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Q3 2018 Green Plains Inc and Green Plains Partners LP
Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the Green Plains Inc. and Green Plains Partners Third Quarter 2018 Earnings Conference Call. (Operator Instructions) I will now turn the conference call over to your host, Jim Stark, Vice President of Investor and Media Relations. Mr. Stark, please go ahead.

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

Thanks, Gigi. Welcome to the Green Plains Inc. and Green Plains Partners Third Quarter 2018 Earnings Call. Participants on today's call are: Todd Becker, President and Chief Executive Officer; John Nepl, our Chief Financial Officer; and Jeff Briggs, Chief Operating Officer. There is a slide presentation available, and you can find the presentation on the Investors page under the Events & 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 sections of our Form 10-K, 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 would 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. We did report a net loss of \$12.5 million or \$0.31 a share and generated approximately \$32 million of EBITDA for the third quarter. For the last 12 months, EBITDA has totaled \$133 million.

The consolidated crush margin was \$0.11 a gallon for Q3, which was \$0.02 better than Q2. Green Plains produced approximately 305 million gallons of ethanol in the third quarter. Year-to-date, we have exported 18.5% of our production and expect that Q4, we'll see nearly 30% our production shipped out of the country.

We continue to ramp up volumes at our JV terminal in Beaumont. And in the fourth quarter, we have one of the biggest sales books we are executing against since we opened the terminal. Exports remain a bright spot for the industry, and we should see 5% to 10% growth in 2019 over the current year. We have seen very early interest and demand for 2019 as the price of ethanol is very attractive globally and more and more countries adopt pro-ethanol policies.

Green Plains Partners reported \$16.8 million of adjusted EBITDA and a coverage ratio 0.96x for the quarter and 1.02x coverage ratio for the last 4 quarters. The agribusiness and energy segment experienced a bit of a dip in the quarter. Year-to-date, we have produced \$24 million of EBITDA. And we expect this segment to bounce back in Q4. And we anticipate ending the year with EBITDA in the range of \$35



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million to \$40 million for the full year.

We reported \$12.2 million of EBITDA in the food and ingredients segment for Q3. Fleischmann's performed well again and cattle performed as expected after such a strong second quarter. Cattle feeding margins averaged \$40 EBITDA per head. This was lower than our target EBITDA for a couple of reasons.

As we pointed out last quarter, we did pull some cattle forward in the second quarter because of a very positive sales environment in Q2, which is why margins were so strong. In Q3, we recognized sales of approximately 30,000 heads from the Bartlett transaction that had lower margins because of the short time we owned the inventory. While we did not earn normal margins on these cattle, it was certainly financially advantageous for us to buy the inventory versus custom feeding for Bartlett.

On a year-to-date basis, we have earned \$69 EBITDA per head and anticipate that Q4 will be back in the \$50 to \$55 level and is also trending higher as we have started to see a positive basis return to the market. We remain very excited to be in the business. And we will continue to look for growth opportunities in the future.

6 months ago, we announced an optimization plan that had 5 components to it. First, we were going to take action to prove the value of assets owned by Green Plains as we believe the market was not adequately reflecting this in our share price. While we certainly understand that margins translate into share price movement, we felt we can do several things to prove and create shareholder value.

With that said, we announced last month the sale of 3 ethanol plants to Valero Renewable Fuels and the sale of Fleischmann's Vinegar to Kerry Group. As we indicated in the earnings release today, we anticipate realizing a pretax gain from the sale of these assets, net of adjustments, of approximately \$162 million in the fourth quarter of 2018. In addition, we estimate that cash proceeds, net of fees and taxes, will be approximately \$645 million from the \$650 million of sales.

With the \$234 million of cash at September 30, our pro forma cash as of September 30 approximate -- as of October or November 30 will approximately be \$880 million. We will utilize a portion of that to pay off \$495 million term loan B. And for the first time in our 10-year history of Green Plains, we will have no term debt on the assets of the company. All that will remain is cash, working capital financings and the convertible debt. We will have no restrictions on the use of capital or movement of capital. And this will simplify our accounting and reporting structures. We expect to roll out a new, easier-to-understand segment reporting structure in 2019.

While we are giving up earnings, paying off the term loan B saves us \$38 million of cash interest expense, \$2.5 million of debt amortization expense and \$5 million of principal payments annually. We will also lower our depreciation expense as well. Based on the trailing 12-month performance of the assets sold, these sales transactions are accretive to forward earnings. We should be able to complete both transactions in the next 30 days or so.

We have received HSR clearance on the ethanol plant sales and expect the Fleischmann's transaction to clear quickly as well. We will keep you informed as to our progress. The timing will affect our ethanol production gallons and our food and ingredients segment results for the fourth quarter. We continue to work with interested parties for some additional divestitures. But we don't want to comment any further on these activities as they are in different stages of the process.

Now I'll turn the call over to John to review both Green Plains Inc. and Green Plains Partners' financial performance. And then I'll come back on the call later to discuss the outlook for the rest of '18 and the view on 2019 and a look at the future of Green Plains.

John W. Nepl Green Plains Inc. - CFO

Thank you, Todd. Green Plains Inc. consolidated revenues were \$1 billion in the third quarter, up 11% from the third quarter a year ago. The increase in revenue is attributed almost entirely to 160% increase in revenue for our cattle feeding operations from the acquisitions made in both 2018 and 2017. Revenue in our ethanol production segment declined 8% driven by a 10% decline in ethanol gallons sold, partially offset by a 30% higher selling price for distillers grains.

Consolidated net loss for the quarter was \$12.5 million versus net income of \$34.4 million a year ago. During the quarter, the company



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recognized a net tax benefit of \$14.7 million with approximately \$10 million attributed to the federal and state R&D credits relating to the quarter. Last year for the same quarter recognized R&D tax credits of \$48.8 million. EBITDA for the third quarter was \$32 million compared to \$50.4 million for the third quarter of last year.

For the quarter, SG&A decreased \$3.5 million driven in part by our efforts to reduce controllable expenses. The third quarter included approximately \$1 million of severance expense related to staff departures. I would note for you that once the asset sales are complete, our SG&A run rate will be reduced by about \$2.5 million in the quarter based on the divestment of the assets. This is on top of our current expense reduction program.

Interest expense decreased \$8.5 million for the quarter compared to last year. In the third quarter of 2017, we incurred \$12.3 million in interest expense associated with the termination of previous credit facilities. Excluding that, interest expense increased about \$4 million driven equally by higher average borrowings primarily for cattle inventory and a roughly 90 basis point increase in our LIBOR-based financing.

For Green Plains, CapEx was about \$14 million in the third quarter, which breaks down as follows. Just over \$5 million was related to maintenance CapEx for the ethanol production segment with an additional \$3.6 million for growth capital, including our initial outlays for our first high-protein feed project in Shenandoah. We spent nearly \$3 million on maintenance and growth capital for the vinegar company and about \$4 million in maintenance capital for Green Plains cattle.

Going forward, our maintenance CapEx for ethanol assets should be -- should still be around \$0.01 to \$0.015 per gallon. Outside of the high-protein feed initiative at Shenandoah, we do not have any significant growth capital spending anticipated for the remainder of the year. We anticipate we will spend about \$12 million in CapEx in Q4 with about \$6 million for growth.

Our total debt at the end of the third quarter was just under \$1.4 billion. This balance includes \$557 million on our commodity revolvers, which were secured by working capital collateral, including readily marketable inventory of \$684 million. After we pay off the term loan B in the fourth quarter, our long-term debt balance will be approximately \$337 million, including borrowings for the partnership of about \$136 million. Net of the transaction costs and repayment of the term loan, we expect to add approximately \$150 million to our existing cash balance. This, along with our revolver availability, puts us in a very strong liquidity position.

On Slide 10 of the IR presentation, you will note our net debt leverage ratio was 6.3x at the end of the third quarter versus 4.1x a year ago. We did provide a pro forma look at Q3 as if we had completed the 2 transactions and paid off the term loan as of 9/30. As you can see with the debt paydown, our pro forma net leverage ratio was 2.5x, a significant improvement over recent ratios. This does not include any gain on the sale of the -- in the pro forma calculation.

I would say our goal, excluding stock buybacks, would be to maintain a net term debt balance near 0 as shown in the pro forma numbers as of 9/30. I would also note though for everyone that there is still approximately \$83 million of the \$100 million stock buyback authorized by the board of Green Plains in August of 2014. And we are evaluating the best way to execute a stock buyback strategy.

Our liquidity position at the end of the quarter was solid at \$234 million in total cash, along with approximately \$492 million available on our revolvers. This amount does not include the credit facility of the partnership, which had \$107 million of availability -- I'm sorry, does include. I should note that with the completion of the ethanol asset sales, the partnership's total credit facility will be reduced by \$35 million, leaving about \$72 million of borrowing capacity at the partnership.

For Green Plains Partners, we reported adjusted EBITDA of \$16.8 million for the quarter, which was \$400,000 better than the third quarter in 2017. The partnership had 314 million gallons of throughput volume at its ethanol storage assets, which included an incremental 8.6 million gallons related to transload volumes.

Distributable cash flow of \$14.9 million was flat to last year. Distributable cash flow for the third quarter was affected by a \$747,000 adjustment related to storage and throughput quarterly minimum volume commitments, a catch-up in higher interest expense due primarily to a 90 basis point increase in our LIBOR-based credit facility. We had a negligible amount of CapEx during the third quarter.



The distribution of \$0.475 per unit declared on October 18 results in a coverage ratio of 0.96x for third quarter. On a 12-month basis, adjusted EBITDA is \$69.8 million. Distributable cash flow was \$63 million. And a declared distribution of \$61.8 million resulted in a 1.02x coverage ratio. Finally, on a consolidated basis, we were free cash flow positive in the third quarter even in a lower-margin environment.

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

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

Thanks, John. And I have to say that I'm pleased with our efforts and the results on our portfolio optimization plan. There were certainly a lot of opinions on asset values and whether there would be a robust process. We received initial bids from 9 different parties with 16 distinct plant bids, whether bundled or not. We narrowed it down in the next round and finally awarded the plants to the best overall bid.

We had some individual plant bids at even higher values. But we wanted to sell the first phase as a bundle for ease and ability to close on a large, meaningful transaction. This should also indicate to our stakeholders that we own quality assets that were attractive to multiple buyers. Our focus now in the near term is to do all we can to lower our break-even costs on our platform. We plan to attack this on 2 fronts: continue to reduce controllable expenses and eliminate inefficiencies across our business.

We indicated that we will reduce controllable expenses by \$10 million to \$15 million. And we are on a path to actually exceed that. Most of these savings will be realized in the full year 2019 results. In addition, we plan on continued investment in high-protein feed technology, which we will refer to as high-protein cornmeal in the future. So our expenses are coming down, and when the term loan B is paid off, that will significantly reduce our interest expense.

But there is more to be done, our efforts to refocus our team, and we also started to plan on reducing operating expenses at our non-ICM plants. We will not make this investment now. But we believe we can narrow the spread another \$0.06 a gallon over time and be within pennies of our best plants, like Obion and Shenandoah. We'll keep you up-to-date on our engineering of this plan and the costs. But they are much less today than it would have cost 5 years ago.

We continue to make good progress on our high-protein feed technology. We continue to work on all aspects of the build. And with an updated timeline, the Shenandoah location should be completed during the third quarter of 2019. We are getting closer to a decision on the next couple of locations to deploy this feed technology and hope to announce those by the end of the year.

At a minimum, we anticipate a \$0.10 to \$0.12 incremental add to the ethanol crush margin at each of the locations we install this technology. But today, based on the realized value for high-protein -- for this high-protein product available today, this could be closer to \$0.20 a gallon. As we deploy the technology to 3 plants that represent slightly more than 1/5 of the gallons we will produce, we would experience a \$0.04 to \$0.07 a gallon improvement on average across our entire ethanol production segment's crush margin. While this will take years to implement, it is one big step to getting consistent, predictable cash flow reducing volatility over time.

I would like to note that in certain feed markets, high-protein feed produced from corn does have advantage over soybean meal. This could generate high-protein soybean meal. This could generate a premium price over current meal prices for our own high-protein products. We believe that our next-generation protein products from ethanol plants we will produce will provide clear nutritional advantages over high-protein soy meal for a large variety of livestock and aqua feed applications.

As animal feed nutritionists are looking well beyond crude protein levels, we see a more balanced amino acid composition and distinctly lower amounts of anti-nutritional factors play key roles in outperforming competition from soy and help to achieve maximum product value. Additionally, we believe that further processing steps can be implemented to create additional applications with specific benefits. As I have indicated, I have never seen in the last 10 years more interesting, real technologies that could be deployed at ethanol plants that will change the mix where we earn our margins. In the next 5 to 10 years, protein and oil could be the major contributor to profitability of this industry.

Now with that said, we need to focus on the here and now. Over the last 90 days, the ethanol margin environment has been weak.

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According to EIA data, we are 1.8 million barrels higher in inventory than the same period a year ago. And we are about 3 million barrels too high from what I'd like to see. And while that sounds like a lot, it's really only about 120 million gallons of oversupply. And I believe over the next several months, the industry can correct this situation as the current margin environment will cause a broader slowdown in our opinion.

But what fixes this oversupply? The quickest solution will be for the industry to show discipline and slow production down, which could eliminate this excess very quickly even by the end of the year. Unfortunately, the ethanol industry has historically taken longer to react. Yet this time, it is starting to feel a bit different. The weekly data is not reflective of reality in our opinion. Not every plant is surveyed and the export plug number to reconcile is never accurate.

But that's what we have and that's what drives our behavior today. In fact, even at our export terminal, they only survey our stock data once a month. So while we could be full on the day they survey it and unload everything the next day in a boat, over the next 30 days, you'll never see that inventory go down. And we've seen that happen at 2 of our terminals. And they also don't survey all of our plants.

The next fix could come from expanding exports and getting China back open for ethanol exports. China was on pace to purchase at least 200 million gallons of U.S. ethanol in 2018. And simple math would lead you to see that we would not be oversupplied if China had stayed a customer. With that said, without China next year, we believe the U.S. can grow another 100 million gallons over 2018 levels really led by Brazil, Canada and other stable countries.

The fix that has us most excited is E15. The U.S. fuel market is the largest in the world. And getting access to another 5% of the gas tank potentially adds 7 billion gallons of ethanol demand here at home. While we can't and won't get all that demand, it is on the radar now. The acting EPA administrator has stated this week that we will have E15 available year-round by the summer. And that was very exciting news.

E15 is a game changer for the industry. And with the administration's efforts to move forward with year-round E15, the sales lead us to believe this is only a matter of time before we see more independent retailers announce, like the recent ones we have seen. Momentum is in our favor. And we are seeing more economical upgrade plans for stations that could also accelerate adoption. We anticipate E15 in 1,950 stations in 2019, resulting in total new demand with year-round blending of 300 million gallons.

Finally, we are concerned about the pricing mechanism for the industry and believe it needs to be addressed. The industry prices almost 1 million barrels a day of production based on a small amount of trading volume during a window of time every day. We believe that the industry should consider other pricing mechanisms that more fairly represent the value of ethanol in the marketplace. And we plan on working on that vigorously.

For Green Plains Partners, we believe that the agreement to exchange 8.9 million units of Green Plains Inc. ownership for the storage and transportation assets and railcar leases keeps the partnership on solid ground. The transaction is accretive to the partnership as it reduces distributions payable more than the earnings reduction from the sale of the 3 ethanol assets. Last month, the partnership of Green Plains agreed to extend the company's interest in offer period in JGP Energy Partners or our Beaumont export terminal through the end of June 2019.

We have always believed that growing our downstream distribution capabilities was important to our business. And Green Plains Partners is a vehicle to achieve that growth. With that said, we will again start to look at opportunities to acquire terminal assets where we can add value and we have a need for more throughput. Our goal with the partnership is to maintain the distribution in a long-term coverage ratio target of 1.1x.

We had a lot to cover today, so this was a bit longer than usual. We plan on holding an Investor and Analyst Day over the next 3 months as we fully roll out our new plan for the next 10 years to return to profitability and grow our earnings. And we invite you all to be there. Thanks for joining the call today. We appreciate our stakeholders' confidence and patience as we continue to pivot Green Plains into our next 10 years of profitability and growth.



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Now I would like to ask Gigi to start the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from Adam Samuelson from Goldman Sachs.

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

So I guess, the first question, maybe digging a little bit on the portfolio optimization plan and kind of where we are and where we go from here, can you talk about the minimum cash balance that you want to maintain at the parent level? Just thinking about you're going to have a lot of cash come with completion of these divestitures. You talked about potentially kind of reexamining the repurchase and going after what's left under that authorization. But beyond that, especially if there are additional asset sales on the ethanol side that are to come, how we should think about the deployment of those proceeds.

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

Yes, what we had said and indicated earlier, that we would like to maintain at any given time between \$100 million and \$150 million minimum cash once our debt is all paid off. And so once we get to that point and we see margin stabilize, if we're sitting with over \$300 million of cash as a starting point at the end of Q3 -- Q4, then we will start to look at the alternatives of what we can do with that cash. And so I think what we like to see is over the next several weeks is as margins hopefully stabilize and recover because we do believe the industry is starting to slow down and we should start to see some of that reaction in the weekly data, I think it will become much clearer on the deployment of cash.

I would say, first and foremost, obviously Shenandoah is the most important thing we can do for the platform in terms of increasing margins and lowering our breakeven. And as we get more confidence in that, we will start to look at the next couple of plants. But that really will not be much spend in 2019 and probably more like a 2020 spend. So once all that is said and done and our debt is paid off and we have the excess capital on to the balance sheet, I think we will move then into the next phase of the things that we talked about and look to either repurchase programs or other options for our cash.

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

Okay, that's all very helpful. And then maybe just questions on the margin environment that we're in today. Third quarter results, actually -- margins up sequentially, given -- it was actually surprising to us, given the trajectory of margins in the quarter and the decision in late August to actually slow production. Just talk about kind of frame kind of where margins are today, we would look to -- we would calculate at a loss position. But just help us frame kind of how you're thinking about the margin.

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

Yes, I think your calculation is correct. I think the industry broadly is in a negative position today. I wouldn't say there's many plants that would be positive, even some of our best plants. And that's something that I think we'll start to see. And we have seen and identified across the industry at this point indications of somewhere between 700 million and 900 million gallons going offline or slowing extensively that we believe will start to work through the numbers over the next several weeks. And while it certainly will take some time for the market to believe that, our view is sometime in the next 30 days, we will start to see production levels come down and stocks start to get drawn out.

What we're seeing now is there are physical markets in the United States that you cannot buy product because of the tightness. But it's not reflective in the margins. And so there's completely disconnect between what people are willing to pay for ethanol and what's happening in the daily pricings, which is why we indicated we believe that, that mechanism is broken and needs to be examined and look for alternatives as an industry. And again, we're big advocates of that. So it's just going to take some time. But right now, margins are weak across the industry.

Operator

Our next question is from Ken Zaslow from Bank of Montreal.



Kenneth Bryan Zaslow *BMO Capital Markets Equity Research - MD of Food & Agribusiness Research and Food & Beverage Analyst*

Todd, you were on a board of a company that was willing to sell its company at a higher value than what the stock was implying. And over the last couple of months, you actually have shown that the private value of your assets are higher than that -- that's given by the market. Why don't you just take a step back and just sell all the assets and get -- realize the full value of your assets? Like what's preventing you from doing that?

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

I think from our standpoint, we didn't build the company just to sell it. I think we'll examine all opportunities that are in front of us. And we'll do the best thing for our shareholders. And I think from the perspective of when you look at a platform like ours and it has vinegar, it has cattle, it has ethanol, it has terminals, it is -- it may be confusing to some. But we will do the best thing for our shareholders. And if that means our portfolio optimization plan is the plan, that's what we'll do. And if we can achieve greater values by doing something else, I don't think anybody on our board would be against that as well. So from our standpoint, we're always focused on the shareholder. And if the best outcome is doing what you mentioned, then we'll do whatever the best outcome is for our shareholders in the long run.

Kenneth Bryan Zaslow *BMO Capital Markets Equity Research - MD of Food & Agribusiness Research and Food & Beverage Analyst*

Okay. My second question is you talked about evaluating your best options for share repurchases. What are your options? I'm not sure, like what's the variations? It seems like you either buy the stock or you don't buy the stock. But what are you thinking about in terms of the variations?

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

Well, we would like margins. Look, so first of all, we haven't closed anything. So we'd like to get all that closed. We like to pay off our debt, evaluate the balance sheet at that point, have margins stabilized a bit to make sure that our cash balance is strong in a period of inflection and then from there, make a decision very quickly. I don't think -- as we indicated, that is 1 of the 5 things that we're going to do. We've talked about a 10b5-1 versus open market purchases. And we're just evaluating what our best options are for a major stock repurchase when the time is right.

Obviously, if you look at the economics -- and again, we're not going to spend all our money on that, so I think that can come through free cash flow in the future. But if you also look at the economics of this protein initiative, you can hedge off 2 to 3 years of this product at those type of margins to really stabilize and grow earnings of this company as well. So it might be a bit of a battle. But at this point, our focus is on getting everything done, getting the balance sheet where it should be on day 1 and at that point, evaluating how quickly to move on all the other aspects.

Operator

Our next question is from Heather Jones from Vertical Group.

Heather Lynn Jones *The Vertical Trading Group, LLC, Research Division - Research Analyst*

So talking about the current margin environment, Todd, do you believe that a fair amount of the industry is at negative cash margins?

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

Yes, at this point, we believe that a fair amount of the industry is now at a negative cash margin.

Heather Lynn Jones *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay, then a details question. Could you give us, on a pro forma basis, assuming everything closes, your cost savings program, et cetera, where should we expect SG&A to be at on a run rate basis in '19? And where are you anticipating interest expense to be?

John W. Nepl *Green Plains Inc. - CFO*

Heather, this is John. I think from an SG&A standpoint, there's 2 buckets. One is, as I mentioned earlier, we're going to take out about \$2.5 million just related to the divestments. And then we're also looking at potentially another hopefully about a \$4 million a quarter impact with the other cost reductions. So somewhere around, let's just say, \$6 million, \$6.5 million a quarter of reduced SG&A on a go-forward basis, okay?



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

And so this year is -- if we were going to go the whole year on interest, we will be close to \$90 million of total interest expense for the company. And we had indicated that just taking the term loan out was -- is about \$40 million, less than that.

John W. Nepl *Green Plains Inc. - CFO*

We'll be a little bit higher probably in cattle next year. So I would say probably a \$55 million number to start might be about right. We're working on that right now.

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

As well as taking rates into consideration. But as you saw this quarter, the higher interest rates were a drag on our interest costs. That's why I think that one of the key points for us was to get rid of some of this debt and continue focus on that. And in addition, late next year -- just lastly, late next year, one of our converts will convert as well based on the way that we rolled it forward, which will also reduce cash interest.

Heather Lynn Jones *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Now given the improvements you're going to make at some of your plants, let's assume the industry slows -- but let's just assume not a normal -- well, I'm not -- let's not assume anything, I'll just ask you. Based on what you think the ethanol business is going to do and the other businesses that you'll have left after these divestitures, do you think your interest expense level will now be at a level where you can get rid of the tax rate disadvantage, given the new tax code? And would it limit tax interest deductibility?

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

Well, we still are a high working capital company because of the cattle business, which is the one of the things we mentioned to explore at some point, whether that should go off-balance sheet in some type of partnership. And that, at that point, would pretty well take care of most of that liability that is there. John, do you want to comment on that?

John W. Nepl *Green Plains Inc. - CFO*

Yes. No, I think we'll be in a much better position. We haven't done the detailed math on that. But up to this point, any amount that we haven't been able to deduct, we've been able to carry forward as a deferred item. But I think our expectation would be that we should be in a very close position to be able to deduct all the interest going forward. Obviously, that's going to hinge largely on the margin environment of ethanol. But we certainly will be much closer than we have been.

Operator

Our next question is from Eric Stine from Craig-Hallum.

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

So just curious, I mean, I can appreciate the thoughts about ethanol pricing. And there's not really great transparency in local markets and doesn't give a true indication of what's going on. But just curious, and I know you're taking steps, but maybe what some of those steps could look like because that seems to be like -- it might be a bit challenging just to add more transparency to the industry.

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

Well, in terms of the daily pricing, if you look at the window that prices every day on a small amount of volume, that prices almost 1 million barrels of daily pricing that sales that are -- that the industry has on, and we don't believe that fairly reflects the actual market that's out there as that sometime even trades under the physical prices available in the Chicago market. And so when we look at that, we would like -- obviously, the first thing is if we get our customers to buy a more flat-priced product from us without the use of the daily pricing market, in addition, work with other exchanges to come up with alternatives and other opportunities to do something and see if we can get away from a very small amount of volume trading or pricing a lot of volume every single day.

And we believe that, that has caused margins to remain under pressure even when physical markets are trading and convergence is not happening. And when then you look around the United States, when you take a place like an Obion, Tennessee that we trade at \$0.05 to \$0.07 higher than historical because you can't buy product or whether Houston is trading at a \$0.05 premium to historicals because



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there is a product available and you look at all of those factors, yet you see the Chicago market under pressure, trading below physicals at times. And that's the thing that we believe is holding back this industry at this point. And we're going to see if we can look at other options to work with our customers to price our product.

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

Got it. So whether it's on a company basis or industry-wide in getting -- whether it's Growth Energy or RFA behind it, I mean, it sounds like, fair to say, that's the plan?

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

Yes, there's been discussions across some industry players to see if there's other options that we can use that makes it more transparent and more liquid and something that has a more meaningful relationship to the actual values that are taking place out there.

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

Got it, okay. And maybe second one for me, just on export markets and growth next year, and obviously China will have a big impact if it were to come back, but beyond some of the obvious ones, maybe just talk about some of the other markets that you are looking at to contribute to that growth and will become increasingly important next year.

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

I mean, Canada is a very strong market right now for U.S. ethanol. And in 2019, we expect that to continue to grow. We expect Renova Bio to have a very positive impact on our relationship with Brazil and places like that. India continues to grow. And if you saw the recent discussions by their leader, talking about the need for more alternative sources and to clean up their air and the increase in motorized vehicles that are happening, the renaissance that's happening in India. Mexico is still on our radar screen, although it takes longer -- that is taking longer than we thought. But it is still something that we look at.

The Philippines continues to be a strong market. Peru, Oman, Colombia, Jamaica, I mean, when we look at all of that, we still feel like even without China in, we'll be in that 1.75 billion gallon range. And then hopefully, we start to see movement out of the G20 and the President on China and get ethanol squarely on the table. And if you look at their support for ethanol with the E15 initiative, we're working very hard with the administration to make sure that ethanol is front and center in any China negotiations as the tariffs need to go away and they want to buy the product. We would be wide open right now from a price perspective into China right now if it was available.

Operator

Our next question is from Craig Irwin from Roth Capital Partners.

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

So Todd, one of the things we're hearing is that Wheeler has told Grassley and Ernst and a few other Senators that he's not going to submit the NOPR or the notice of procedural rulemaking at EPA to implement year-round E15 until February. Can you confirm whether or not this is something that you're hearing? And do you think it's feasible to see the NOPR approved and for us to see fully approved E15 year-round before the summer driving season in '19 if we do start in February?

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

Well, the summer driving season is what we're focusing on. And this week or late last week, he quoted -- it was quoted that he said, "We will be able to go to year-round E15 by next summer." And he said they are working on it. They're putting out -- they want to get out the proposal to get out the comments and finalize it before the driving season. That's what we have to go with. And I think the retailers are taking that statement along with the fact that they believe that President Trump is fully committed as we move from the midterm elections to go right into probably into the Presidential elections cycle.

And Iowa is still up for grabs in our opinion with the Republican governor, even though some of the Democrats went to the congresspeople. So in general, we're going to take the administration's word for it. We think they're committed to it. We think it's something that is not a very hard thing to do. And while certainly there might be lawsuits, when rule starts to get made, retailers have



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reacted historically in the past. And we're starting to see that with several announcements coming out from major retailers around the United States that are making major transitions to E15.

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

Great. My second question is really a clarification. So I believe I heard you say earlier that if exiting the fourth quarter, you have a cash balance that exceeds \$300 million, you would look much more seriously at renewing your activity on your buyback. Can you say whether or not you currently expect positive cash flows based on operating commissions in the market? Or would this have to be something that would be a residual cash balance after closing all the transactions that are supposed to close this quarter?

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

Yes, I mean, basically how we're looking at it is everything should close this quarter. We're on the path to do that. We will add that cash to the balance sheet to our ending balance from Q3. At that point, we will easily have over \$300 million, if you take a look at what we said, plus the \$230 million. We'll await to see how the operating environment finally closes out. But we should have no problem exceeding well over \$300 million -- or over \$300 million in the fourth quarter. And at that point, we'll examine all the options once everything is closed.

I mean, we're not going to do something today until we get everything done, paid off, closed because we still have restrictions even based on our term loan that's outstanding today that we can't actually start the buyback -- any type of buyback program at all until we pay off that term loan without asking for a waiver. But since we're within 30 days of everything happening, we're not going to go after that and pay for that. So it's just a matter of time that we have to get through all of the things that we're trying to accomplish. We have a lot of work going on to do that. And once that's all complete, then it will be part of our normal portfolio optimization plan that we have outlined.

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

Okay. And just as a follow-up, there is no need specifically for free cash flow to boost the cash position either in the fourth quarter or the first quarter for you to initiate once the term loan is fully paid down. Is that accurate?

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

We would like to see a more positive operating environment. I will tell you that. I mean, that's something that we talked about. But we also believe that the industry is slowing down. And it should start to be reflective in those numbers. It may take a little longer than expected. But in general, I think we would like to see a more stable operating environment. When you -- and again, I won't take this long. But when you go look out on the curve, your best margins right now on the curve are in Q3 of next year.

So we don't really -- we've never had quite a curve like this before where you hedge out -- you could hedge out actually 3/4 away and get the best margin. But even out there, it's not something that you want to invest a lot of capital in your hedges, other than having to make margin calls if the market recovers. So again, we just want to make sure in a stable operating environment, where margins start to recover, at that point, we can make better decisions on the timing and the speed of what we want to do.

Operator

Our next question is from Pavel Molchanov from Raymond James.

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

Given that we're 48 hours from election day, I thought I would pose this. While we're waiting for the EPA to work its magic hopefully with E15, is there anything on the legislative side in the new congressional session that is relevant or that you would like to see coming from the Hill?

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

Yes, I mean, I think -- no, there's nothing really relevant. But if you look at the outcome of what's happened here, status quo over the next couple of years into an election cycle going to Iowa, I would say the chance that legislation to alter the RFS, or renewable fuels standard, would be hard-pressed to make it through anywhere in a divided House and divided Senate and then a President that would -- is fully



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supportive of the ethanol industry and agriculture. So I would say the next couple of years, you may hear some things. But it's probably going to be some of the most stable years that's related to the renewable fuels standard that we've seen because there really isn't a path to get any changes through, other than what the EPA is doing with E15 and some rebalancing.

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

Okay. And any sense of -- assuming that E15 does materialize as a regulatory matter by next summer, how many gallons of incremental demand could we realistically count on kind of on a year-over-year comparison basis?

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

For 2019, our view, and we indicated in the call already today, is that the stations that will be implementing, along with other stations that we don't even know of yet, we believe it will be a potential 300 million gallon increase in domestic demand in 2019. And that's over the couple thousand stations that we know of. But there are definitely more stations that are doing it outside of the growth -- or the Prime the Pump initiative that was started a few years ago.

So the other exciting thing is that we're hearing from our retailers that we do business with that the cost of retrofit is coming down very, very, very fast. In fact, they believe that there will be kits -- potentially have kits available to retrofit pumps very fast and that the -- any regulation around that will be very clean. So that's very exciting as well. And then if you look at the new stations that are being built by retailers, you'll see that the 3 blends of gas are unleaded, the E15, which they're calling unleaded plus, but it is E15 and obviously premium and then diesel.

John W. Nepl *Green Plains Inc. - CFO*

Sorry, unleaded 88.

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

Unleaded 88, sorry, unleaded 88. So a lot of retailers have rebranded E15 to be unleaded 88. And they're actually seeing in some markets, it could trade at a premium to unleaded because of the octane value. So people are experimenting with the price spreads right now. But it trades anywhere from a discount to a premium, all based on what the consumer is willing to pay. But they view unleaded 88 as a very positive outcome for them.

Operator

Our last caller is Laurence Alexander from Jefferies.

Nicholas Cecero *Jefferies LLC, Research Division - Equity Associate*

This is Nick Cecero on for Laurence. I was wondering if you could provide just a bit more color on the cattle feeding margins and what's been driving some of the quarter-over-quarter swings that we've been seeing.

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

Yes, so what we said in the second quarter, where we achieved over \$80 to \$90 a head margin, is that we pulled forward some of our marketings from Q3 to Q2 because of the strong environment. So we fed them less days but made bigger margins on them, then keeping them into Q3. And then in Q3, we were obviously impacted by a very short marketing cycle of the new cattle that we had brought in. And so that took our margins down on average overall. But on the cattle that we owned at our own plants, we achieved pretty well standard average-type margins. When you look forward into Q4, right now, margins on the cattle that we have on feed that will be marketed in Q4 right now should achieve our baseline \$55 a head that we announced when we look at our minimum feeding margin.

But what we've seen here recently is with a positive basis and better returns, there is a chance we will outperform that. I think the most interesting thing right now is you could actually buy cattle today, put them on feed for marketing in 6 months from now and the margin stays somewhere between \$60 and \$70 a head, depending on what you buy on the forward curve as well. So I think we're in a pretty stable feeding margin environment right now that achieves the returns, which we talked about, which is 15% to 20% return on equity and 7% to 10% return on invested capital. And we're able to achieve those returns, although obviously it takes a lot of working capital to do that.



Operator

Our next question is from Selman Akyol from Stifel.

William Michael Axmacher Stifel, Nicolaus & Company, Incorporated, Research Division - Research Analyst

This is Will Axmacher on for Selman. First question was, was there a specific reason for the extension on the offer period regarding your guys' JV with Jefferson?

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

Yes. What we want to do is again because of the uncertainty around China and exports, it's taken longer to get long-term contracts through there, although the terminal was basically sold out in October and continues to be sold out in November. So while we're running a lot of volume through, it's a long-term contracting that we need to get one more stable piece into our export matrix, which is China. And I think the uncertainty around that has caused people to hold off on long-term contracting.

But the performance of the terminal has continued to get better since we started it up. The execution is better, the unload times are better, the load times are better and the rates in terms of the costs are coming down. So I think from the standpoint of getting the best value for our shareholders that own this but also making sure that it's set up well for these stakeholders and the unitholders at GPP, we wanted to make sure that we have it in the best place to drop it down at a later date than today.

William Michael Axmacher Stifel, Nicolaus & Company, Incorporated, Research Division - Research Analyst

Got you. And then one last question, what's the status of the remaining railcars after that asset sale?

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

Well, we'll still run all the cars. All the cars will remain that is for the fleet of Green Plains that GPP manages and leases. And there should be no major impact other than what we are letting go with the ethanol plants that we sold. But that was all calculated in how the unit price and exchange was calculated. So it should not be any negative hit to GPP unitholders.

Operator

At this time, I'm showing no further questions. I would like to turn the call back over to Todd Becker for closing remarks.

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

Thank you, everybody, for coming on the call today. We know it was another long one, but we had a lot of to cover. We're in the final stages of closing some of these transactions, which we think long term for our shareholders as it can create a lot of value. And we'll continue to work on your behalf in the future and keep you updated and give you the dates for our Investor and Analyst Day that will be coming up in the next quarter or so. So thanks for everybody coming on the call today, and we'll see you next quarter.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect.

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