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GPRE - Q2 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 Second Quarter 2018 Earnings Conference Call. (Operator Instructions)

I will now turn the conference over to 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, Latiff.

Welcome to the Green Plains Inc. and Green Plains Partners Second 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, our Chief Operating Officer.

There's a slide presentation available, and you can find the 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 this morning's press releases and the comments made during this conference call and in the Risk Factors section of our Form 10-K, 10-Q and other reports and filings with the Securities and Exchange Commission. You may also refer to Page 2 of the website presentation for information about factors that could cause different outcomes. We do not undertake any duty to update any forward-looking statement.

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



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

Thanks, Jim, and good morning, and thanks to everybody joining the call today.

We reported a small net loss of approximately \$1 million or \$0.02 a share and generated approximately \$42 million of EBITDA for the second quarter. The consolidated gross margin was \$0.09 a gallon for Q2. The crush was affected by negative expense absorption of approximately \$0.02 to \$0.03 a gallon related to running our platform slower.

We saw good improvement in our financial performance for the second quarter led by our food ingredients segments, which reported a record quarter of \$90 million of EBITDA. We also recorded a strong year-over-year improvement in our agribusiness and energy services segment.

Green Plains produced 296 million gallons of ethanol in the second quarter versus 275 million gallons for the same period in 2017. That was 80% of our operating capacity for the quarter. Ethanol production ran slower in the second quarter, which is now going to be a thing of the past. Our approach going forward will be to run our plants at 90% or higher of our operating capacity. As a reminder, our regular scheduled maintenance and the amount of export products we produce can have an effect on our production rates during any quarter. But going forward, we will now flex our production down, which has had the unintended consequences of benefiting others rather than for the benefit of Green Plains shareholders as of late.

We increased our production levels for the month of July, which -- with very little impact to EIA data and margins overall. While on paper the industry can easily produce 1.1 million barrels of ethanol per day, we are seeing an overall trend of higher repair and maintenance costs and inconsistent run rates more broadly, which we believe allows us to ramp production up as we have made the necessary repairs and maintenance as a top priority in any market conditions.

For our company, I have to say we are disappointed by the Federal Trade Commission's decision to put us through a second request related to the proposed GPP-Delek Logistics joint venture to acquire terminal assets from American Midstream. We, along with Delek through the JV, have decided to terminate our agreement to acquire the Amid terminal assets because there was no assurance we could overcome the regulatory obstacles from the FTC's review. We believe our resources should be placed on other initiatives, such as the drop-down of our 50% ownership of the joint venture in the JGP terminal in Beaumont, Texas and other growth and acquisition opportunities for the partnership.

Our company ethanol export volumes for the second quarter were 65.7 million gallons or 22% of our total production, with the majority moving through our terminal in Beaumont. We await the outcome of numerous trade disputes, which we believe provide great upside to our export volumes.

Green Plains Partners reported \$16.9 million of adjusted EBITDA and a coverage ratio of 0.97x for the quarter and 1.03x for the last 4 quarters. As we ramp production volumes higher, we believe the partnership will be in a position to capitalize on this effort, and we expect our quarterly coverage ratio to be over 1x for the rest of the year.

The agribusiness and energy segments turned in a good quarter with \$12.8 million of EBITDA. This performance was driven by our ongoing grain storage strategy of capturing the market carries and lifting the piles later in the year. While we have reduced inventories at all of our locations, the opportunity to refill these locations is actually coming before harvest as farmers and commercial grain companies are making space for another year of large corn and bean crops. More importantly, the term structure of the market is allowing those who have space to earn above-average returns on that space.

Food ingredient segment had its best quarter to date. We continue to see solid results from both our cattle operation and Fleischmann's Vinegar. But in particular, cattle feeding was strong in the second quarter. Our feeding margins averaged over \$100 EBITDA per head. While certainly a very strong quarter, we expect the rest of the year to return to normalized feeding margins we have articulated in the past.

Fleischmann's continues to see performance above our expectations, and we are starting to see the benefits from the capital deployed in our capacity expansions. Our apple cider vinegar business continues to see growth, along with white distilled vinegar, both organic and non-GMO. We



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are starting to see demand from the fast food industry as well in our industrials business, which we believe will help our long-term growth of the business.

Since we acquired Fleischmann's, we have seen cumulative annual growth in revenue and EBITDA of 8% and 15%, respectively, and expect that to be the case going forward. Yesterday, we announced the acquisition of 2 cattle feedlots from the Bartlett Cattle Company. We're very excited about this practice as these feedlots are well run and have been well maintained. So for -- this purchase adds 97,000 head of capacity, giving us total capacity of 355,000 head. With this acquisition, we are purchasing the existing cattle in inventory, which will provide us the opportunity to ensure the transaction is immediately accretive. We believe the baseline for this business going forward will be marketing between 650,000 and 700,000 head of cattle per year at a \$50 to \$60-a-head baseline feeding margin. As you know, we have certainly achieved higher than that in the past, notwithstanding normal volatility in margins with our goal of high single-digit returns on invested capital and high-teens pretax return on equity.

We look to continue growing this segment as we have had good success on cattle feeding over the last 4 years. Additionally, we still plan to explore taking this business off balance sheet in the future.

For the first half of the year, our non-ethanol segments have generated EBITDA of \$89 million. We are on track to achieve our previous guidance of non-ethanol EBITDA between \$160 million and \$180 million.

Now I'd like to turn the call over to John to review both Green Plains Inc's. and Green Plains Partners' financial performance, and I'll come back later on the call to discuss the outlook for the rest of the year and the status of our portfolio optimization plan.

John W. Neppi - Green Plains Inc. - CFO

Thank you, Todd.

Green Plains Inc. consolidated revenues were \$987 million in the second quarter, up 11% from the second quarter a year ago. The increased revenue is attributable primarily to the growth in our cattle feeding operations from the acquisitions we made in 2017. Revenue in our ethanol production segment declined 4%, driven by an 8% decline in ethanol gallons sold, partially offset by higher DDG sales.

Consolidated net loss for the quarter was \$1 million versus a net loss of \$16.4 million a year ago.

During the quarter, the company recognized a net tax benefit of \$8.3 million for federal and state R&D credits related to the current and prior periods. Excluding the impact of R&D credits, our net tax benefit was \$2.5 million, resulting in a consolidated effective tax rate of 34%.

EBITDA for the second quarter was \$41.8 million compared with \$24.1 million for the second quarter last year. For the quarter, SG&A increased \$4.1 million, driven almost entirely by timing of incentive-related compensation year-over-year as well as the growth from our cattle feeding operations.

Interest expense increased \$2.6 million, driven in part by higher average borrowings primarily for cattle inventory and roughly 90 basis point increasing our variable interest rates.

For Green Plains, CapEx was about \$7 million in the second quarter, most of which was maintenance capital across our ethanol production assets, the cattle feedlots and the vinegar plants.

We anticipate we will spend about \$11 million in capital for the remainder of 2018 with the majority of that being maintenance capital. These numbers exclude any capital related to our high-protein DDG project, which is still in the engineering and contracting phase.

Our total debt at the end of the second quarter was just under \$1.3 billion. This balance includes \$457 million on our commodity revolvers, which is secured by working capital collateral, including readily marketable inventory of \$548 million. Total term debt, including our term loan B and convertible debt, was \$838 million.



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Because of our agreement to acquire the Bartlett Cattle feedlots, we have amended the Green Plains cattle senior secured revolving credit facility, increasing the maximum commitment from \$425 million to \$500 million to fund the additional working capital requirements. The amended credit facility includes an accordion feature that enables the credit facility to be increased by up to \$100 million with age and approval.

On Slide 10 in the IR presentation, you will note that our term debt leverage ratio was 5.5x at the end of the second quarter versus 3.7x a year ago. This is primarily the result of a decline of \$49 million in trailing 12-month EBITDA and an increase in our term loan debt balance year-over-year. Our term debt leverage ratio did improve versus last quarter.

Our liquidity remains solid with \$251 million in cash along with approximately \$510 million available on our revolvers at the end of the quarter.

For Green Plains Partners, we reported EBITDA of \$16.9 million for the quarter, which was slightly better than second quarter of 2017. Green Plains Partners had 314 million gallons of throughput volume at its ethanol storage assets, which included an incremental 18 million gallons related to inventory liquidation and transload volumes.

Distributable cash flow of \$15 million was down just over \$300,000 from \$15.3 million reported a year ago. Distributable cash flow was affected by higher interest expense due primarily to an increase in the rate of our LIBOR-based credit facility.

We had a negligible amount of CapEx during the quarter.

The partnership's distribution of \$0.475 per unit declared on July 19 resulted in a coverage ratio of 0.97x for the second quarter.

On a 12-month basis, adjusted EBITDA was \$69.3 million, distributable cash flow was \$63 million and declared distributions were \$61.2 million, resulting in a 1.03x coverage ratio.

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

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

Thanks, John.

As I -- as we indicated in the release this morning, our portfolio optimization plan is on track with the strategic objectives we communicated in May. We are in the middle of a robust process, which we believe will allow us to significantly reduce or eliminate term debt by the end of the year. I am not at liberty to comment on specific information related to the process or values or the number of plants or which plants or even how many gallons other than to say we are encouraged by the interest level across the board and reverse inquiries on assets as well. Once again, we believe there is a significant discount between public and private valuations of plant assets, and we see proof of that in our process. We certainly understand the need to communicate developments of this plan as they occur. We will do so when we are ready for both our Green Plains shareholders and our partnership unitholders. As I said earlier, we will remain focused on proving value for our shareholders.

We have also made good progress in our plan to reduce controllable expenses starting with this quarter. I'd like to point out that some of these expense reductions will come through some of our segments and are not all on our corporate activities' lines, although we have made some workforce reductions as we start to plan for the future.

Our high-protein initiatives is in full swing. We continue to work through permitting, engineering and site preparation for the installation of this technology at our Shenandoah location. As we make process on deploying this process technology, we will -- the more we believe in the -- excuse me, as we make progress in deploying this process technology, the more we believe in the revaluation of this industry through a technology revolution.

Global demand and processing margins remain very strong for all things protein, and the ethanol industry should participate in that going forward, as we raise the protein levels for the products we produce through various technologies.

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We are determining the next several locations where we would deploy technology to increase the value of our products. Our review is the ethanol industry remains 2 to 3 days in an oversupply position. Margins have shown some improvement but still lag behind mid-cycle levels, and the -- and this time last year, same margins.

Gasoline demand is approximately 1.5% ahead of last year on a year-to-date basis, but domestic ethanol blending is flat from a gallons perspective. The 2018 ethanol blend percentage in the fuel supply has averaged 9.7% in 2018 from 10% in 2017. The lower ethanol blend percentages in 2018 overall can be attributed to the overreach of the EPA, granting the large number of small refinery exemptions. This issue will be litigated, however, as the Tenth Circuit Court of Appeals agreed on Friday, July 27, to hear the ethanol group's lawsuit challenging EPA's actions on the granting of exemptions.

Through Prime the Pump, we continue to work with retailers on expanding their store footprints, selling E15 and potential new retailers looking to begin selling this product. Some of the biggest independent retailers are implementing aggressive strategies to roll out the E15 across their locations as the discount to gasoline remains very wide, and they still get the benefit from RIN prices for blending ethanol. Spot blend margins for the additional 5% blend can be as high as \$0.90 in some areas of the country.

Green Plains and the ethanol industry are focused on pushing through the RVP waiver for E15 and getting prior refinery exemptions reallocated in future periods. We saw strong support from the White House on E15, as evidenced by the recent comments from the President.

The industry production of ethanol is running 2% higher than 2017's run rate, supporting our previous assertion that the next phase of debottlenecking is more costly. Exports have remained strong, totaling \$776 million through the end of May 2018. That is 31% higher than the same period of 2017. Our expectation for 2018 exports is closer to the lower end of the range of 1.6 billion to 1.8 billion gallons, but we do have hope that ongoing tariff discussions could increase export volumes toward the end of the year.

We are focused on 4 main growth areas for global trade in a low- or no-tariff environment. China, Japan, Mexico and the EU, which, along with the RVP waiver, can really change the balance of the industry very quickly.

The corn crop is in good shape. We believe there could be an upward revision to the yield per acre in the coming weeks. Currently, the replacement value of the stores to corn is averaging 95% to 100%, which is down from Q1 of 110% but much better than the second quarter of 2017, which was averaging around 80%.

As it relates to Green Plains Partners, I'm pleased to welcome Martin Salinas to the general partner Board. He brings a wealth of MLP experience to the partnership, and I look forward to working with him.

With the AMID terminal acquisition terminated, we have refocused our attention on dropping the Beaumont terminal, and we'll work to have that completed in the next 60 to 75 days. We have again refocused our efforts to look for acquisitions as GPP is well capitalized and has the capacity needed for a transaction to happen.

I want to reiterate what I communicated on the last earnings call. Our goal with the partnership concerning our portfolio optimization plan is to maintain the distribution and long-term coverage ratio of 1.1x. We plan to use any cash proceeds in the appropriate manner to achieve this and will take the necessary steps to execute this strategy.

We also believe that the reduction of term debt for Green Plains improves its credit quality, which have a positive impact on the partnership.

Overall, our goal remains to improve the market capitalization, delever our balance sheet and improve our financial flexibility as we focus on the future.

I want to thank everyone listening in the call today for their support as we recreate Green Plains.

I'd like to ask Latiff to start the Q&A session.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Adam Samuelson of Goldman Sachs.

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

First, a question just on the ethanol market. And Todd, I mean, there's some -- a bit more subdued comments in the near term given some of the oversupply. Is it a fair characterization in your mind that you really need some sort of change on the tariff structure in the export market in the back half of the year to get this market tightened up? Or is there anything else that you see that would change that sooner?

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

Yes. I don't think the market's going to tighten up much from here to the end of the year. I also don't think it's necessarily going to grow a lot of stocks either. I think where we're at right now is that we're basically using what we produce. Gas demand, as reported today, was excellent. And so I think continuing with a strong gasoline demand numbers at least keeps the market from growing a bunch of stocks. But I do believe we are going to need some impetus to start to draw 2 million to 3 million barrels, which is what's needed, and we thought that impetus would come from a strong Chinese program. Obviously, that is being put a bit on hold. We'll wait and see what happens through this recent discussion or potential discussions. Brazil, we're expecting a strong finish as well. We'll have to wait and see where that comes in. So we're counting on them to be in the last half as well. From a domestic standpoint, we are kind of -- we are where we're at from what's of kind of being -- what's being reported. So in general, we'll probably stay at these levels, and margins will just -- depending on how shutdowns go throughout the industry and with some heat coming into next week as well and then, obviously, execution on some of the export programs at least in this quarter potentially. We saw some strength come into the quarter. And right now we're just steady.

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

Okay. And then switching gears on the portfolio optimization plan. I know you characterized the process as robust but still ongoing. I mean, can you just provide any kind of time line or guidepost for when you think you could be in a position to make announcements? And, I mean, is it something where only ethanol plants are really on the table? Just beyond the ethanol businesses themselves, what else are -- that you can speak to? Any additional color would be helpful.

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

Yes, our goal is to have some of the sales process completed in early fourth quarter, if not a significant piece of that. And then from there, anything left that has to close should close in the fourth quarter. We haven't announced specifically, other than in the people involved in the process under NDA, what is -- what we are looking at. As well as, like I said, we've had reverse inquiries. But in general, we had basically talked about -- in the past calls that we're focused on gains or proving value on the -- some of the assets that we have to prove value for the rest of the assets. And so we're certainly looking across the portfolio. We've had interest across the portfolio in every good business that we operate. But at this point, we're mainly focused on our ethanol segment as we believe there's a lot of value to be proven there, and we'll see how this whole thing ends up. But we believe we are on track for late third quarter, early fourth quarter announcements and potential closes.

Operator

Our next question comes from Farha Aslam of Stephens Inc..



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Farha Aslam - *Stephens Inc., Research Division - MD*

When you say Green Plains up to full capacity, does that mean kind of 355 million gallon run rate? What did you decide as full capacity for you at this time?

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

Our view is -- so we're bringing it up now as we speak, but our view is our platform will run in the low 90% on a day in and day out basis because of shutdowns and repairs and maintenance and things like that. So we believe it's the long-term run rate at 90% to 92%. And it could be higher as well. It'd be somewhere between 340 million and 355 million gallons just depending on -- there are certain things that happen during the quarter that just shut down a plant for a couple of days, which could impact it. But other than those things happening, normal repair and maintenance schedules, some quarters will be higher, some quarters will be lower, but we're going to start to push/pull out on most of our assets. I would only say Hopewell is the one that has more of a seasonal assets. It'll start to come back up harder with harvest happening in the East Coast and being able to buy corn cheaper. And then there's other opportunities to bring that plant up, up and down, but that plant will probably be the swing volume more than anything else -- everything else at this point. Other than normal fixes, normal turnarounds will run in the 90% to 92%, 93% of capacity.

Farha Aslam - *Stephens Inc., Research Division - MD*

That's helpful. And then when you look at the ethanol market in your release, you highlighted that spot basis is robust or better. But on this call, you said that margins are pretty lackluster because of the oversupply, down from last year. Is -- should we think of it short of in line with the June quarter? Or how should we think about what you're realizing on the gallons you're producing?

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

Yes. From where we started out the quarter now that we're a month through it, so far we've been averaging in line or a little bit better than last quarter, but we saw some low double-digit margins to start out the first 30 to 45 days. We'll have to see where we finish out. We're still highly inverted in the market, so we -- it's hard to predict where August and September will ultimately end out. But what we did see last quarter and really starting towards the 1st of the year is there's been a disconnect between the Chicago market of what gets priced every day and then the tightness in other markets around the United States. And so we had sold significantly -- or not significantly but higher basis level than index values than we did all of last year, which was very weak. So there seems to be a disconnect between tightness in certain markets and the overall margin structure, and we'll have to see how that plays out. And that's really driven by this really good gas demand number. On any given day, when your -- when the market is trying to get the benefit of the \$0.90 ethanol blend in certain markets such -- there's a lot of tightness that has been around. But the stronger market still has remained one of the weaker spots while everything else has been very firm.

Operator

Our next question comes from the line of Ken Zaslow of Bank of Montréal.

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

So my first question is, I must be not understanding fully the strategy. I thought that strategy was to exit businesses. And then I think the last couple of days, you actually -- you guys actually acquire a cattle feeding business. What is the intention? And then why is it [a disparate] strategy?



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

Well, what we had said is we're going to reduce exposure to the volatile ethanol crush that we've had where we believe that our ethanol assets are disconnected from a valuation standpoint between the private and public valuations. We saw this opportunity as a small capital investment, but it's a -- from a return on invested capital and an opportunity to continue to diversify away from a much more volatile ethanol business than what we see in our ability to manage risk in cattle. We think for our shareholders, it was a good opportunity to increase the non-ethanol operating income going forward and more predictable non-ethanol operating income. We're 3, 4 years into this strategy. Over those last 4 years, we've averaged over \$60 to -- \$60 a head on margins for all of the cattle that we've fed and brought to market. And we've consistently been able to achieve those type of numbers. Some quarters are \$25, some quarters are \$100. But in general, we've always been able to achieve a return on our capital better than we see in the ethanol business. I would say the growth that we did -- that we announced yesterday by acquiring the Bartlett Cattle Company, which we're very excited about, that puts us in a good spot for the time being, and I don't anticipate any significant growth in that area at this point. But we still believe that the all things protein initiative that we have gave us a good reason to acquire that while we're divesting of certain assets that are not as predictable from an income and earnings standpoint.

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

So it's safe to say that you're not going to be divesting your cattle feeding business. Is that a fair conclusion? You wouldn't be buying to sell, right?

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

Yes. What, we had said is -- the thing that we're focused on cattle is -- because it does skew some of our numbers on our balance sheet, is that we are looking at a potential -- at potential off-balance sheet transactions to see if there's a way to get it off balance sheet and talking with partners on that. And that's our focus there so that it does help a lot of our ratios to take that debt off balance sheet.

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

Well, I also thought that there were other non-ethanol assets that were up for sale as well. Or could be if there was a right price for it. Is that not -- that is the case?

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

That is the case.

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

Okay. Then my next question is, I think you mentioned that cattle market was a little weak, but you expect a recovery. What is the fundamental basis behind that?

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

No, what we said is we have such a strong \$100 a head margin in the second quarter. Now returning back to normalized, what we would say is that \$50 to \$60-a-head margin structure overall is kind of what we focus on when we buy a head of cattle. And again, some will be lower, some will be higher. It's a little harder to buy cattle in the beginning of the years that are going to get marketed in the half of the year just because of some of the tightness. But now we're starting to see that change as well, which -- with new cattle placements as more feeders coming to market. Basis levels have continued to remain firm. Demand for -- cattle demand has still been robust. And I think overall, from our standpoint, we're just a conduit for that, and we want to earn a minimum margin on our capital. And we just won't buy cattle under a certain level. And so the fixed investment is still very low relative to the opportunity. And so if we make the decision that we do want to feed cattle at a certain margin level, it reduces our overall



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debt levels but not necessarily is net negative for the business. So we can -- and I think what you've seen, Ken, one last comment on that, the cattle feeding industry has consolidated. You saw the acquisition earlier in the year, the big one of the largest cattle feeder. You're also seeing #2 and #3 make acquisition to smaller lots and ourselves at #4 making acquisitions of smaller companies as well. And what you see in a daily -- in the daily market is much more discipline coming around the need to buy feeder cattle. And so while in the past a lot of cattle feeders were directly focused on taking care of the packing demand that was owned by those companies, there's not a lot of packers anymore that own cattle feeding operations. And so the cattle feeding operations are much more disciplined in their approach to buy feeder cattles. It can become a little bit more predictable than they have been in the past on returns.

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

And my final question is, how do small refinery exemptions get resolved? When will that stop? And how does that work? Because that seems like last year, the issue was debottlenecking. This year seems to be the small refiners in China, like -- it's like you're always on the cusp of actually getting a good -- everything setting up well, and all of a sudden, the -- everything -- somebody pulls the rug out from underneath you guys. What's the story with the small refinery exemptions?

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

While certainly disappointing from our perspective, it is driving the reason why we're not blending at a full 10% right now. We think that on a go-forward -- what has happened in the past in a number of small refinery exemptions, especially with the money that refiners are making, there is not a lot of hardship anymore, and RIN prices have come down to \$0.20. So at this point, we don't see how that EPA could issue many small refinery exemptions going forward, nor do we see how they could issue them in the past. We're going to -- the industries are going to fight very hard to get those reallocated as under the law, they should be. I think that we are making sure that our contacts in D.C. and our champions in D.C. are continuing to fight the battle, but we are having to deal with the fact that the EPA administrator granted small refinery exemptions to what we believe were companies that should not have gotten them and has really taken the market a bit out of whack this year and out of balance. And so going forward, I don't think it will be as robust, so I don't think it'll be as big of an issue. It was more of a -- we believe it was more of as parting gift to the refining industry, and we continue to fight every day to try to get those reversed and/or reallocated. But on a go-forward, we don't think it'll be as much of an impact as it was in the past as RIN prices are hovering around \$0.20. So we should get that out of our -- at least that factor out of the mix going forward.

Operator

Our next question comes from Craig Irwin of Roth Capital Partners.

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

So Todd, I did want to ask about the small refinery waivers. This case moving forward in the Tenth Circuit, can you maybe discuss the remediation opportunities that are being pursued there? What do you think the industry should ask for? Would you expect the President of small refinery exceptions in the past being reallocated to prove a pathway to a way this plays out? What are the other scenarios that you look at if we assume that giving waivers to some of the largest refineries in the country was illegal and inconsistent with the law and that, that's the finding of the courts? What do you see as the potential outcome or range of outcomes for remediation here?

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

It's not a short-term outcome, it's a long-term outcome. I mean, ultimately, this thing will fight its -- will make its way through the courts depending on the rulings, and it's a multiple-year process. So we don't see the EPA at this point reallocating unless the White House pushes for that. And that's not necessarily something that we believe and even understand what happened necessarily to even go to a point where reallocation is a short-term issue. So I think we're living with the refinery waivers this year that were given out, and I don't see a lot of remediation for the immediate term over



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the long term. Potentially, it could be either through more -- a reallocation down the road, a reset down the road. It's really kind of hard to say what will happen, but I think what has happened is now something we have to deal with from a market perspective. And it's very hard to say when and if and how the courts will rule down the road and then what that impact would be. We were asking -- or at least the court case is asking for the reallocation of those small -- of the small refinery waivers, which is, by the way, that's how it's written in the statute. So that's something that we want to continue to fight for.

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

Okay. And then I think everybody on this call would agree with sort of cautious -- the cautious comments you made about Chinese demand in the second half. But can you maybe update us on the industry outreach to China? The macro of them having 10% of the world's arable land, 20% of the world's population means that they're a big customer for Ag going forward or the U.S. if they want to improve their quality of living. And obviously, their 10% blend mandate that they've put in, if they're ever going to reach that, they're going to have to buy a lot of U.S. ethanol or U.S. corn to get there. Can you maybe describe the conversations that are going forward today in spite of the trade issues going back and forth?

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

Yes. You said most of it. I mean, basically, there's a 10% mandate by 2020, and we don't think internally they can meet that, and they would need to import U.S. gallons to do that. We were expecting 200 million to 400 million potential gallons, which would change the whole economics of this industry. And we continue to tell the trade reps and the administration of what the impact of this trade war is on the ethanol industry, not just agriculture. If we had that, it would be a very different market today, and we will be in a very different situation and discussion today. So we need one of these markets to hit, whether it's Japan opening up in 2019, we believe it's a 100 million to 200 million gallon market in 2019; whether it's Mexico starting small. It's a longer-term gain, but Mexico potentially could start to open up. If you look at the EU tariff situation, we're \$0.20 close right now because of their tariff. But if they took their tariff off, we'd actually be \$0.40 positive to import margin into the EU. And obviously, Brazil, hoping we get some strength out of the end of the year, but the long-term, Renova Bio is really the thing that we're focused on over the next several years. And really, it's things like -- around the world, decarbonization in the -- much looking -- much more like the LCFS market that we see in California, that could be a benefit to U.S. ethanol as we continue to take our carbon intensity numbers lower as well so that we can hit a lot of these markets. And then the big ones are things like the work we're doing in the Philippines and India and Indonesia. In particular, we think there's an opening there. There's a lot of growth. It's just not hitting right now. And so at this point, we're in that 3- to 4-day oversupply position. If any of those markets open up in a big way, we could take care of it pretty quick. If Japan takes another 100 next year, that's 2.5 million barrels all of a sudden off, 2.5 days almost off the pending stocks. So it's really just a function of time. And as we -- as one of the earlier question came, it's always on the cusp, it's always on the verge and we just have to have a few things happen. But I think it's starting to shape up. If we can get to through this trade war issue, I think at that point, the world opens up for our fuel.

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

Great. And then a last question, if I may. Trump's come out fairly strong in support of the blend waiver for ethanol. Can you talk about how this could take place, whether or not it would have an impact this year or more likely next year, and what you're hearing from your representatives there?

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

And we're trying to get there. I mean, the President has come out. He knows the importance of the E15 waiver or the RVP waiver to his farm states Coalition. And -- but obviously, he's trying to win Pennsylvania as well, and I think that -- so we have to deal with that. There were deals on the table which I think were doable, and that was one RINs were significantly higher. Now we're in the \$0.20. And if you're in the refinery business, you have no real motivation to come up with a -- come back to the table to negotiate. So now it's really just a function of the administration realizing that the hurt is gone from the refinery industry, yet the ethanol industry didn't get much in return except a lower RIN and no RVP. And that's why I think the -- we are very focused on continuing to get the President to support it. Obviously, he's walking the fine line between farm states and oil



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states, and we have to always respect that. But at a \$0.20 RIN that the market is today, any RIN cap in the past would have been irrelevant because, as we said, the more ethanol you blend in E15, the lower RINs are going to go anyway. But E15 is the price. And so I think there's a path. I think this administrator in EPA has to walk the fine line, obviously, but I think he's more open than the last administrator was. And we are continuing to push. They can do it, and we're continuing to put all the -- all our resources into getting an RVP waiver. It is the single most important event that this industry could have for its long-term growth in both ethanol and agriculture.

Operator

Our next question comes from Eric Stine of Craig-Hallum.

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

I just want to stick with that question a little bit just on the waiver. I mean, obviously, under Pruitt, it was pretty clear that nothing was going to happen unless it included a number of other things as part of kind of a grand compromise. I mean, do you think that under new leadership here, that there's potential for the waiver to move forward standalone? Or do you still think that, I mean, it's got to be part of something larger?

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

There it can go both ways. I mean, I think this administration can make the call right now to give us an E15 waiver with a -- while the benefit of the small refinery exemptions and low RIN prices have already given the refineries everything they needed, and we're getting the low end of the stick on that one. And so they can do it right now. We're pressing them to do it. The new administrator understands the importance of it. He understands the ethanol industry very well from some of the past things and his past work. So in general, they can make a call tomorrow, and that's what we're asking them to do. Obviously, the -- it's on the President's mind. As soon as he lands in Iowa, he says we're very close on E15. We'd like to get some clarity on that. I think our senators, our champions from the farm states between Nebraska, South Dakota, Iowa and other states that are very important to this administration, are pushing very hard in trying to get clarity. And I think we're on a path. I think we've given up everything so far from the side of what the refineries have gotten, and we really have gotten nothing in return. And that's a -- that is really where the rubber is going to meet the road, is them -- is the administration realizing that if you really want to make a big pitch to agriculture during this trade war, RVP is the answer, and it's not necessarily the need to spend \$12 billion on subsidies.

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

Right. Okay, maybe last one from me just on the cattle acquisition. I mean, just remind me how we should think about that transitioning to Green Plains' own cattle. Should we think about similar to the Cargill acquisition there where it's [4 quarters]? Or does it change just given the size of this operation versus that?

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

Yes, this one is a little bit different. With the Cargill acquisition, we fed their cattle and got paid a fee to do that. With the Bartlett acquisition, as of right now we own all the cattle in the lots, and we will earn a margin on that, which is why we said we believe it will be accretive immediately and going forward. So it's a little bit different of a transaction. So that should start to hit our numbers starting in Q3 and Q4 from an EBITDA per head standpoint instead of just a small feeding margin standpoint.

Operator

Your next question comes from the line of Selman Akyol of Stifel.



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

A couple points on clarification, if I could, just to start off with. Since you're not pursuing the terminals from American Midstream, did you dissolve the JV with Delek? Or is that JV still in force but looking for other assets?

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

Yes, no, the JV is still in place. I mean, it was just a JV we had put in place for that. And going forward, we'll have to figure out what to do with that. Do we pursue assets together or separately? We have a great relationship with them, and we believe we'll work together well in the right situations. So that's how we've left that at this point.

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

Okay. And then you also...

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

And then we have the other -- and we do have the other JV with them anyway. So, I mean, we are in a JV in general with those guys in Oklahoma.

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

Got you. And then previously, you had mentioned talking and looked at some off-balance-sheet items and maybe pushing it to partners. Can you just give some further color along that on what you were referring to?

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

Our off-balance-sheet that we're looking at is getting cattle off balance sheet because of the size of the working capital financing that it takes, and that's throws off our numbers in terms of when we just -- it just gets bundled in straight debt, and it's really working capital back by ready, marketable inventories. And so from the standpoint of that, that's where we focus most of our off-balance-sheet transactions.

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

Yes, we do have -- we are still working on getting the Beaumont terminal pushed down to the partnership. And that was -- had been scheduled for earlier in the year, and then we announced last quarter that we moved that deadline to middle of October. And so we're still on target to get that done yet this year.

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

Okay. And then also just with Martin Salinas being on board at the board level, are you guys broadening your search for what kind of assets you would have partners invest in? Or can you give any color on where else you may go here? Or should we just think of it as being all terminal related?

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

Yes. At this point, obviously, our strong sense of what we're looking for based on the things that we do is to look for terminals that we can enhance profitability by owning the supply that goes into, at least, a piece of that terminal, and then using our supply chain to see if we can enhance those

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volumes instead of paying others to go through their terminals. That's really been the goal of acquisitions. That was the goal of the American Midstream acquisition in Little Rock and down in Texas, is that we both believe in the JV we can enhance the profitability through pushing our own volumes through as well as keeping third-party volumes flowing as well. And we just think that there would be a -- with the FTC at this point. So Martin's strength and ability and what he achieved in his career is nothing but helpful from the standpoint of looking at acquisitions. And we still believe that using Green Plains Partners as a growth vehicle in downstream is what it was meant for and what we will still use it for in the future. And so that hasn't changed much. Obviously, not getting this deal through is a bit of a setback, and so -- but we do have extra capacity now to get a transaction done, and we will continue to search for transactions, as we do every day.

Operator

Our next question comes from Pavel Molchanov of Raymond James.

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

Throughout the past decades, we've obviously seen a lot of up cycles and down cycles for ethanol. But it feels like your response to kind of the print headwinds, let's say, has changed from years past where you're actually looking to be a net seller of ethanol plants rather than an accumulator. And I'm curious what prompted that shift because in the past, when prices were low, you were looking to take advantage of that by buying off assets.

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

Yes, I mean, basically, what we're looking at now is we want to be -- start out debt free, term debt free, where we obviously will sell some converts outstanding and working capital financing. But we want to start out, again, term debt free while we look at the next 10 years in ethanol. And we think the next 10 years in ethanol, while certainly there's really interesting potential between some of these things that we talked about of RVP and global export demand for the cheapest product in the world today, I mean, there's nothing cheaper from a molecule standpoint than ethanol today sitting at \$0.60 to \$0.70 to \$0.80 under gas in certain locations. And so obviously, that's going to be a key factor going forward. But the bigger factor really is -- and what we have said, and I know you have done work in the past, which is, what else can an ethanol plant do? And so while we look across multiple agricultural processing industries and we see that if you can make high-protein, you're getting paid for it in the world, there are now technologies that exist that an ethanol plant can increase the value of their co-products of distillers range through multiple different opportunities. And so we chose the first one, which was the Fluid-Quip technology, to raise our DDG protein above 50% or 50% or above, and that will get us our first step. And that's going to take a capital to do that, so we wanted to start out the next 10 years of refocusing ourselves on the high-protein distillers markets globally and use that capital and excess capability to really start to expand those margins. Why is that important? Because we believe that by making 50 protein distillers grains, we will walk it every day with an additional -- a stable \$0.10- to \$0.12-a-gallon margin plus \$0.03 or \$0.04 a gallon on -- or \$0.02 to \$0.04 a gallon on corn oil before you even make a gallon of ethanol margin. And so while we'll have to contract to start to get that done, but the over long term, we still believe that we're still committed to the industry. But we wanted to make sure we have full financial flexibility in our balance sheet. We also believe there's a mismatch between the private and public valuations, and that's why we want to prove value for our shareholders as well, and we think we'll be able to do that by the end of the year.

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

Okay. RINs are obviously pretty depressed right now for corn ethanol, but they are still exceptionally strong for cellulosic. And as a company that has historically stayed away from any kind of exposure to the cellulosic part of the value chain, I wanted to ask if anything's changing in your thinking in that regard, whether it's the cellunators or getting into potentially some full-scale plant development in that regard.



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

Yes, I would say full-scale plant development is not on the table for our company in terms we don't believe necessarily there's a full-scale technology that exists today that we wouldn't -- that we would want to spend capital on. Now there is some technology that's out there today where you can increase your protein to -- in the 30s -- high 30s and 40s that you can generate and advance RIN because you can make some advanced gallons through cellulosic -- some cellulosic bolt-on, as they would call it, to increase some of your volumes. So there's a bit of that out there, but that doesn't achieve the goal or what we want to achieve, which is the absolute highest protein that we can make out of our commodity, out of our distillers grains. And so that's why we're focused on 50 protein-plus. We think if you're going to increase the value of the distillers proteins, you should increase it to the soybean -- high-protein soybean meal levels and not below it. And so that's why we're fully focused on that and not at all focused on cellulosic or advanced RIN generation.

Operator

Our next question comes from Patrick Wang of Baird.

Patrick Wang

Todd, my first question is just clarifying on an earlier point. Can you talk about your appetite for dropping non-ethanol-related assets to GPP? It sounds like there's been no change in strategy there where GPP would generally focus on the terminalling type of business rather than possibly going into cattle.

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

Look, cattle is not really anything you can drop into an MLP under the law. So if we have anything in our asset base that can be dropped, I would say we would do that much like we're doing with our terminal development. But there's nothing beyond that, that can actually be dropped, if anything else, that we own today into the MLP. There has to be external acquisitions of qualifying assets.

Patrick Wang

Okay, understood. And then how, if at all, does the portfolio optimization process at Green Plains Inc.'s square up with the initiatives that we previously discussed around growing non-affiliate revenues at the partnership? Or should we just think about those as 2 separate work streams?

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

No, I think what you have to assume is that if we divest an ethanol plant, there is a contract that we would have to then monetize back to the partnership. The partnership would then get cash back that they can do one of several things. One is to invest in assets to maintain distribution levels and grow them. And that's one thing that we can do. The other thing to do is to then -- if there's no opportunity to do that, we can keep -- we can pay off our debt at the MLP. And thirdly, the other thing we can do then is tender for shares to keep the distribution coverage ratio steady and not be dilutive. So we are fully focused on the plan that if we divest an ethanol plant, there will be cash going down to the MLP and the MLP could do one of those 3 things. And then obviously, we will be well financed and ready to make acquisitions as we continue to search for them.

Operator

And our last question comes from the line of Heather Jones of Vertical Group.

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

So I had a quick question on E15. I know that as of -- given the current infrastructure that's in place and if you were able to get the RVP waiver, what is your current estimate of what -- how much that would increase domestic demand?

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

Jim, you have those numbers. You want to kind of run those through where we think '18, '19 and '20 are in the different situations?

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

Right. I think based on our comments from first quarter, we should be doing similar around 170 million gallons this year off of about a 70 million run rate last year. And that is based on not having the RVP for this summer. So remember, we switch over to winter blends come September 15, so E15 will be back for 2001 and newer model cars. The hope, certainly, with our push to get to RVP through E15 now is we'll have the debt cleared to have it not be interrupted as we go into summer driving next June 1. Our -- I believe what we also have to put out there is the amount of gallons going into '19 with the waiver in place would be to double the amount of gallons. So we could be looking somewhere around 350 million gallons. That does assume we continue to expand the station locations. We're currently about 1,450 stations, going to 1,800 to 2,000. As Todd mentioned earlier, we do have a number of existing retailers that are looking -- expanding their footprints. We have potential new retailers that are still going through the process and want to be a part of the plan. And that's in the face of everything we continue to push through for the E15 waiver where RINs are -- it's really a lot of it being driven economically by the spread. So I hope that answered your question, Heather.

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

It does. So when you're committing, Todd, to running 90% to 92%, is it basically -- implicitly, you're saying that the inefficiency that was causing you on your plants, you basically don't think your running lower can influence the [plot] or man enough to get the prices up enough to offset the inefficient -- cost inefficiency. Is that fair?

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

Yes, I think where we're at today with gas demand where it's at, where the industry really runs at below 1.1 a day, where turnarounds always happen and pushing your old plants harder. For some in the industry, it has been a harder thing to do and more costly. I think what we're seeing as capacity increased this year, which is what we expected, was 1% to 2% versus what we've seen in the past several years, the 5% to 6% or 7%. And so now that we're at a steady state, it's not just going to be Green Plains' job to regulate the industry and the industry volumes. And so we've put enough -- we've put money into our plants over the last couple years to make sure that when we run harder, we can do it because we've made the necessary repair, the maintenance that our cost structure is not going to increase. And so we think that by running lower over the last several -- 3 to 5 quarters is a negative \$0.02 to \$0.03 absorption of our cost structure, while certainly last year at this time when we did get it, we made it all up. What we're starting to see now is that as we ramped our volumes back up, we're really not starting to see a big growth in stocks or growth in production, which means others are either not able to ramp up quite as much as they thought or others are making the decision to run full rates on their own margin structure. So it's not just going to be the job of Green Plains to be -- to regulate volumes in the industry, and we feel like we're just going to push as hard as we can for our shareholders. And obviously, we could change that idea going forward, but at this point, we think we've done the job that we need to do, and we're set up right now to benefit from some of the things that we've done over the last couple years. Like we've said, we were upgrading plants, we were changing some of the old plants from continuous to [patch], and that put us down. We were doing other things as well. And so we're at the point now where we're fully ready to run as hard -- as full out as we can and let the chips fall where they may.



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

Okay. And just 2 quick questions. One, you talked -- you did \$100 roughly a head in Q2 for cattle. Your target is \$50 to \$60, so does that imply that we should see a pretty significant deterioration in Q3 margins versus Q2? And secondly, with Trump's farm, a, bills have you seen any slowdown? Or do you anticipate any slowdown in farmer marketing while they await those payments?

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

So obviously, if we made \$100 in Q2 and we say we're not going to make it in Q3, there will be a drop in our earnings just quarter-over-quarter. But consistently, throughout the year, we still maintain our view that we will earn \$50 to \$60 a head on our cattle. And again, some quarters may be \$30 and some quarters may be \$70. But in general, over a trailing 12, we believe that could still happen. So yes, it's -- obviously, you can see that in Q3, cattle margins will be off because we did so well in Q2. And it's probably not -- we can't replicate that necessarily every single quarter, and sometimes it's just how you buy and sometimes it's how they close out, sometimes it's just a strong basis. So yes, I think you can anticipate that the last half of the year, probably not as strong as the first half because the first half was exceptionally strong but still within the range of what we had indicated to you earlier. In terms of farmer marketing, this is very interesting because we are -- as we said, we lifted our grain storage and sold our grain storage and lifted our piles that we have. You know that we have made a significant investment on storage in the last couple of years and we earned our return, which is why the reason we had a strong Q2 on grain handling margins, expecting that come September, October, November we'll refill those storage. We'll actually -- what we're seeing right now is we're refilling now because there is basis with weakness in the West, the farmer has a significant amount of corn still to market, the commercial needs to make space for a big harvest coming in corn and beans. And without a Chinese program, we're going to have -- what are you going to do with 200 million to 300 million bushels of extra beans every single month except to push out storage of something else in your tanks. And so that is a positive for the ethanol industry, is the fact that we're starting to see robust farmer and commercial marketings of corn, the lower basis levels. We could actually come in to harvest more full than we've ever come in to harvest before because we're filling piles that we would not even start to fill until October. We're filling them now. And you can carry that grain all the way through next year at this point. So this would be a year potentially, if the Chinese program doesn't get worked out, that the grain handler will earn a better-than-historical return on his space.

Operator

At this time, I'd like to turn the call back over to Todd Becker for any closing remarks. Sir?

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

So thank, everybody, for coming on the call today. Obviously, we have a lot going on at Green Plains. Our portfolio program, optimization program is fully on track, as outlined to you. We expect in the next 90 days to be able to make announcements and discuss some of the things to achieve the goal that we outlined on May 7 to you. And it all remains on track, and we continue to thank you for your patience. And hopefully, we'll get some of these things done, get some better markets ahead of us. And we'll talk to you guys next quarter. Thanks a lot.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day.



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