 under market, that's $0.40 a gallon or $0.40 a bushel, which is almost $0.15, $0.14, $0.15 a gallon. And I think that that's really been the major impact to where the margins have gone here as of late, and hopefully, as we get into Q4, we start to get back into more normal basis levels especially if the USDA gives us something positive next week.

Adam L. Samuelson - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. That's helpful. And then just on the capital allocation kind of actions, I mean, you alluded to the significant discount and the equity value today relative to the year and the Board view of asset value. Is it -- just why not try -- think about trying to do something more aggressive in the near term or do you think that the longer term oppurtunity between Project 24 and high pro just is in the best long-term interest of shareholders. That gap just seems very dramatic just before the stock prices today.

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Yes. I think we have to focus on Project 24 first because that's getting the house in order. And in terms of keeping it, competitive in the long term. $0.24 a gallon across our whole platform, if you do the math the way we do it and that's what the market has to compare themselves to, $0.24 a gallon, we think puts us back into that top 10 or 15 percentile of the industry, maybe 20 percentile. And that's what's needed for the long term maintaining our strategic position in the industry in any market. And I think we're starting to see that already on the forward curve when we start to plug in $0.24 versus $0.32 last year or $0.36 in the first quarter. We can see our ability to start to withstand some of this volatility a bit more as we get through the process. That's number one, but that's not going to be the greatest use of our cash.

Secondly, protein is a long game. Whether we build 1 now and 8 later or whether we build 8 now and 2 later, that's going to be dependent on our responsibility to our shareholders to allocate capital properly. And so we're going to meet our Board of Directors. We meet regularly, and our next discussion is going to come off here and our view's we're going to develop a capital allocation plan against getting this our value correct in the market. And certainly we're going to get pushed around basis the current ethanol margin but that's not representative of number one, where we sold assets; number two, where we're getting indications of value for our assets; and number three, of what we should -- how we should look at our current stock price. And our Board is highly sensitive to that. They take it very seriously, and I think that we're going to look very seriously at allocating capital to get that back in line. Now it's going to be -- obviously, the ethanol margin environment is something that often will overtake any effort to do that, but then what we want to do is position ourselves by reducing share count in the future that when a small turn comes it's a big return for our shareholders. And with a book value of -- in the low 20s and the stock price in the low 8s, there's a significant disconnect. People are looking to short term at this company and not taking a viewpoint of the fact that once cattle's off balance sheet, we'll have well over $0.25 billion of cash to withstand what's going on. Q4's about a cash burn slightly positive, slightly negative based on the current market. So things are already changing. So we're not going to go away for quite a long time. And especially the fact that we don't really have much debt left on our balance sheet.

So I think overall, it's going to be first and foremost, getting Project 24 done; secondly, looking at our capital allocation relative to our stock price; and obviously, the long game is going to be transitioning to protein, but we cannot ignore that we believe we're significantly undervalued in the market, and we won't ignore that.

Operator

And our next question comes from Eric Stine with Craig Callum.

Eric Andrew Stine - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Maybe just on your production in the context of the industry. I know you've -- in the past, you've cut back, the industry did not follow and now you've got -- you made a decision to be at 90% and run that going forward. I mean given that it seems like where the industry potentially at a pain point and that could see a real drop in production, is that 90% level something that you would -- even if it's for a short period of time, you would revisit given if you take some off, it would have a pretty big impact on the industry? Or is this something where 90% is locked in and given your balance sheet you can just -- you're just going to wait it out?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Yes. Our view is we have to -- in order to achieve Project 24, part of the ability to achieve that is to run at above 90%. And we actually think our plans can run well over 90%, and that's something we'll look at as well. At this point only having 1.1 billion gallons, I'm not sure this going to make or break this industry anymore. When we have 1.5 billion and we're able to take up 300 million or 400 million gallons, the interesting thing is that it had very little impact in the first quarter. And we hear out there that everybody is waiting for Green Plains to slow down then I can at least state today that that's not our intent. It's actually, our intent to run at 9 -- above 90% not only to benefit our Project 24 but also to benefit our ownership and the partnership as well. And so we cannot achieve $0.24 a gallon without running hammer down every day. And that's what we're going to do and even try to get below that number basis anything that's only basis 90% production. We believe our asset is going to run as high as 94%, 95% on a daily basis, driving our OpEx per gallon even lower, and we think that puts us in the best position. We were not in the best position last year. We weren't in the best position 2 years ago. Our OpEx per gallon was $0.32 to $0.33 a gallon, and now we're fully focused on driving that significantly lower. And that is a significant impact for our shareholders. And while we have done the job for the industry in the past, and as I said, it worked really well the first time, it didn't go -- it's about a push a second time, and it locked our shareholders' significant value the third time. The fourth time, we're just going to keep going. And it's the responsibility of this industry to also decide when they need to do their work as well, and I think this cash burn is equal opportunity at this point. And so there are others that need to probably stop or slow down, and we're starting to see that. And I don't think Green Plains has to do the work anymore for this industry.

Eric Andrew Stine - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Got it. Okay. Thanks for that clarification. And then maybe just last one for me. I know part of the optimization program has been thinking about selling assets, and it sounds like that's still a possibility. But given that the different from end of last year when you sold your 3, it's now very much a buyer's market. So kind of what you're seeing in the market on that front, and maybe if you can handicap chances that you do sell something or one of your plants or a couple by the end of the year?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

It's not a buyers market for Green Plains plants because we're not going to sell the stress value, number one. As I said in the conference call, our plans are turnkey. There's nothing that needs to happen to them when you buy them. The CapEx has been done, the maintenance has been done, the safety and environmental is up-to-date, and our plans are in turnkey shape. And that's a very different value proposition for a buyer than other processes that have been out there and other things and other plants that might have been for sale. And so how we look at it is now we don't want to sell a lot more. If we sell 1 to 2 more possibly, maybe 1 to 3, but I don't think that -- I think it's more like 1 to 2. I would -- we are working with interested parties. We still have parties coming in. They know that we're not going to sell it at a stress value. We don't have to do that especially with the fact that our balance sheet is in such good shape. Our cash balances are high, margins are getting back closer to breakeven for the fourth quarter. And so there's really not a need to sell anything at the stress values. Although we would still like to get at least 1 to 2 more done, I would handicap that with the parties that we're working on at 50-50 or better by the end of the year. And I think we have opportunity, possily even greater than that to get some things done. That would just give us more cash onto the balance sheet to allocate, obviously, like we just talked about and really position Green Plains well in Project 24, reducing our share count and investing in the next-gen Green Plains 2.0, which is protein. So while you have seen processes get whole, some processes get done cheaper, we're really not that type of seller. So if anybody approaching us from a buyer's market perspective, we're probably the wrong guy to approach at this point.

Operator

And our next question comes Craig Irwin with Roth Capital Partners.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

So Todd, your comments about the EPA and how the administrators chosen to implement their noble field standard. Clearly, the harshest, most critical comments I've heard you make in more than 10 years. You've kind of been careful and cautious in criticizing the EPA over the last several

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years, and this, I think, was just blunt as I've heard you been about some egregiousness steps there. Do we really need to see EPA come in line and be an honest broker and implement the renewable field standard properly to find our way out of this difficult margin environment? Is it possible for us to see remediation without EPA actually taking the correct steps in the near to intermediate term?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

I think one thing that we've seen relative to the EPA's administering this RFS and even these SREs is that with the old administrator out who made up the rules for what we would call friends of his in the oil patch versus this administrator who I think is more reasonable, at least from that perspective, and the fact that the President has to come through Iowa and just can't continue to issue exemptions to the world's most profitable companies while agriculture and the backbone of our culture, which is the ethanol industry suffers, I think that viewpoint is coming through. It's still a battle. It is still a oil-driven EPA, as for my view. I think that with the removal of Pruitt and now Warren as well going away, we have a chance now to at least get some better viewpoints. This administrator understands the importance of infrastructure and E15 and rolling it out. I think they've gotten bad data from their friends at oil on blending, and we know they have because nobody is held accountable the 15 billion gallons and the SREs allow them not to be held accountable for that, which is why they have to stop and I think that's why this President is getting involved. So I think overall, with what's the changes in the EPA, the President getting involved in refinery exemptions and the fact that agriculture is suffering so great under the current policies, I think we have some potential remediation. I don't think it's financial remediation, but I think it's remediation from the fact that what's happened over the last couple of years and the first couple of years administrator paves the next I think we have a chance now to at least have our voice heard and the fact that there are some big, big decisions that have to get made into the future. So while certainly I am, have been -- I am very highly critical of what's happening there today, I am optimistic that changing of the guard and continued involvement by this President in agriculture we'll get some things that we need out of EPA as well. But make no mistake, this is a not a biofuels EPA. This is a oil industry EPA today.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

I would agree with you. I think Trump remembers 118 of the 230 counties that flipped around the Trump or ag counties. So hopefully, Administrator Wheeler can do the right thing.

Moving on to Project 24, so I understand the endpoint. It makes a lot of sense, but in the short term, we're feeling quite a lot of pain from the negative crush margins. And the necessity of running the platform at high levels of utilization to implement Project 24, shouldn't we really factor the increased cash losses as we run at higher levels of utilization into the overall returns on Project 24? I mean is this something that we think -- you think we need to look beyond in a very short term because we'll see some quick results? Or are we really looking at returns when you factor the cash losses today that are little bit lower?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

I think the problem right now is this curve is in -- this ethanol margin curve is in the area where that, that if I run slower, I burn more cash because variable contribution margin for us, as we reduce our OpEx even to $0.28 a gallon, and that's not -- not a lot of that is driven by -- just driven by watching some of the things that we've been doing making better decisions, getting better contracts, those types of things. The slower I run, the more money I actually burn. So now that we're getting into the 20s instead of the 30s on our OpEx per gallon and going into the low 20s, the more I run, the more cash at these levels that we would actually burn. So it's going to be up to a different part of the industry to run slower because that's what happened to us in the first quarter of this year, Craig. We ran slower, and we lost more. Running slower to try and get the industry back in balance, yet the industry decided to take advantage of that and run harder and just offset everything that Green Plains did with our Project 24 program. We -- there's really only one way to run these plants today unless you -- margins get so negative where variable contribution is negative, and at that point, we can always look at it -- but today, the harder I run or the slower I run, I will -- we will actually burn more cash. And we're not going to do that for our shareholders anymore, especially in the position -- financial position that we're in today, which is to really move Project 24 as fast as we can. We're trying to accelerate it as fast as we can so that we -- when we get into 2020, we're getting very close to those levels, especially by the second quarter, that we will be basically just having to run all day everyday, hammer down. And the difference though, if you think about it, is let's say even last year, when we were $0.32, and if in 2020 we're at $0.24, $0.08 a gallon over 1.1 billion gallons, that is a $90 million to $100 million of additional cash that we get just by running even at the same margin structures. So while I'd like to say that Green Plains is going to do the work for the industry going forward, that's not going to be our responsibility for much longer.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Great. And then last question, if I may, is around cattle and feedlot. So I think everybody understood that your core competencies at Green Plains were good match for entering into the cattle business and, I guess, the world's changed. So everybody also understands your deconsolidation. Post deconsolidation, do you think we still retain some of the benefits that we're chasing originally from being in the feedlot business? The intelligence on demand for distillers grains, the understanding of the economics on the demand side for the distiller grains that it brings from being a large-sized operator in that market. And would you expect that to be a consistently positive contribution on the operating income line looking forward?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Absolutely. And all that actually. So the cattle business joint venture will be housed on our trading floor. We will be still managing treasurer or providing services for treasury, risk management, overall accounting, those type of services, IT. We'll have a Board of which we will be part of, but it will still be very closely aligned to our platform in terms of getting the benefit for both because the cattle feeding operation gets the benefit from the fact that we produce a significant amount of the feed that they use and also buy a lot more corn than they do. And the platform, the production platform still will get the benefit of the fact that we know what's happening in the rations whether wheat is being fed or corn is being fed, how do the stores work in. But even more importantly now is as we evolve to Green Plains 2.0 in the future, when you think about producing high protein, you're going to have the ability to dial up more high protein, which will then produce different types of products other than the storage grains, which has an energy value in the cattle feeding business and we think that puts us in an advantage as well. So not much is going to change on a daily basis for the guys that run the business. We'll be involved to help them in the decision-making processes, risk management processes. And really on the acquisition side as well, it will be really up to the Green Plains team to still go out and find -- along with the head of the cattle feeding business, which we have today anyways to go out and find acquisition targets diligently -- acquisition targets and help arrange financing for that. So while off balance sheet from an optical perspective and to make sure that we can deconsolidate the debt, Green Plains will still own 50% of this business, and we're going to try and double the size of this business going forward off the balance sheet. We could never do it on the balance sheet. We like the business a lot. It provides high return on equity, high return on invested capital. And it's not a business we're interested in exiting, but it also confuses potential investors on debt levels. And I think we just wanted to get ourselves to a very clean position that when you look up Green Plains on your Bloomberg machine, you're going to see our convertible debt, you're going to see our working capital financing for some grain and some ethanol, you're going to see cash, and that's all you're going to see. And you're not going to be subjected to figuring out where this other $300 million or $400 million of debt is coming from. And if you go back a couple of years ago, we had close to $1.5 billion of debt. And now, a couple of years later, through portfolio optimization and getting cattle off balance sheet, we're going to basically have almost 0 net debt, not inclusive of maybe $100 million to $150 million of working capital financing fully backed by inventories and receivables. So we have put this company in a very good position. Obviously, the market is not participating with us on that, but we put the company in a very good position that we're not going to go anywhere anytime soon.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Great. And one more question, if I may. Shenandoah and the high pro. Seems in your presentation, you're pointing with a lot more confidence towards $0.15 a gallon rather than the range of sort of $0.12 to $0.15 you talked about a few times over the last couple of years. Can you update us on where we're at with Shenandoah? Do we expect this to start making a positive contribution at the end of the year? What have you learned?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Well, we've learned a lot of things, and so one of the things we learned is when we went back and worked with our technology provider, we talked to them about that CapEx is just too high, OpEx is just too high, and we want to get more margin out of this project. And they did a great job coming back to us with a reengineered plan where we reduced our CapEx overall of the project by about $7 million or $8 million while reducing operating expenses and increasing the margin overall. And really setting it up for duplicating that technology among the others that we're also looking at as well. So it won't -- we won't just be a one technology company. So what we've learned is number one, we wanted to get the CapEx down. We didn't think long-term, that was the way -- that it was just really too expensive over the long term. And so secondly, we've also learned is the product is now being sold from a few plants around the United States that make this product today, and the largest one has already announced a second -- the largest producer has already announced a second plant, and we're sure that there's going to be 3 and 4 or 5 more that -- or 2 or 3 that they're going to announce as well. So our view is the product -- our view and our intelligence tells us the product is getting sold at [soy meal] plus. It is a 50% type protein product. It is being exported and used domestically. It is being widely accepted as a high-value product. Even more exciting than that is that we are starting to see technologies coming out of the enzyme and chemical companies that are taking this protein not only to 50 but to 52, 54, 56 with the endgame trying to get to 60 through mechanical and enzymatic increases and that, all of a sudden, takes a product into a $1,200 a ton range instead of a $300 or $400 a ton range, and that's what we're focused on. So absolutely everything that we've seen, every assumption so far we've made is validated, is coming true. And so our view is for illustration purposes, we put 15. But there's going to be times it's going to be 20. There's going to be times as it's going to be 12. But overall, we believe over the long term, 15 is the baseline that we're going to use for our investment thesis. But everything that we've looked at has validated the fact that there's a market for this product, it's accepted, and we're still continuing to work on opening new markets for this. So a week on in, in Shenandoah, late in the fourth quarter, we expect that our product will have a home and will start to contribute positively in the first quarter of 2020.

Operator

And our next question comes from Pavel Molchanov with Raymond James.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

In the case of biodiesel, what we've seen is China stopped buying U.S. soybeans. And as a result, biodiesel margins went through the roof. Now that it appears that China has effectively halted purchases of all U.S. agricultural commodities, including corn, I'm curious would that actually be a tailwind from the standpoint of the crush spread?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

No. Not really. I don't think that's necessarily -- it's a different case. I mean I think that, obviously, $9 beans and cheaper oil have given the ability of the biodiesel guy to make a margin because of China. I think China was never really big corn buyer. China is more important to the ethanol market long term for us because they do have a significant demand pent up there, and we think up to 3 billion gallons. And the last time China was taking our product, we were at a positive $0.15 to $0.20 a gallon margin, and that was with our high OpEx, by the way. And so, as we go forward, the China situation is definitely something that we're going to have to deal with. We think the positive comments out of Brazil are beneficial for us around potentially taking more tariff free or dropping the tariff altogether or at least extending for now. That demand for them -- the demand in that market continues to grow every year, and I think we can be good trading partners with them. But I don't think from the standpoint of China for us, that's a positive to the crush today.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

Okay. One more about China. So I suppose officially they're still mandating E10 in 2020. Nobody believes that, that will happen. But what's the current level of kind of the average nationwide blend in the Chinese market that you're aware of in practical terms?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Oh, in practical terms, we think they make about 500 million gallons internally -- 500 million to 600 million gallons internally over a 30 billion to 40 billion gallon market. So it's a very small percentage. That's why we think the market could be up to 3 billion gallons plus, potentially even higher than that in the Chinese market. So it's very small what they can do internally today. And I still think some of the provinces would want the product. It's really just going to come down to the end of this trade war and when it will end and how it will end, and that will be much more impactful on the ethanol industry going forward. But I think we'll be the supplier of these in the short term -- short to medium term of any product they need over and above what they can produce internally before they start to potentially ramp-up their own production.

Operator

And our next question comes from Selman Akyol with Stifel.

Selman Akyol - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of Equity Research*

Can you just remind us how long GPRE has to use up the MVC payments on a go-forward basis?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Yes. We should have most of that wrapped up by the end of the year and potentially into the first quarter a little bit. But overall, we're just trying to -- obviously, if we can ramp production and run at least higher the 90% run rates, we can use that up much faster and -- but that should be potentially by the end of the year or early in the first quarter.

Selman Akyol - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD of Equity Research*

Okay. And then just going back to Jefferson terminal. I know it's kind of one of those assets that could be dropped in, but given sort of the optimization upstairs, do you guys ever look at just trying to sell that straight out in order to raise capital?

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Yes. I think -- look, we think Jefferson was built and started off right at the beginning of a trade war. So performance to date has been adequate for Green Plains Inc., but to drop it to Green Plains Partners, it would be not optimal for the unitholders of Green Plains Partners today unless, obviously, we see resolution of trade wars, et cetera, throughout the world with U.S. But overall, we've been running anywhere from 7 to 10 trains through there a month with our partner at Fortress. And that is not something that I think we would not look at going into the future. We think though there's a strategic reason for having it, but there's also other reasons to say that maybe we could allocate and get better returns on our capital doing something else as well. So I guess what the question is, would we ever look at potentially divesting that terminal? That is always an option that we've always had as well to allocate that capital better back into Green Plains Inc., and that's something we look at as well.

Operator

That is all the questions we have for today. I will now turn the call back over to Todd Becker for closing remarks.

Todd A. Becker - *Green Plains Inc. - President, CEO & Director*

Yes. Thank you, everybody, for coming out in the call today. Obviously, a challenging quarter. But Green Plains is also executing on the final stages of portfolio optimization plan. We're putting ourselves in a very good position going forward. We're setting the company up well to succeed. Obviously, we need a few things to happen around trade and the industry and the margin. But I think long term, the company is going to be here, and we are in solid shape to continue to get through the current environment and we think set ourselves up well for our shareholders in the future. So thanks for your support. We'll talk to you next quarter.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program, and you may all disconnect. Everyone, have a wonderful day.