Deutsche Bank

16 Jun 2011 - 09:16:24 PM EDT

INDUSTRY ALERT

Breaking News

Food

Analysis of Senate Ethanol Vote

Focus stocks

Bunge (BG.N),USD65.50 Buy, Price Target USD80.00

Corn Products International (CPO.N),USD53.12 Buy, Price Target USD62.00

Hormel Foods (HRL.N),USD28.90 Sell, Price Target USD22.00

Sanderson Farms (SAFM.OQ),USD44.90 Hold, Price Target USD38.00

Smithfield Foods (SFD.N),USD21.70 Hold, Price Target USD26.00

Tyson Foods (TSN.N),USD18.08 Buy, Price Target USD21.00

* The Senate approved an amendment by Sen. Feinstein (D-CA) that would repeal the $0.45/gal ethanol tax incentive and $0.54/gal import tariff by June 30. These incentives are currently slated to expire at year end. The 73-27 vote had bi-partisan support: 33 Rep, 38 Dem, 2 Independents.

* As revenue/tax legislation cannot originate in the Senate, it appears the amendment will be "blue-slipped" (essentially stripped) from the bill. However, the vote is symbolic of the movement to change ethanol policy.

* An amendment offered by Sen. McCain (R-AZ) to bar the use of federal funds for ethanol infrastructure failed 41-59. This is critical as we view the move to E15 as more imperative to the industry. The most signficant element of US ethanol policy is the mandate, but we do not believe there is broad support to alter it.

* Assuming the mandate remains, a repeal of the $0.45/gal incentive would have no impact on blending, given current economics. Ethanol is trading at about a $0.15/gal discount to gasoline. SHOULD gasoline prices fall below ethanol, refiners would only blend to the mandate. The resulting overcapacity in ethanol would pressure margins, lead to plant shutdowns and ultimately pressure corn lower until margins are profitable again. This would persist until supply and demand are equal in 2015. The corn-based mandate is 12.6 bil gal in 2011 and 13.2 bil in 2012. The industry has 14.4 bil gal of nameplate capacity with 14 bil operating.

* We believe a compromise solution is most likely. The Admin commented that it is open to new approaches, but opposes a straight repeal of the incentive, according to OPIS. Sen Feinstein continues to be in negotiation with Sens Thune (R-SD) and Klobuchar (D-MN) on a compromise. The latter Sens introduced a bill that would gradually phase out the tax incentive, while allocating some of the savings to infrastructure build. It would convert the incentive to a variable credit based on the price of crude oil with the credit expiring at the end of 2014.

* Stock implications: ADM - negative should gasoline move to parity or below ethanol as there would be a transition period where margins would tighten until corn moved lower. BG - LT positive as the import tariff would be removed, paving the way for easier access for Brazilian ethanol. CPO - neutral - we don't see a big change in corn prices (particularly if a compromise bill were enacted).

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