3D ADVISORS

| This 3DAdvisors Report Covers: | |
|---|---|
| | **Insider Trading**: Insider Trading Behavior |
| ✓ | **Accounting**: Quality of Earnings Issues |
| | **Governance:** Corporate Governance Issues |
| | **Fundamentals:** Analysis of fundamentals |

# Observations on 3Q08 Earnings and SEC Form 10-Q Bunge Limited (NYSE:BG) Update

**November 13, 2008**

Contact: Bob Gabele (954) 779-3974 or bgabele@3DAdvisors.com

Bunge Limited, through its subsidiaries, operates as an agribusiness and food retail company worldwide. The company operates in three divisions: Agribusiness, Fertilizer, and Food Products. Agribusiness division purchases, stores, transports, processes, and sells agricultural commodities and sells to oilseed processors, feed manufacturers, wheat and corn millers, and edible oil processing companies, as well as to livestock, poultry, and aquaculture producers. Fertilizer division produces and supplies fertilizers to farmers in South America. Food Products division offers edible oil products, including bottled, packaged, and bulk oils, as well as shortenings, margarine, mayonnaise, and other products derived from the vegetable oil refining process; and milling products, such as wheat flours and corn products comprising dry milled corn grits, meal and flours, and soy-fortified corn meal and corn-soy blend. Bunge Limited was founded by Johann Peter Gottlieb Bunge in 1818 and is headquartered in White Plains, New York.

## Summary of 3DAdvisors Findings for BG

- **Accounting:** Observations on 3Q08 earnings and SEC Form 10-Q

---

## Discussion of 3DAdvisors Findings

Bunge shares have bounced off the 52-week low of $27.60 reached on 10/28/08 (intraday) and have since rallied back, with yesterday's close of $39.83 representing a 44+% move off those late October lows. Yet the drubbing the stock took last month had more to do with the overall market sell off and less to do with the significant financial and operating risks that we feel are still present and not fully reflected in the stock at present levels. Specifically, as we pointed out in our last update on 10/10/08 and earlier updates on 04/07/08 and 08/15/08, the principal risk facing the Company is related to liquidity as it continues to generate little in the way of true cash from operations (despite various obfuscations in the 3Q08 results to the contrary) and its weak balance sheet greatly limit its ability to borrow more money in the current credit environment which it *must* do in order to keep operating.

Moreover, the continuing softness in soybean prices, while crop input prices remain high, has kept pressure on Brazilian soybean farmers and increases the likelihood that the quality of the related $1.6 billion in receivables from farmers will deteriorate even further. In short, none of the issues looming over the Company that we described in the 10/10/08 update as a 'perfect storm' has abated. In fact, with the Company in the midst of negotiating replacement facilities for roughly $1.5 billion in revolvers that expire this month and next, and with the independent auditors sure to be looking at many of the significant accounting questions we have raised as we head towards the end of the year, we believe there is a good possibility that things could come to a head sometime during the fourth quarter.

**Figure 1.** BG Daily Closing Price (Top) and Trading Volume (Bottom, Millions of Shares), 11/01/07 through 11/11/08. Red diamonds are the dates of the three most recent 3DA update reports. Source: Reuters and 3DAdvisors, LLC.


In this update we provide, in summary format, the observations of our senior accounting analyst regarding both the 3Q08 earnings release and the related SEC Form 10-Q that was just filed on Monday (11/10/08). Many of his observations reflect a continuation of our earlier findings which have been discussed in detail in earlier reports, but there also a few new disclosures that further enhance our motivation to keep a close eye on developments.

Accounting: Observations from 3Q08 earnings release and SEC Form 10-Q

- Although no borrowing was outstanding under any of the revolver or commercial paper credit facilities at 09/30/08, which was probably window dressing, almost half of the Company's claimed borrowing capability has 2008 and 2009 expirations. That is probably more important than what was or was not outstanding at 09/30/08. The $1 billion 364-day revolver expires this month. From the 10-Q:

  > "We have a $1 billion 364-day committed revolving credit facility with a syndicate of banks that matures in November 2008. We are currently in the process of refinancing that facility with a proposed new 364-day revolving credit facility in an anticipated amount of approximately $800 million. In addition, we have $500 million of 4.375% senior notes maturing in December 2008. We intend to repay these notes using available cash and borrowings under existing credit facilities."

  Given current debt market conditions where even the highest rated credits are having difficulty raising new money, we wonder how these negotiations are going. In the prepared remarks at the start of the 3Q08 conference call that took place on 10/23/08, with regard to the negotiations for replacing the revolver that expires in November, CFO **Jacqualyn Fouse** commented, "…we have begun the marketing for our November revolving credit facility rollover. That marketing is going well and we expect a good outcome on that transaction."

  We have serious doubts that it could be "going well". For starters, we wonder why they have decided to replace the $1 billion 364-day committed revolver with an $800 million facility when the need for cash is so obvious. We also note that in the 10-Q it is disclosed that in September the Company entered into a ¥10 billion syndicated term loan (interestingly, the amount is stated in Yen rather than US$, which would be about $100 million at the time the loan was funded) and are curious as to why the Company would go to Japan for just $100 million. We suspect it reflects how difficult it is for the Company to raise new cash. Despite the comments by Ms. Fouse, we think the Company has quite a challenge in front of it to find replacements for the expiring revolvers which are desperately needed.

  Combine that with the possible deterioration in the quality of its receivables from Brazilian farmers which would more than likely invite a debt ratings downgrade, making it even more difficult if not impossible to secure new debt facilities, and we still think there is a very real possibility that the Company could run out of cash (see the detailed analysis in our last update on 10/10/08). Again, we continue to think this is the principal risk to BG shares at the present level.

- In the cash flow statement released with the 3Q08 results, it was reported that in the quarter cash flow from operations generated $2.2 billion. Ms. Fouse clearly attempted to promote this as a very positive result for the quarter and indeed it was the first line of the press release announcing the Q3 results and certainly seems impressive in the context of the current economic environment. In the prepared remarks during the conference call, the CFO commented:

> "With respect to cash flow for the quarter and the nine months on Slide eight, we have very strong funds from operations driven by the profit performance both for the quarter and the year-to-date."

Yet through the first six months (ended 06/30/08), cash flow from operations was a negative $483 million, and only turned to a positive $1,727 million through nine months on the strength of the $2.2 billion reported in Q3. But looking at that $2.2 billion for the quarter, the three largest contributors were Payables ($1,073 million), Inventories ($909 million) and Foreign Exchange Loss on Debt ($385 million).

It seems that "strong funds from operations" is more driven by stretching out payables and accounting adjustments than it was "driven by profit performance".

- For the 9 months ended 09/30/08, the Company entered into the following new debt facilities, all of it before the recent turmoil in debt and equity markets in October:

| Amount | Type | Maturity | Use |
|---|---|---|---|
| $250 million | Term Loan | 2011 | Debt Repayment |
| $475 million | Term Loan | N.D.[1] | Debt Repayment |
| $100 million[2] | Term Loan | 2011 | Debt Repayment |
| $650 million | Revolver | 2011 | General |

[1] Term was not disclosed by the Company.
[2] The loan amount was disclosed as ¥10 billion, which was approximately $100 million at the time of funding.

Except for the $650 million revolver, all of the new financing was used to pay off existing indebtedness, so no new cash came out of it.

- Despite the 52% increase in revenues in Q3 from the year ago period, the Company lost more than a full percentage point (from 9.3% to 8.1%) in gross margin. This undoubtedly is due in large part to heavy charges to cost of goods sold to write down readily marketable inventories to market value.

Top line growth for the quarter all came from higher prices: physical volume was down.

- The Company explains the higher earnings at Fosterfil as the cause of the increase in minority carve-out. Fosterfil, although not wholly-owned, is consolidated, so higher earnings in that company would result in a higher carve-out for minority interest. Oilseed processing operations in Poland also contributed to the increase. For the nine months ended 09/30/07 the carve-out for minority interest was 16% of income from operations after income tax. For the nine months ended 09/30/08 it was 29%.

We have noted previously that half of the cash shown on the balance is held at Fosterfil and not available to Bunge unless and until a dividend is declared. The big unanswered question though is who has the authority to see make the decision to declare the dividend, assuming that Fosterfil is in a financial position to do so. It seems to us that if the management or Board of Bunge had that authority, they would say so.

- Of the $309 million secured advances to farmers, the amount of $243 million is the subject of legal action that has been initiated to collect the outstanding balance. No mention of any progress. The uncollectible allowance is just $79 million. For the nine months ended 09/30/08 interest earned on the advances in the mount of $33 million has been booked. Nothing is said about payment, probably for good reason, such as non-payment.

- With unrealized gains on derivatives of $2,466 million and unrealized losses of $1,885 million there is still a net gain. However, the Company says so little about the derivatives that it is not possible to draw any conclusions. Those numbers are merely snapshots at a point in time and major changes could have occurred since 09/30/08. FASB has issued a pronouncement on derivative disclosures, but the Company has not yet adopted the new rules.

- Obviously the Company continues to exercise a great deal of discretion in applying fair values to inventories. As long as they can claim to be entitled to use Level 2 that discretion will continue. The Level 3 analysis is not of much help since the real action is mostly in Level 2.

- The Company certainly did not make any definitive statement as to its lack of culpability in the EU competition investigation. It sounds like they might be on the wrong side of the law on that one. Usually in such cases companies make statements to the effect that they believe that their practices were incompliance with applicable laws. Not so here.

- There is foreign exchange translation adjustment in OCI in the amount of $936 million. There is the big equity change we have been looking for, or at least most of it. Normally the entry described in that manner would be the gain or loss recorded when translating the balance sheet of foreign denominated accounts into US Dollars and that may be just what they want the reader to conclude. There are no details and this is the only equity detail we have seen, but part of our answer on receivables and inventory changes in the cash flow and the balance sheet probably lies within this number. Of course the dollar did strengthen against the real considerably during the fourth quarter, so that effect is in the number as well. Any gain or loss from translating the financials for any period to US dollars goes into OCI. Gain or losses on actual transactions get into the revenue and cost accounts in the normal manner as the transactions take place.

- The Company changed its method of presenting segment earnings, but it really doesn’t mean any thing. It does enable them to show segment earnings before interest, but so what. The interest numbers are still in the same presentation. For the quarter, interest eats up 41% of the Agribusiness Segment earnings before interest and tax.

- Devaluation of the real on US $ denominated financing of working capital caused a loss of $215 million in the fertilizer segment. The wording is convoluted, but appears that it is reflected in a write down of fertilizer inventories. That should be part of the FX loss shown on the income statement.

There are so many moving parts to the FX gains and losses that one would almost have to see the books to be sure that no fudging went on. Opportunities abound.

- The third quarter net income got a $41 million benefit from a Brazilian tax credit to be used over a future period.

- Income tax expense in the quarter was almost nothing. They attribute it to income in lower tax jurisdictions and a Hungarian investment tax credit. Very suspicious, in our opinion.

- The Company attributes lower readily marketable inventories to lower commodity prices and reduced inventory. We'd bet the prices are leading the pack in that race.

- The picture on trade accounts receivable and allowance for doubtful accounts is essentially the same as at our last look and the allowance appears to be just as inadequate as ever.

- Soybeans not yet priced at prevailing prices amount to $101 million up from $22 million at 12/31/07. Obviously they are priced at some number. The question is when they are re-priced, do they go up or down. If they go down substantially, not pricing them at prevailing market at 09/30/08 may mean the Company was able to move a loss into the fourth quarter that belongs in the third or earlier quarter. Or, it could be that they are simply forestalling having to record giving a lesser credit to the farmer when he pays his debt to the Company in soybeans. This latter scenario would seem to make collection of the advances to the farmer or payments for fertilizer (which are paid in soybeans) even more doubtful. He may not want to pay for something for which he believed he was going to get more credit when he delivered the beans.

- Goodwill is valued at $366 million on the Company's balance sheet. The Company reviews goodwill in the fourth quarter of each year to determine if impairment has occurred. More frequent reviews take place if indicators of impairment exist. It was disclosed in the 10-Q that the Company believes that, among other things, a sustained significant decline in its share price and market capitalization may be an indicator of goodwill impairment. This struck us as an odd disclosure, and given the history of serious obfuscation and poor disclosure, it seems that the Company is clearly telegraphing that an impairment charge is coming.

  Late in the quarter ended 09/30/08, the Company's stock price declined and its market capitalization did indeed drop below its book value. While the Company does not believe that the decline represents a permanent decline in the value of its business, the annual assessment of whether there has been impairment in the value of goodwill will include consideration of the implications of the lower stock price and market capitalization.

- The significant credit and counterparty risks to which the Company is exposed in the normal course of business appear not to have been given any attention as yet in terms of any possible losses. The fourth quarter could bring some big surprises. It is hard to believe that there are not some significant losses buried in some of the derivatives resulting from the current credit squeeze.

- The Company's net commodity position has changed measurably from 12/31/07. The short position is vastly different.

- We still don't understand how losses on commitments to purchase ocean freight time are exactly offset by gains on freight derivative contracts. It appears the commitments are with the ocean freight companies and the derivative contracts are with counterparties not related to the ocean freight companies. That part seems straight forward but we don't see how they exactly offset. Somehow the Company has the ability to cause a gain to be realized in an amount that exactly offsets the losses caused by the changing freight prices. Maybe the derivative contract requires the counterparty to pay the Company whatever it loses on the freight commitments.

- The Company has still not achieved satisfactory internal control over financial reporting though they have disclosed they hope to accomplish this goal by 12/31/08. This little fact can't be helping the negotiations for those new credit facilities in this environment. Given all the complexities and unanswered questions, we wonder if the partner in charge of the Bunge audit has a fair chance of understanding all that is going on in the Company's financials.