Pacific Ethanol: surfing the biofuel wave

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This week Pacific Ethanol announced it had received all the necessary permits to begin construction on a 50 million gallon per year ethanol plant in Calipatria, California

As work crews prepare to break ground within the next thirty days, the company's accountants are busy allocating the US$325 million in funding it closed with five banks on 27 February.

The dual tranche debt facilities cover the company's US$573 million portfolio - consisting of five ethanol plants - and will be used to scale up its production to a combined capacity of 220 million gallons per year by the middle of 2008.

Furthermore, Pacific says it plans to have 420 million gallons online by the end of 2010.

Facilities - Five plants in the US

The Calipatria plant will be located in southern California's Imperial Valley, about 150 miles east of San Diego.

The site has access to an existing rail loop owned by the American Grain Company and is a short drive from US Interstate 8.

Pacific says the area's high concentration of cattle is ideal for the offtake and consumption of wet distiller's grain - a byproduct of production.

Calipatria is one of three Pacific ethanol plants in California. Its first facility was built in Madera, north of Fresno, and is already in operation - producing 35 million gallons per year. Another facility near Stockton is currently under development.

The company has two other plants currently under construction in the Pacific northwest - one at the Port of Morrow, located on the Columbia River near Boardman, Oregon and another in Burley, Idaho, which is mid-way between the fuel markets of Boise and Salt Lake City.

The Port of Morrow plant will also produce 35 million gallons per year, while the Burley plant is expected to put out 50 million gallons per annum.

Pacific also has a 42 per cent stake in Front Range Energy, which owns and operates a 40 million gallon ethanol plant in Windsor, Colorado. The Windsor facility was completed last summer.

Drivers - Politics and money

The rapid growth of Pacific over the past two year's is on par with the US industry as a whole.

Ever since the federal government passed favourable legislation in July 2005, proposed biofuel facilities have been popping up faster than the troublesome weeds that often compete with feedstock crops for real estate in a farmer's field.

The energy bill passed that summer required an increase in ethanol use by refiners to 7.5 billion gallons by the year 2012. As a result, the market for biofuels in the US has skyrocketed - especially since many states have also banned MTBE (Methyl Tertiary Butyl Ether), a fuel additive formerly required to increase octane levels of gasoline.

Ethanol is now the only other commercially viable additive that will bring gasoline into compliance with state and federal clean air regulations.

That sits well with Pacific. There's no bigger transport fuel market in the US than California - which for a long time has had some of the country's toughest emission laws.

It's hard to deny the influence of politics on the rising tide of ethanol in the US. It's even harder for politicians to ignore it.

As founder and chairman of the board, Pacific's Bill Jones knows a thing or two about both. With over twenty years of experience in California state politics - including a stint as the 27th secretary of state, the self described second-generation farmer and rancher has moved out of the policy sector and back into business.

Jones, a republican politician in a historically liberal state, has been described as an oddity in the 'green' sector. However, after California legislation sparked a surge in demand in January 2003, he co-founded Pacific Ethanol.

Pacific says Jones had followed the development of the ethanol industry for years - perceiving it as a solution for a number of problems, including environmental and economic issues.

Financing - Five banks for five plants

Financers looking for an ethanol project to back will have no problem finding one in the current marketplace.

However, securing the right deal has been a bit trickier, with the bigger players preferring portfolios consisting of multiple projects.

Last year, WestLB provided a US$275 million debt facility to AS Alliances Biofuels for its greenfield portfolio of three plants.

This year, the bank's New York branch - together with Mizuho, Grupo Santander, CIT and Rabobank - provided Pacific with a duel tranche term loan of US$300 million to bank its portfolio and recapitalise its Madera plant.

With an underwritten value of US$573 million, Pacific provided US$248 million in equity.

The financing package arranged by the banks includes a first tranche for US$200 million with separate pricing for the building phase - up to 20 months. The loan margins are LIBOR + 325bp during construction and LIBOR + 375bp thereafter.

The second tranche is for US$100 million priced at LIBOR + 435bp. The banks are also providing a US$25 million working capital and letter of credit facility.

All of the facilities have seven year terms and funding is divided equally amongst the banks.

Latham & Watkins acted as legal adviser to the lenders. Chadbourne & Parke advised Pacific.

Pacific is acting as its own construction contractor and the portfolio's offtake agreement is with the company's subsidiaries.

Upon completion of the facilities, Pacific will be responsible for any repairs to the plants for a period of one year.

Conclusion - Tortillas and OPEC

For the past few years ethanol has been spurred by rising oil prices which in turn have been driven by growing demand, tighter supply and political instability in producing regions.

As a result, the American public has grown uneasy about its energy dependence and a wave of 'homegrown' alternatives have taken root.

The green push - as ethanol promises a cleaner burning fuel - has made the movement stronger, as has the 'midwest effect' - with four election swing states in the corn belt and farming communities receiving premium agriculture subsidies.

However, it's not all good news.

Ethanol's boom in the US has raised problems with the food industry. In Mexico, labourers worry about the price of tortilla flour. North of the border, major soft drink manufacturers are said to be concerned about shortages of corn syrup - a food sweetener which was ironically adopted when sugar prices were deemed to high.

These problems exist is chiefly because the US relies heavily on corn to produce ethanol. But that may be changing.

This week the US federal government dished out US$385 million for six cellulosic ethanol projects which will produce the fuel from corn stover, wheat straw, milo stubble, switchgrass, and other waste feedstocks.

It's all part of president George W. Bush's goal to make cellulosic ethanol cost-competitive with gasoline by 2012.

Additionally, the president would like to reduce America's gasoline consumption by 20 per cent in ten years. His 'Twenty in Ten Initiative' aims to increase the use of renewable and alternative fuels in the transportation sector to the equivalent of 35 billion gallons of ethanol a year by 2017.

So as Pacific makes public its lofty pans to nearly double its stated 2008 capacity by 2010, the layers of sophisticated financing - including project finance - continue to feed on the boom. Will it last?

Better keep one eye on OPEC and the other on the grain exchanges.

The project at a glance

Project Name	Pacific Ethanol Portfolio
Location	California, Oregon and Idaho (USA)
Description	Portfolio of five ethanol plants (at various stages of devlopment)
Sponsors	Pacific Ethanol
Operator	Pacific Ethanol
EPC Contractor	Pacific Ethanol
Project Duration (Including construction)	about 12 months from groundbreaking
Construction Stage	Various stages (one completed, three under construction, one under development)
Offtake	Pacific Ethanol subsidiaries
Total Project Value	US$573 million
Total equity	US$248 million
Total senior debt	US$325 million
Senior debt breakdown	US$200 million US$100 million US$25 million (all with 7 year term & divided equally amongst banks)
Senior debt pricing	LIBOR +325bp during construction thereafter LIBOR +375bp LIBOR +435bp
Debt:equity ratio	57:43

Participant banks	WestLB Mizuho Grupo Santander CIT Rabobank
Legal Adviser to sponsor	Chadbourne & Parke
Legal adviser to banks	Latham & Watkins
Date of financial close	27 February 2007