From the editors of *Farm Equipment...*

Ag Equipment Intelligence

News, Information & Analysis for the Ag Equipment Marketer

July 15, 2010
Vol. 17, Issue 3

- Ethanol Challenges
- Soggy Canada
- June Sales Mixed

Bearish Crop Report Turns Bullish, Good News for Ag Equipment in Second Half

As farm commodity prices go, so go ag equipment sales.

With that said, the July 9 World Agriculture Supply and Demand Estimates (WASDE) report from USDA is seen as generally a positive for ag equipment manufacturers and dealers going into the second half of the year. But changing government data will, in all likelihood, keep the equipment sector guessing.

Corn Volatility. First, market analysts were surprised by the USDA's projected drop in overall corn acres reported on June 30. The they were shocked by the agency's estimates on July 9 that 2009-10 ending corn inventories were 13% lower than estimates from just a month earlier.

USDA's crop acreage report revised the corn-planted acres down to 87.9 million acres compared with 88.8 million acres in March, but it was much lower than industry expectations of 89.3 million acres. The ag agency also lowered its corn-harvested acres down to 81 million acres, from 81.8 million.

A week later, USDA lowered its 2009-10 corn ending stocks estimates to 1.478 billion bushels, from 1.603 billion bushels. Earlier industry expectations were 1.4 billion bushels.

At the same time, the agency lowered its 2010-11 carryover estimates by 200 million bushels to 1.373 billion. Industry estimates called for 1.269 billion bushels. USDA maintained its corn yield estimates at 163.5 bushels per acre. This is below its 2009-10 estimate of 164.7 bushels per acre, but 2.7 bushels above the 1990-2009 trend.

From all this, the good news for the ag equipment sector is USDA raised the corn pricing to \$3.45-\$4.05 per bushel, from \$3.30-\$3.90 per bushel. According to Henry Kirn, machinery analyst for UBS, the midpoint range of \$3.75 is 20 cents per bushel above last year's estimate of \$3.55 per bushel.

Soybeans, Wheat Stable. Compared with corn, soybean and wheat acreage and ending stocks remain relatively stable, though USDA expects a 106% increase in the 2010-11 estimated soybean ending inventories. It also expects a 27% increase in inventories as a result of the 2009 crop production.

At the same time, USDA raised its farm price range for the 2010-

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Deere Keeps Final Tier IV Strategy Close to the Vest

A June 24 webcast and conference call to discuss how John Deere "will deliver Interim Tier IV-compliant engine solutions and how the technology will be rolled out to dealers and producers in coming months," did little to reveal what direction the company will ultimately take to meet the 2014 final regulations. But it did reveal that the new engine technology is coming with a hefty price tag.

Emission Tech. While Deere has publically announced that it is sticking with its cooled EGR (exhaust gas recirculation) engines to meet Interim Tier IV emission standards, they say they're leaving all options open to other approaches in meeting final standards.

Both of Deere's major competitors, AGCO and CNH have already committed to selective catalytic reduction (SCR) to meet both interim and final regulations on diesel engines larger than 174 horsepower. Many industry observers believe Deere will necessarily need to follow their lead to meet the Final Tier IV requirements in order to remain competitive when it comes to fuel efficiency.

For now, Deere is falling back on the value proposition that EGR is "The right technology. Right now."

During the conference call, a panel of Deere staffers said the major drawback to SCR technology for farm tractors is that it forces farmers to handle a second liquid in addition to diesel fuel. Diesel Engine Fluid (DEF) is a mix of ionized water and urea that is contained is a second liquid tank on the tractor. DEF is injected into the engine's exhaust stream to produce harmless byproducts of nitrogen gas, water and CO2.

They say EGR engines will require no additional intervention from the operator.

Rollout Schedule. Deere also did not reveal its schedule to roll out

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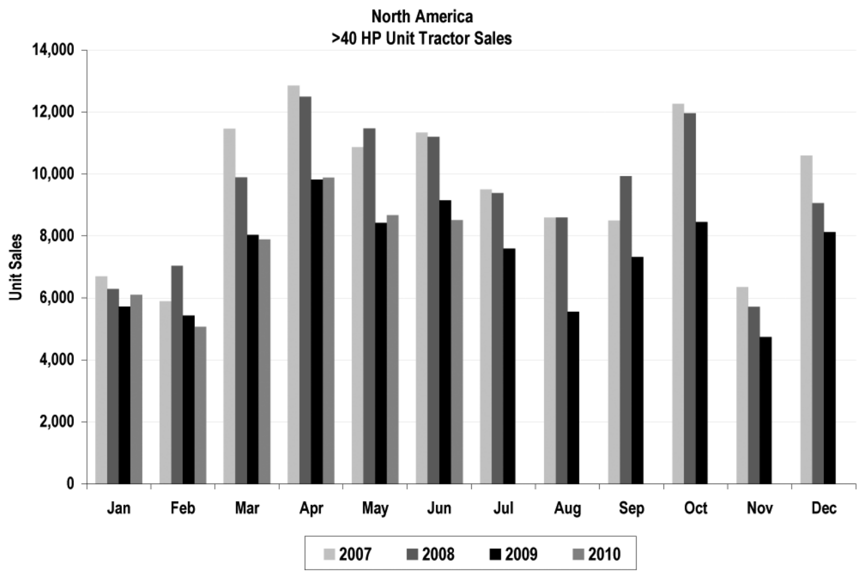
11 soybean crop to \$8.10-\$9.60 per bushel, from \$8.00-\$9.50 per bushel. The midpoint of \$8.85 per bushel is 70 cents below last year's estimate of \$9.55 per bushel.

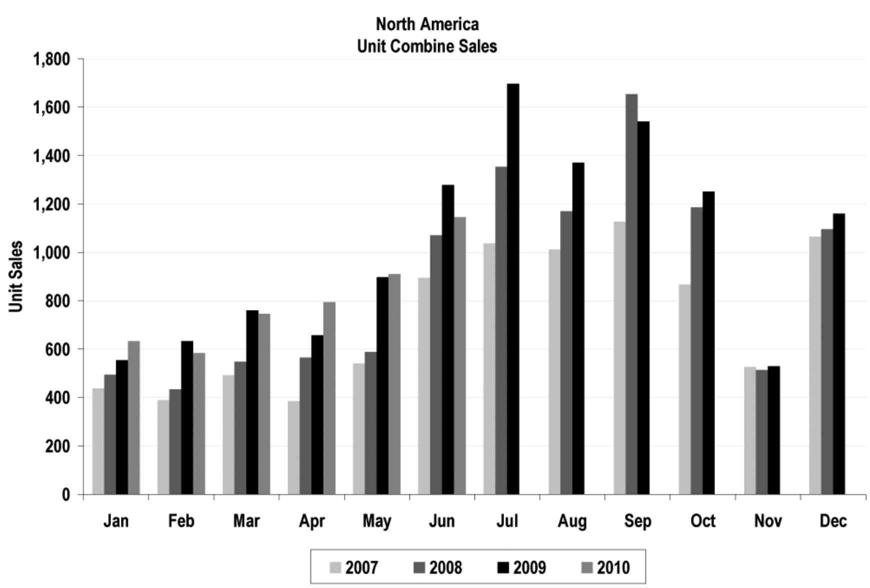
North American Tractor Unit Sales 2007-10 (40 HP & Larger)



Source: AEM

North American sales for farm tractors over 40 horsepower fell by 7% in June 2010 compared with the same month in 2009.

North American Combine Unit Sales 2007-10



Source: AEM

Retail sales of combines in the U.S. and Canada were down 10% in June compared with the same month in 2009.

Wheat ending stocks were raised to 973 million bushels, from 930 million. The agency expects a 48% increase in inventories based on the 2009 crop. It also raised the price range for the 2010-11 crop to \$4.20-\$5.00 per bushel, from \$4.00-\$4.80. The revised midpoint of \$4.60 per bushel, is 27 cents below last year's estimated price of \$4.87 per bushel.

Equipment Upside. Industry analysts see strong positive signals for the equipment side of the business in the most recent data. Earlier this year, the agency projected farm cash net income to increase 8% year-over-year in 2010.

Kirn continues to see solid outlook for machinery sales throughout the second half of 2010. In a July note to investors, he said, "Although down from the prior year, we note that corn, soybean and wheat prices remain well above historical averages, and farmers are expected to remain profitable in 2010."

Overall, Ann Duignan, machinery analyst for JP Morgan, sees the USDA reports as a "slight positive" for farm equipment.

"Our model suggests cash receipts from major crops were \$95.5 billion in 2009-10, which is -6% year-over-year, and \$95.8 billion in the 2010-11 crop year, which is flat year-over-year. Given the strong correlation between cash receipts and ag equipment sales, we think [the USDA report] is a slight positive for AGCO, CNH and Deere."

Robust Second Half. On July 9, the Assn. of Equipment Manufacturers reported that June U.S. and Canadian sales of 2WD tractors slipped 8.7% compared with June 2009. North American sales of 4WD tractors improved by 31% while combine sales dropped by about 10% vs. June of last year. (See p. 7 for detail.)

Duigan discounts the most recent sales numbers, as May and June sales of

AG EQUIPMENT INTELLIGENCE is published monthly for the farm equipment industry by Lessiter Publications Inc., 225 Regency Ct., Suite 100, Brookfield, WI 53008-0624. Please send any address changes as soon as possible to the address shown above.

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farm machinery are typically weaker than other spring and summer months.

"May and June are generally light months as farmers completed planting and are waiting for the fall harvest. As such, we're not overly concerned with the lighter June sales data," Duignan says.

"Looking ahead, we're expecting a modest pre-buy in 2010, ahead of the 2011 emission standard changes. Furthermore, despite recent unfavorably wet weather, an early planting season should deliver strong crop yields and a potential near-record year for crop receipts. As a result, we are forecasting very robust sales in the second half of '10," she says. AEI

Grain Price Forecast

$/Bushel	2009	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11	3Q11	4Q11	2011
Corn											
Spot Mo. Current Forecast	…	3.85	3.75	3.90	3.80	3.83	4.00	4.20	4.10	4.05	4.09
Actual to Date	3.75	3.72	3.57	…	…	…	…	…	…	…	
Wheat											
Spot Mo. Current Forecast	…	5.15	4.70	4.90	4.80	4.89	5.10	5.25	5.20	5.15	5.18
Actual to Date	5.33	4.98	4.70	…	…	…	…	…	…	…	
Soybeans											
Spot Mo. Current Forecast	…	9.65	9.35	9.00	8.70	9.18	9.10	9.20	9.05	9.00	9.09
Actual to Date	10.21	9.57	9.59	…	…	…	…	…	…	…	

Notes: Gray Bars = JPM Last Forecast; All forecasts are period averages. To-Date prices as of June 24, 2010
Source: JP Morgan Global Commodities Research

Grain Transport Focus of New Video Series

With the challenge of feeding a rapidly growing global population, the ag industry has set the lofty goal of increasing grain production by improving crop yields. Specifically, farmers have been challenged to boost average corn yields to 300 bushels per acre and soybean yields to 100 bushels per acre by 2030.

As the industry works toward those targets, the one question that has gone unasked is: How can U.S. transport systems support this type of growth without major improvements, specifically on our rivers?

Veteran reporter Frank Lessiter aimed to shed some light on the current state of the Mississippi River transportation system when he boarded the Show-Me State, a towboat pushing $5.4 million in grain down the river last fall. He chronicled his three-day journey in *Shipping Out*, an 8-part video/blog series now appearing on farm-equipment.com. This series is sponsored by Great Plains Manufacturing, one of the largest privately held manufacturers of farm equipment in the U.S.

Look for the series today at www.farm-equipment.com. AEI

FARM MACHINERY TICKER (AS OF 7/13/2010)

Equipment Mfr.	Symbol	7/13/10 Price	6/10/10 Price	1-Year High	1-Year Low	P/E Ratio	Avg. Volume	Market Cap.
AGCO	AGCO	$30.47	$28.15	$40.29	$24.61	25.84	1.70 M	2.83 B
Alamo	ALG	$23.61	$22.54	$27.05	$10.30	13.09	89,123	277.37 M
Art's Way	ARTW	$5.15	$5.90	$7.12	$3.42	25.88	5,817	20.55 M
Caterpillar	CAT	$66.79	$59.95	$72.83	$30.25	34.27	10.25 M	41.93 B
CNH	CNH	$26.97	$24.31	$33.45	$11.72	NA	382,127	6.41 B
Deere	DE	$59.37	$57.87	$63.68	$34.96	25.65	4.87 M	25.22 B
Kubota	KUB	$39.71	$40.84	$51.08	$37.35	21.12	21,527	10.10B
Dealer Groups								
Cervus Equipment	CVL	$10.35	$11.65	$18.00	$10.35	NA	11,249	NA
Rocky Mtn Dealerships	RME	$7.53	$8.70	$10.83	$3.96	NA	45,753	NA
Titan Machinery	TITN	$14.00	$13.10	$15.44	$9.81	16.26	198,798	248.95M

equipment with the new engines, saying only that high-horsepower tractors with the new diesel engines will be available for the 2011 model year.

At the same time, the company announced that its 2011 combines would not be outfitted with the Interim Tier IV engines. It will continue using its existing Tier III technology for the new combines and rely on emission credits to meet government requirements for NOx and particulate matter.

Higher Pricing. Regarding pricing, Deere said during the conference call that the Interim Tier IV technology will add about 5.7% to the price of a tractor for 2011 compared to a similar tractor in 2010. This will be on top of a 3.5% price increase that was implemented in March, which will raise the overall price by 9.2% for 2011 models. That could add $13,000-$14,000 or more of cost to its 8R series tractors.

Earlier this year, one tractor manufacturer told *Ag Equipment Intelligence* that he expects that SCR technology will add 2-4% to farmers' invoices. This, he said, would amount to $7,000-$8,000 to the cost of a tractor outfitted with a SCR engine.

Split Decision. While Deere is firmly entrenched with EGR technology — at least for now — AGCO has firmly committed to SCR technology for its entire line of engines.

Case IH, on the other hand, has said it's going with SCR engines on its high-horsepower engines, but will stick with EGR for its smaller equipment.

At a June 21 media event at its Engineering Center in Burr Ridge, Ill., the company said that it favors the SCR approach because it offers farmers a significant advantage when it comes to fuel economy. It will also allow them to move more easily into developing Final Tier IV engines in 2014.

Engineers from Fiat Power Train (FPT), which develops and builds diesel engines for Case IH, say they also fear recirculating exhaust gases that contain soot and other contaminants back into the engine. This, they believe, could ultimately lead to significant engine problems for the operator.

Case IH also says it will offer EGR engines on its smaller horsepower equipment because fuel economy for those user is not nearly as critical as it is to customer for the high-horsepower machinery. With that being the case, the company says they can avoid some of the cost associated with operating the SCR engines. AEI

Weather, Tough Livestock Markets Soften Outlook for Canadian Ag

After 2 years of record income, Canadian farmers and ag equipment retailers are girding themselves for a much different year in 2010. Not only has weather taken its toll in the Western Plains, but the global recession looks like it's finally catching up with the Canadian economy.

Lagging Income. In mid-Spring, Agricultural Canada issued the 2010 farm income forecast that projected that the country's farmers were facing a 91% drop in net income compared with 2009 to $291.5 million.

According to published reports, cattle farms are expected to lose an average of $5,195. Much of the loss is due to country-of-origin labeling requirements for meat products in the U.S., and the strong Canadian dollar.

Higher expenses are being blamed for the falling net incomes of hog producers in Manitoba, Quebec and Ontario.

After record income years in 2008 and '09, grain producers are anticipating a much leaner year in 2010, as well.

According to Agriculture Canada, the biggest hits will be seen in Alberta, where farmers will see a 254% drop in net incomes. Saskatchewan producers are expecting to see a falloff of 55% in net income for the year.

Soggy Fields. On June 30, Calgary-based Rocky Mountain Dealerships (RME) issued a press release stating that it expects exceptionally wet weather in western Canada to affect its second quarter equipment sales.

RME is one of Canada's largest agriculture and construction equipment dealerships with 29 locations throughout Alberta, Saskatchewan and Manitoba.

According to RME, due to heavy moisture levels, many of the company's customers were late in seeding their crops, had flooding and as a result had to re-seed their crops. In some cases, they were unable to seed a crop for this season. Saskatchewan was hardest hit, but some overlap was felt in Alberta and Manitoba where the majority of RME's business is located.

As a result, the company has experienced softer second-quarter sales of ag equipment. As of June 30, provincial crop reports list Alberta as 95% seeded, Saskatchewan at 76% and Manitoba at 85%.

The Canadian Wheat Board estimates that 8.25 million to 12.5 million acres of Prairie cropland will not be planted this year. Most of the unplanted acres are in the province of Saskatchewan. In 2009, this region planted approximately 60.9 million crop acres.

Equipment Sales. The Assn. of Equipment Manufacturers July 10 report on Canadian retail sales indicates the market for farm machinery has softened significantly compared with June 2009.

According to the report, sales of tractors in the 40-100 horsepower range dropped 33% last month, while unit sales of 2-wheel drive tractors larger than 100 horsepower fell 34.7%. Four-wheel tractors sold in June were down 43.3% compared to 12 months ago, and combine unit sales were off 29.1% during the month. AEI

Germany's Lemken Stays the Course with Aggressive Expansion Plans

A new distribution, service and assembly center near Moscow, Russia, and start-up production of moldboard plows in India are among plans for cultivation, seeding and spraying equipment specialist Lemken.

The new investments follow a record spend over the past 3 years equivalent to more than $29 million in new production and logistics facilities at the company's German locations. A new painting plant, which has improved both appearance and corrosion resistance, was also commissioned last year.

"We are planning and building with a long-term perspective," says managing director Dr. Franz-Georg von Busse. "In spite of the current economic downturn, these investments in quality and delivery capacity are already paying off."

The German family-owned concern adjusted to the current market by laying off more than 150 temporary staff taken on to manage demand in the boom years.

"Members of our core staff were happy to take additional holiday in lieu of overtime worked at the start of the year and this helped to quickly reduce capacity and stock," says von Busse. "By the end of 2009, Lemken had 866 employees world-wide, including more core staff than in 2008."

With significant exposure to central and east European markets, trading conditions in 2009 ended Lemken's 5-year run of continuous growth, during which sales volume more than tripled. Revenues in 2009 were down 16% on the prior year at the equivalent of $256 million — but it was still the second-best sales figure in Lemken's 230-year history.

The new distribution and service center near Kaluga, southwest of Moscow, will be completed this year as planned. It will also serve as an assembly plant for implements specially developed for the Russian market. The proposed factory in India will be producing plows for tractors up to 60 horsepower by 2012.

"Farmers and contractors remain cautious in their investment planning, so we expect another decline in sales volume this year," says von Busse. "However, we still look optimistically to the future and the satisfactory order situation at the beginning of the year has already ensured continued production capacity utilization." AEI

Record Crops, Subsidies, Sugarcane Fuel Brazilian Equipment Sales

With its crop harvest complete and at record levels, sales of farm machinery in Brazil continued on an upward trend. It remains to be seen if the country's record-high harvest will have implications for U.S. farmers. This could show up within the next couple of months.

"While the market remains strong year-to-date, equipment sales volumes could slow from here as corn and soybean harvesting is behind us and farmers are actively marketing their grain," Ann Duignan, JP Morgan analyst, told investors in a note.

"We expect combine sales to remain seasonally low in July and August, but tractor sales to pick up as farmers are making plans for the next growing season. Additionally, they are in the midst of a record sugarcane harvest. Furthermore, the government's announcement to extend rural farmer financing programs for 2010-11 will likely further bolster ag equipment spending."

Sales Stay Strong. The Associação Nacional dos Fabricantes de Veículos Automotores (ANFAVEA) in Brazil released June tractor and combine sales on July 12. The number show total farm tractor sales in Brazil were 5,140 units, up 45% year-over-year vs. up 64% in May and up 55% in April.

Combine sales reached 189 units in June, up 64% year-over-year compared with a 29% increase in May and up 2% in April. Combine sales increased 17% for the first time in 5 months, rebounding from its seasonally slow period. AEI

Art's Way Year-Over-Year Net Income Rises 15.8%

Despite a falloff in overall revenues in the period ending May 31, Art's Way Manufacturing reported on July 13 that net income for the 6-month period ended May 31 rose nearly 16% compared with the comparable period in 2009.

The company's primary business is manufacturing a wide range of farm machinery niche products. Based in Armstrong, Iowa, Art's Way also operates wholly owned subsidiaries for the manufacture of pressurized tanks and modular animal confinement buildings.

Its agricultural products segment had revenues for the 3 months that ended on May 31, of $4,606,000, compared to $6,165,000 during the same period of 2009, a 25.3% decrease.

According to the company, the decrease was largely due to lower sales of OEM blowers and Miller Pro equipment, but was offset by increased sales of grinder mixers, augers and manure spreaders.

Year-to-date sales were down to $8,202,000 from $10,874,000, a 24.6% decrease. Year-to-date Miller Pro sales decreased by $1,460,000, which were offset by auger sales of $1,028,000. Another factor in the reduced sales was a $1,636,000 reduction in OEM blower sales.

The company's year-to-date gross margin for this segment was 26.8% compared to 23.8% as of May 31, 2009.

Overall, the company reported net sales for the 3 months ended May 31 were $6.7 million. Consolidated order backlog was $13.6 million vs. $10.5 million in May 2009. AEI

Corn Ethanol Continues to Fuel Corn Demand & Machinery Sales, But Challenges are Mounting

With ethanol using slightly more than one-third of all corn produced in the U.S., it has been the single largest factor in rising prices for corn in recent years. It has also been credited with fueling the rising demand for large farm machinery that manufacturers and dealers have experienced over the past 3 or more years.

While many experts point to the growing need to feed a rapidly rising worldwide population, Barry Bannister, analyst for Stifel Nicolaus, points out in a note to investors that exports of corn from U.S. producers has risen only slightly in the past 30 years.

"U.S. corn exports were 2.401 million bushels in 1979 and 2.436 million bushels in 2007. This despite the fact that the world population during this period increased by 2 billion people."

> *"Ethanol is credited for fueling the rising demand for large farm machinery over the past 3 years …"*

According to the analyst, it was the rising price of crude oil after 2002 that ignited the ethanol "boom" and took corn prices to new highs. This, in turn, has provided much of the momentum for continuing strong demand for new ag equipment.

Hitting the Wall. Currently, the ethanol industry is awaiting a favorable decision by EPA to raise the blend limit from 10% to 15%, but it's facing some formidable opposition, most notably from groups like the Outdoor Power Equipment Institute. OPEI has been openly vocal about opposing an increase to gasoline blends because it reportedly causes problems with small engines.

But some industry analysts believe that EPA is likely to rule in favor of the higher blend for vehicles produced since 2001, which represent 70% of all cars on U.S. roads today. By 2012 or 2013, a higher blend will be required to meet the legal mandate, which requires 12 billion gallons per year of corn ethanol this year — a 12% increase — and 15 billion gallons by 2015.

"However, beyond 2010 the incremental growth in the mandate falls to ~5% until 2015 when it stabilizes at 15 billion gallons," Ann Duignan, JP Morgan analyst, told investors.

"According to our analysis, ethanol is still a major swing factor in corn demand, and represents about 34% of total corn production in the U.S. However, the rate of growth in usage is going to slow going forward. The USDA expects corn usage for ethanol to level off at about 5 billion bushels, or ~34% of corn production."

Duignan adds that at least part of

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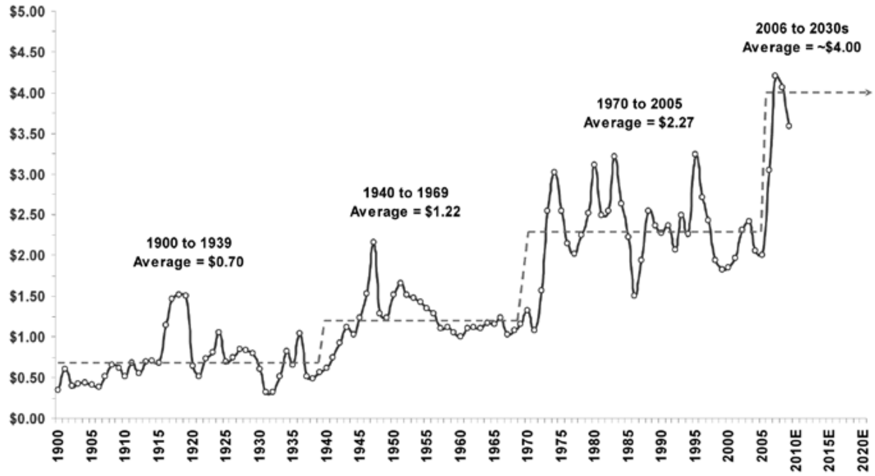
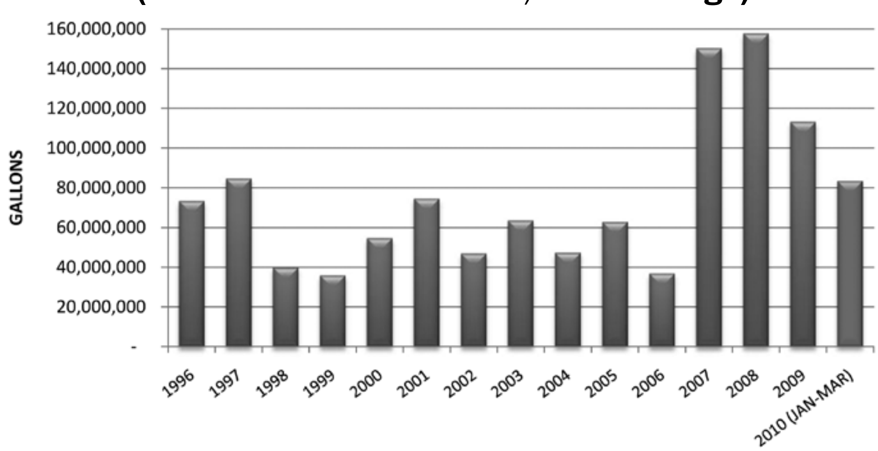
U.S. Corn Prices — 1900-2009-10 ($/Bushel)



Source: Bloomberg, USDA price chart and Stifel Nicolaus

According to Barry Bannister, analyst with Stifel Nicolaus, corn prices per bushel have "stepped up" 75-85% abruptly every 30-35 years and there is always a catalyst. In the 1970s, it was U.S. corn exports and cost-push inflation from the oil shocks. In the 2000s, it was the bio-fuel mandate. "We doubt corn prices will vary greatly from $4/bushel for the next 2 decades," Bannister says.

Total U.S. Ethanol Exports — 1996- 1Q 2010 (Denatured & Undenatured, Non-Beverage)



Source: USDA GATS system

In the first quarter of 2010, U.S. producers exported 83.5 million gallons of ethanol, a nearly five-fold increase over the first quarter of 2009.

Machinery Sales Mixed in June

The most recent ag equipment sales figures from AEM is making it clearer that industry trends are not as clear as they were a year ago. "Row-crop tractor, 4WD tractor and combine inventories continued to fall year-over-year in June, though new diesel engine emission standards, associated new model roll-outs and potential pre-buy activity, make interpreting industry inventory statistics increasingly difficult," says Robert McCarthy, analyst for RW Baird.

- North American large tractor sales recovered somewhat in June, increasing 4.5% after a 2.3% decline in May. They were led by a jump in 4WD tractor sales. June is a seasonally average month for both 4WD and row-crop tractor sales (~8% of annual sales).
- U.S. & Canada row-crop tractor sales declined 0.8% year-over-year in June, in line with May's 0.7% decline, which had slowed from a +6% comparison in April. Row-crop tractor inventories fell 24.6% below previous-year levels.
- 4WD tractor sales jumped 31.3% year-over-year in June, following a 10.1% decline last month and a 40.3% jump in April. Inventories declined 7% year-over-year on an absolute basis.
- Retail sales of combine were slow in the first month of the selling season. Combine sales fell 10.3% year-over-year in June, down from a 1.3% increase in May. June is the first month of the key June through October combine selling season. It represents 10.5% of annual combine sales over the past 5 years. Nearly 50% of annual combine sales typically occur over the next 4 months. Absolute levels of U.S. combine inventories in May fell 3.5% year-over-year.
- Compact and mid-range tractor sales comparisons turned negative in June. Compact sales declined 8.6% following an 8.5% year-over-year increase the previous month, while mid-range sales fell 11.5% after a 5.7% increase in May. Compact and mid-range inventories remained well below last year's levels, and were 19.8% and 26.1% lower year-over-year, respectively. **AEI**

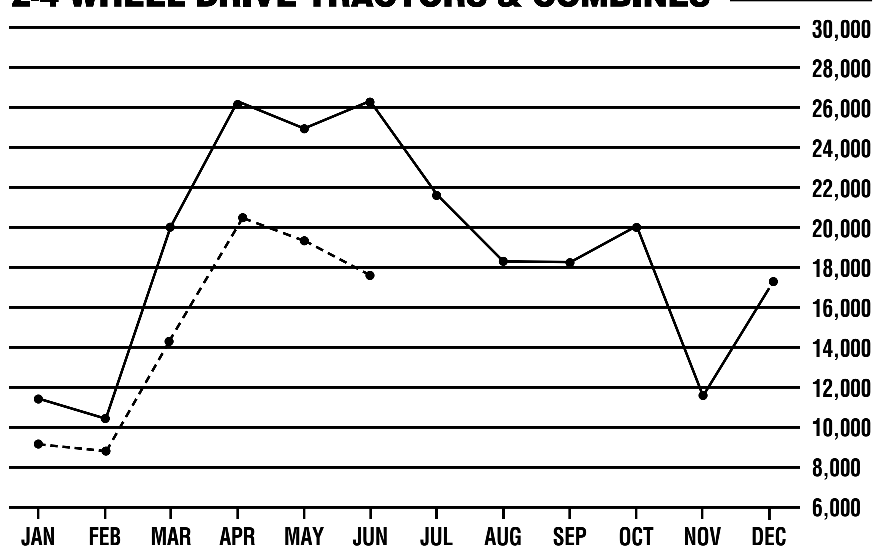
JUNE U.S. UNIT RETAIL SALES

Equipment	June 2010	June 2009	Percent Change	YTD 2010	YTD 2009	Percent Change	June 2010 Field Inventory
Farm Wheel Tractors-2WD							
Under 40 HP	9,332	10,343	-9.8	46,991	44,385	5.9	40,717
40-100 HP	5,276	5,793	-8.9	24,266	26,271	-7.6	23,182
100 HP Plus	1,914	1,782	7.4	13,242	12,291	7.7	6,357
Total-2WD	16,522	17,918	-7.8	84,499	82,947	1.9	70,256
Total-4WD	494	300	64.7	2,554	2,069	23.4	891
Total Tractors	17,016	18,218	-6.6	87,053	85,016	2.4	71,147
SP Combines	910	945	-3.7	3,822	3,869	-1.2	1,392

JUNE CANADIAN UNIT RETAIL SALES

Equipment	June 2010	June 2009	Percent Change	YTD 2010	YTD 2009	Percent Change	June 2010 Field Inventory
Farm Wheel Tractors-2WD							
Under 40 HP	1,394	1,389	0.4	5,517	5,465	1.0	7,083
40-100 HP	474	707	-33.0	3,038	3,242	-6.3	3,519
100 HP Plus	281	430	-34.7	2,130	2,036	4.6	1,656
Total-2WD	2,149	2,526	-14.9	10,685	10,743	-0.5	12,258
Total-4WD	76	134	-43.3	818	680	20.3	258
Total Tractors	2,225	2,660	-16.4	11,503	11,423	0.7	12,516
SP Combines	236	333	-29.1	989	914	8.2	540

U.S. UNIT RETAIL SALES OF 2-4 WHEEL DRIVE TRACTORS & COMBINES



—Assn. of Equipment Manufacturers

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the delay in increasing the blend to 15% is due to the EPA giving the auto industry time to test engines.

Production vs. Mandate. Based on recent reports, ethanol in the U.S. is being produced at record levels. Without the higher blends, production is beginning to outstrip domestic demand. "With a record 827 million gallons in inventory, it's clear that the industry cannot absorb the 12 billion gallon per year mandate," Duignan says.

According to the Renewable Fuels Assn., the U.S. ethanol blending market is nearing saturation and demand has hit what is commonly referred to as the "Blend Wall."

The RFA maintains that as long as this blend wall exists and total gasoline demand remains consistent with recent trends, the domestic market potential for ethanol tops out at approximately 12.5-13.5 billion gallons.

Today's industry has the capacity to produce 13.5 billion gallons of ethanol, with another 1.2 billion gallons of capacity under construction.

But the association reports that a recent surge in U.S. ethanol exports is providing the industry with a new source of demand while it awaits EPA's decision on whether to allow ethanol blends higher than 10%.

In the first quarter of 2010, U.S. producers exported 83.5 million gallons of ethanol, a *nearly five-fold increase* over the first quarter of 2009.

In fact, ethanol exports in the first 3 months of 2010 are already equivalent to 71% of all ethanol exported in 2009. At the current rate, the U.S. industry is on pace to export more than 330 million gallons of ethanol in 2010, which would be an all-time record.

Persistent Challenges. While it's expected that EPA will soon approve the higher ethanol blend levels, Stifel Nicolaus' Bannister believes its expanded use will continue to confront significant challenges.

"Ethanol prices may not keep up with their gasoline equivalent value because the U.S. is rapidly approaching 10% ethanol, the maximum allowed by regulations. Although some analysts are excited about the prospect of EPA approving 15% ethanol, we believe the final EPA decision will caution against such use in older or small engines.

"If so, we believe class-action lawsuits could easily be formed, and for that reason our non-consensus view is that 15% ethanol, if approved on a *qualified basis*, would not be widely adopted due to legal concerns that owners of older cars and small engine equipment could sue blenders and distributors."

In any case, corn use for ethanol is expected to remain at about 34% of total corn production. As such, it will further encourage the solid demand for large farm machinery. AEI

Two Views on Investing in an Ethanol Plant

Ag Equipment Intelligence editors recently spoke with a Midwest farmer where his community was unable to build a proposed ethanol plant. He said that he would have invested in the plant because the higher prices brought about by ethanol demand would have easily justified his investment.

For a farmer like himself that was growing 250,000 bushels of corn a year, he figured a 30-cent difference in the basis price of corn wouldn't take very long to pay for a share of an ethanol plant. At that rate, he says he would earn an additional $75,000 a year. Plus he could haul ethanol byproducts (DDG) back to his beef feeding operation.

"If I never made a dime off the ethanol plant investment, I'd come out ahead with the higher price being paid for corn," he said.

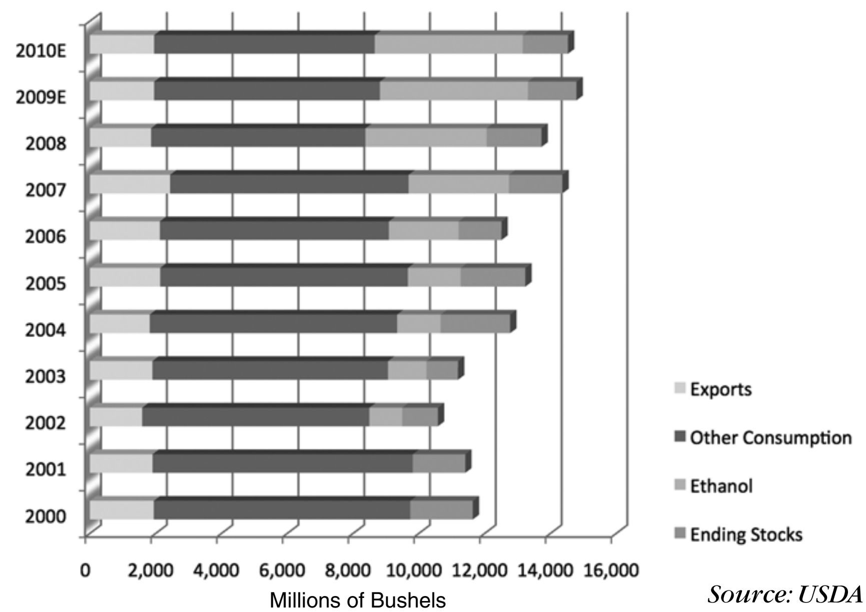
As a follow up to that conversation, *AEI* contacted Dave Johnson at Venture Fuels in Holmen, Wis., to ask if the farmer's reasoning was reasonable.

According to Johnson, the economic benefit for the local farm economy, family farm or livestock operation easily outweighs a small investment in an ethanol plant "as long as the ethanol plant doesn't go belly up."

He offered the following scenario as an example. "Look at a farmer who invested $50,000 or $100,000 in his local ethanol plant. The plant gets built and the money is spent. Twelve months later it files for bankruptcy. The farmer loses all of his upfront investment, plus the ethanol plant backs away from its new crop contracts at $4/bushel. Corn drops to $3/bushel and the farmer is left holding nothing.

"Like anything," Johnson advises, "the farmer should look for a return on his cash investment first. Anything else he gets via a better corn basis price and lower feed costs via DDG is icing on the cake."

USDA Supply/Demand for U.S. Corn 1990-2010



Source: USDA

While exports of corn and "other consumption" remained relatively stable during the last decade, starting in 2002, ethanol began to significantly impact the supply and demand for U.S.corn. It's expected that one-third (34%) of all corn produced in the U.S. will contnue to be used for ethanol production for the foreseeable future.