

NORTH DAKOTA LEGISLATIVE BUDGET SECTION

**NORTH DAKOTA MILL AND ELEVATOR ASSOCIATION
INDUSTRY COMPARISON**

**PRESENTED BY:
MARK MARTENS
EIDE BAILLY LLP**

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North Dakota Mill

Grand Forks, ND

Eide Bailly LLP was engaged to perform an industry comparison evaluation of the North Dakota Mill and Elevator Association (ND Mill). This evaluation must include a comparison to industry averages or standards of:

1. Financial data reflected on balance sheets and income statements;
2. Cashflow data;
3. Ratio analysis of working capital, operating efficiency, marketing, and other ratios;
4. Liquidity ratios to determine appropriate working capital needed for the mill;
5. Pretax income levels;
6. Business opportunities;
7. Capital investment and recommended net assets levels; and
8. Officer and employee compensation guidelines, including gain-sharing programs.

The ND Mill is in the primary business of milling Hard Red Spring Wheat and Durum Wheat grain into flour and semolina. The flour, semolina and mill by-products are marketed in various packaging for wholesale and retail usage. The grain milling industry includes about 400 companies, with the top 25 companies accounting for 25 percent of the industry revenue. The ND Mill is included in the top 25 companies based upon net sales as determined by Standard Industrial Classification (SIC) code rankings.

The industry comparison for the ND Mill in this evaluation include Standard Industrial Classification (SIC) code 2041 *Flour and other grain mill products* with a range in net sales from \$100,000,000 to \$249,000,000. The net sales range used for this evaluation includes 13 companies as of December 31, 2008.

The companies included in the grain milling SIC code include establishments primarily engaged in milling flour or meal from grain, except rice. The products may be sold plain or in the form of prepared flour mixes and dough for specific purposes. This grain milling SIC code does not include revenue from mills that prepare breakfast cereals or meal ground from legumes or nuts; that primarily mill rice; or manufacture prepared flour mixes or dough from purchased ingredients.

The ND Mill primarily grinds Hard Red Spring Wheat and Durum Wheat, therefore, the SIC code peer group operations and financial information is similar but not identical to the ND Mill.

The report will focus separately on each of the eight specified segments of the Industry Comparison.

This report is intended solely for the information and use of the North Dakota Mill and is not intended to be and should not be used by anyone other than these specified parties.

Fargo, North Dakota
November 24, 2009

Segment 1a. – Balance Sheet Analysis

SUMMARY

The unique ownership of the ND Mill by the State of North Dakota creates a balance sheet composition that differs significantly from the balance sheets of comparative grain milling companies. The ND Mill, as a reporting unit of the State of North Dakota, has a net asset (equity) level significantly higher 70.65% and 85.01% of total assets in 2007 and 2006, respectively, than comparative companies at around 45.5% of total assets; very little long term debt in comparison to other grain milling companies and higher short term debt than comparative companies. All financing is through the Bank of North Dakota, another State of North Dakota reporting unit, therefore debt structure, between long term and short term, is not required by the bank debt covenants as in comparative companies but at the option of the ND Mill.

When comparing the ND Mill balance sheets to the grain milling industry, creating a ‘comparative normalized’ balance sheet with similar debt levels, cash, investment and other assets levels, the ND Mill shows receivable balances at about 25.0% of total assets compared to 15% of total assets for comparative companies and net capital assets at 42.0% of total assets compared to about 34% of total assets for comparative companies.

The 2008 comparisons are distorted from industry averages by the volatility in commodity pricing in the Hard Red Spring Wheat and Durum markets to unprecedented levels in March 2008. This commodity pricing increase caused the inventory levels to balloon in comparison to other asset balances. Industry comparison is also distorted as comparative mills include grains milled other than Hard Red Spring Wheat and Durum and therefore did not see the same volatility as the ND Mill.

ASSETS

Current Assets

An evaluation of the ND Mill financial assets indicates the current asset composition differs from that of comparative grain milling companies in three areas for the fiscal years ended 2006, 2007 and 2008: cash; receivables, net; and inventory.

The ND Mill cash balances are very minimal at or below 0.15% of total assets in each of three years presented as compared to an industry average of 5.50% of total assets. While the ND Mill cash balances are less than comparative grain milling company averages, the ND Mill appears to have sufficient liquidity through the revolving line of credit to fund all working capital operating requirements.

The grain milling comparative receivable, net balances average approximately 15.0% of total assets, while the ND Mill receivable balances, net are 30.91% to 33.63% of total assets. The allowance for bad debt appears adequate to cover receivable aging. By “comparative normalizing “ a balance sheet for the ND Mill, showing cash at 5.5% of total assets and investments and other assets at 8.6% and 9.6% of total assets respectively, the receivables, net balance for the ND Mill decreases to about 25.0% of total assets, still above industry comparisons but more within reason of the industry.

Inventory increased significantly from June 30, 2006 through June 30, 2008, with the inventory increase primarily due to an unprecedented increase in the Hard Red Spring Wheat and Durum Wheat commodities pricing in fiscal 2008. This contributed to inventory as a percent of assets increasing from below industry averages at 14.83% and 19.88% of total assets on June 30, 2006 and 2007, respectively, to 42.13% of total assets on June 30, 2008. The corresponding industry average inventory balance is between 24.1% and 23.7%. Volatility in the commodities market may continue to cause significant fluctuations in the percent of assets tied up in inventory during measurement periods.

Non Current Assets

Net capital assets of the ND Mill range from 52.8% in 2006 to 25.47% in 2008 of total assets. The decrease in percentage of net capital assets to total assets is due to more assets held in the form of inventory in 2008. Industry averages for net capital assets are between 33.0% and 34.5%. By “comparative normalizing “ a balance sheet for the ND Mill, showing cash at 5.5% of total assets and investments and other assets at 8.6% and 9.6% of total assets respectively, the net capital assets balance for the ND Mill decreases to about 43% of total assets in 2006 to about 20.0% in 2008.

LIABILITIES

Total liabilities of the ND Mill at 14.99% and 29.35% of total assets in 2006 and 2007 were significantly less than industry averages of about 30% in those comparative years. The ND Mill total liability of 61.74% of total assets in 2008 as compared to industry average of 56.4% is indicative of the financing necessary to carry the increased cost of Hard Red Spring Wheat and Durum inventory balances reflected in the asset section.

The composition of the debt section of the ND Mill is significantly different from comparative grain millers. Of note is the comparative companies have long-term debt equal to about 25% of total assets, whereas, the ND Mill long term debt is 4.91% of total assets in 2008 and zero for fiscal 2007 and 2006, respectively. The ND Mill operates on a current line of credit which ranges from 7.1% of total asset in 2006 to 50.69% of total assets in 2008 as compared to short term debt on an industry average of 4.6% of total assets. These differences highlight the ND Mill’s unique ownership and financing by the State of North Dakota. These differences coupled with the minimal cash and investment balances highlight the cash management policy implemented at the ND Mill.

Section 1b. – Income Statement Analysis

GROSS PROFIT

The income statement financial data analysis shows the ND Mill cost of sales for 2007 and 2006 at 83.33% and 79.87% of sales were less than industry comparisons of 83.7% and 83.6% of sales for 2007 and 2006, respectively. As such the ND Mill gross profit of 16.67% and 20.13% of sales were higher than industry comparisons of 16.3% and 16.4%, respectively. The 2008 data shows the ND Mill cost of sales at 92.73% of sales as compared to industry averages at 83.8% of sales. This increase at the ND Mill is indicative of the increased Hard Red Spring Wheat and Durum costs during this period due to hedging roll costs.

OPERATING EXPENSES

The ND Mill total operating expenses for 2007 and 2006 at 12.44% and 14.03% of sales compares to industry operating expenses of 14.0% in both 2007 and 2006, respectively. The make-up of the operating expenses shows that ND Mill depreciation in 2007 and 2006 was 1.68% and 2.11% of sales, respectively, compared to industry depreciation of 1.2% of sales. ND Mill general and administrative expenses of 1.03% and 1.13% of sales are less than the 2.4% of sales on an industry comparative basis.

The 2008 operating expenses of 6.76% of sales are distorted due to the high selling price of hard red spring wheat flour.

Segment 2 – Cash Flow Analysis

Cash flow analysis shows the ND Mill repaying short term debt and investing in capital assets within operating cash flow in 2006. Beginning in 2007 the ND Mill had an increase in financing to cover investing activities. In 2008, due to hedging rolls and commodity price increases, the ND Mill had a substantial increase in financing to cover investing activities and to cover operating activity cash usage.

Comparison to industry shows the industry building cash reserves each year 2006 through 2007 while incurring large amounts of investment as a percentage of net income. The comparative shows additional financing activities each year for the industry.

Segment 3 – Ratio Analysis

Working Capital

The ND Mill working capital favorably compares to industry averages in 2007 and 2006. Due to Hard Red Spring Wheat and Durum commodity volatility the ND Mill working capital needs in 2008 increased by \$5.0 million over comparative companies. Again the industry comparative mill commodities other than Hard Red Spring Wheat and Durum and did not have the volatility in the commodity markets as the Hard Red Spring Wheat and Durum markets.

Two trends in the ratios analysis should be noted; one, a cash management policy has been implemented whereby the ND Mill is, by choice, heavily reliant on short term debt and any excess cash is used to repay the short term debt, and, two, the ND Mill is not subject to income taxes, which distorts the net income to working capital ratios. The 2008 ratios are distorted by the commodity pricing in the Hard Red Spring Wheat and Durum commodities.

Operating Efficiency

Operating expense ratios of the ND Mill for 2007 and 2006 are at or more favorable than the operating expense ratios for comparative companies. In 2008 the increased cost of grain incurred through hedging rolls caused the gross margin to decline and the operating expense to gross margin ratio to lag industry comparisons.

Turnover

The turnover ratios, as calculated based upon the net receivable balances on the ND Mill audited financial statements, indicate receivable balances at the ND Mill higher than at comparative companies. The difference from industry comparisons include financial statement “grouping” differences, marketing strategy, invoicing and destination timing, and lack of a “year-end” financial and tax receivable cleanup.

The cash turnover is indicative of the cash management policy implemented by the ND Mill where excess cash is used to pay down short term debt. The current asset turnover and working capital turnover are affected by the lower receivable turnover as calculated based upon the net receivable balances on the ND Mill audited financial statements. Fixed asset turnover and total asset turnover lag industry comparatives in 2007 and 2006 and may be indicative of more recent fixed asset investments at the ND Mill.

Segment 4 Liquidity Ratios

The liquidity ratios of the ND Mill again highlight the larger receivable balances than at comparative companies. The difference, again, from industry comparisons includes financial statement “grouping” differences, marketing strategy, invoicing and destination timing, and lack of a “year-end” financial and tax receivable cleanup.

The days in Accounts Payable ratio and cost of sales to payable ratio are indicative of the purchases from growers who must be paid according to North Dakota grain dealer regulations.

The current ratio and quick ratio show deterioration from 2006 to 2008 due to the increased costs incurred in purchasing and holding Hard Red Spring Wheat and Durum. The days in inventory indicates the ND Mill purchased additional quantities of Hard Red Spring Wheat due to market shortages, thus incurring additional working capital requirements and cost of holding that inventory.

Segment 5 Pre Tax Income

Other than in 2008, when the ND Mill experienced losses related to the ineffective hedging (and roll costs) that occurred, the ND Mill shows a higher pretax income which translates into a larger pre tax return on assets, pretax return on sales and pretax return on net worth. The review of these returns should be tempered as the ND Mill has a larger net worth and no long term debt in comparison to other grain milling companies.

Segment 6 Business Opportunities

The ND Mill business opportunities should continue to focus on the benefits to North Dakota farmers and to the State of North Dakota. The ND Mill business opportunities can be segregated into the following areas: growth opportunities, product and service diversification opportunities, customer diversification opportunities and educational opportunities.

Segment 7 Capital Investment and Recommended Net Asset Levels

The ND Mill’s net capital asset on a percentage of total assets varies given the volatility in the hard red spring wheat and durum commodities market which increased the percentage of assets in inventory and decreased the percentage of asset in other categories. The capital assets appear to be of approximately the same age as those across the industry as demonstrated by accumulated depreciation as a percentage of net capital assets.

The ND Mill net assets exceeds the industry comparative net assets in each year presented and of the years presented, 2007 and 2006, exceed the industry comparative as a percent of total assets. Fiscal 2008 is below industry comparatives due to the increased inventory level as a percent of total assets.

Segment 8 Officer and Employee Compensation Guidelines, including Gain Sharing Programs

OFFICER COMPENSATION

The ND Mill Officer total compensation as a percentage of sales is less than that of industry comparisons for companies with similar revenue sizes. The ND Mill officer compensation was 0.33 percent of sales versus 0.90 percent of sales for industry in 2008. In 2007 and 2006, the ND Mill officer compensation was 0.58 and 0.68 percent of sales, respectively, versus 0.90 percent of sales for both years for industry.

An industry break down between executive bonus and non-bonus compensation is not available, however, grain milling company executive bonus programs typically are based upon a percentage of EBITDA (earnings before interest expense, taxes and depreciation and amortization) with a large number of companies setting a range between 3% and 5% of EBITDA. The industry long term compensation programs regularly include equity option grants and/or 'phantom stock' programs whereby compensation is based upon longer term increases in return on assets and return on investment to the ownership.

NON OFFICER COMPENSATION

Employee compensation comparison guidelines are based upon surveys of similar positions at other grain milling companies paid during 2007.

Office Supervisory Staff

The surveys indicate ND Mill office supervisory staff wages paid as a base salary range from 14 percent less than industry to 13 percent more than the industry dependent upon position. The total wages paid (including gain sharing or bonuses) to ND Mill office supervisory staff are between 8 percent below industry to 20 percent above the industry for comparable positions.

Non Supervisory Staff

The surveys indicate the ND Mill non-supervisory staff base salary paid is 15 percent less than industry to 12 percent more than industry for comparable positions. The total ND Mill non-supervisory staff wages paid (including gain sharing or bonuses) are 5 percent below industry to 18 percent above industry depending upon position.

Union Employees

Based upon comparable position surveys, union wage rates indicate the ND Mill average standard rates are 2.8 percent below average standard rates for industry union employees.

Summary

The industry comparison evaluation of the ND Mill indicates, with the exception of the 2008 fiscal year, that overall, the ND Mill compares favorably to peer milling companies, especially in better gross profit and operating expense efficiency ratios. Fiscal 2008 was negatively affected by the spike in Hard Red Spring Wheat and Durum commodity prices and hedging roll costs. Turnover and liquidity ratios differed negatively from industry comparatives due to competitive management practices implemented and more recent fixed asset investments by the ND Mill.