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✓	**Accounting**: Quality of Earnings Issues
	Governance: Corporate Governance Issues
✓	**Fundamentals:** Analysis of fundamentals

How Many More Rabbits Are in That Hat, Alberto? Bunge Limited (NYSE:BG) Update

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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:** How and when Readily Marketable Inventories enhance earnings
- **Accounting:** RMI also have significant impact on cash flow
- **Accounting:** Questions concerning liquidity of Readily Marketable Inventories
- **Fundamentals:** Expectations for improved fertilizer results not supported by data

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Discussion of 3DAdvisors Findings

After having issued numerous reports on Bunge since our initial coverage in June of 2006, we find this most recent update perhaps the most difficult to complete. After all, virtually all of the noteworthy management behaviors, fundamental exposures and business model flaws that we have highlighted over the past three years that suggested an extraordinarily high degree of risk for the shares are still in play. Yet, when any of these risks appear ready to emerge as a catalyst to sink the shares, CEO **Alberto Weisser** just reaches into a seemingly bottomless hat and pulls out another rabbit and talks his way out of trouble. The fact that cash-starved and debt burdened Bunge, which seems incapable of generating any significant cash from operating its business, was just able to pull off a secondary offering of 11.5 million shares is but the most recent example. Among the more memorable feats of prestidigitation:

- Management somehow missed the fact that revenue was overstated to the tune of *$7 billion* during the course of 2007, but disclosed the failure to eliminate inter-company transactions that resulted in the bogus revenue figures just prior to the release of audited financials the following March in the SEC Form 10-K? No problem; CFO **Jacqualyn Fouse** convinces everyone that all is well since earnings were unaffected (see update report on 03/14/08).

- Large portions of the Company's accounts receivable are amounts owed by Brazilian soybean farmers that are of highly questionable quality and remain unpaid for long periods? No problem; Bunge simply moves the moldiest ($287 million) from "Accounts Receivable" into "Other Current Assets" (11/30/07).

- Eight Bunge executives indicted in Paraguay, charged with fraud and embezzlement when a local company claimed Bunge was pursuing it for payment of certain debts that it had already paid off? No problem, Bunge simply writes off the disputed $34 million note in settlement of the matter and brushes the entire matter off as a local event (04/07/08).

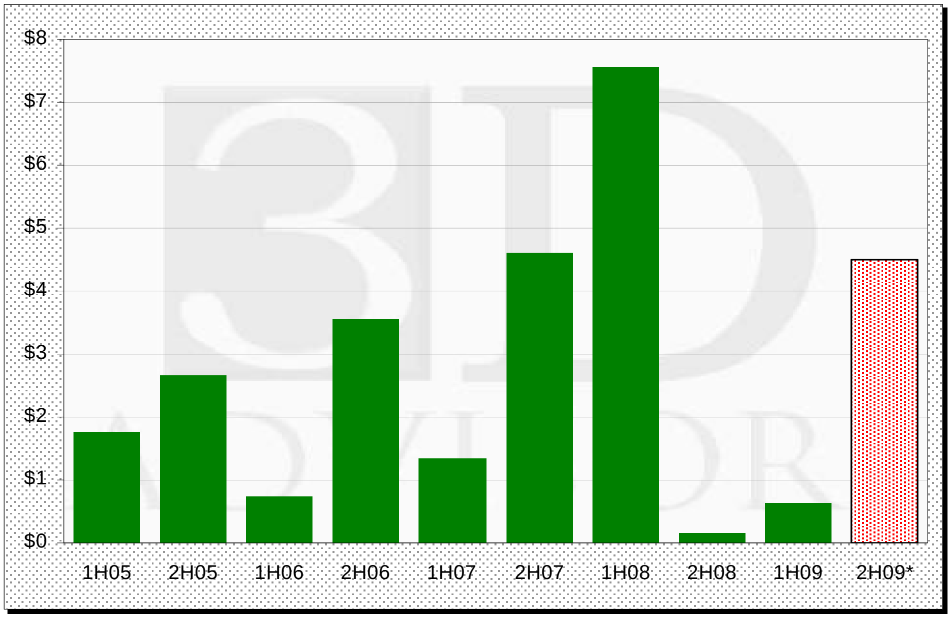
- Bunge has a long standing and persistent history of consuming cash and keeps adding on more debt? No problem; float another note offering. Note offering fails in March of 2008 (03/14/08)? No problem; put a patchwork facility together with a consortium of European banks. Expiring credit facilities need to be replaced? No problem; construct successive patchwork facilities, many covering as little as one year, one reaching over three oceans and involving up to 20 lenders (06/05/09).

- CFO Fouse categorically states on the 1Q08 conference call, when BG was trading at around $120 a share, that in the event of any further cash drain Bunge will not have to sell stock? No problem; barely two months after selling $600 million in yet-another note offering in June of 2009, the Company sells 11.5 million shares in August at $65.50, diluting shareholders by almost 10%.

- Doesn't a big miss in 1Q09 and then "winning ugly" to beat the 2Q09 consensus earnings number on the strength of currency translations mean full-year guidance needs to be lowered? No problem; just back load results into the second half, especially the 4Q09, requiring a near record 2H to make guidance.

The last bullet above is a perfect example of the unpredictability of BG results which stems from lack of visibility and why it has been so frustrating for us and other analysts to follow the Company. Before the market open on 07/23/09, the Company reported that revenue fell 23% in the 2Q09 and profit fell 60%, but it still managed earnings of $2.28 a share versus an analyst consensus estimate of $0.71. The shares finished up 3.2% on the session, despite the fact that the earnings upside came from "foreign exchange gain on debt", an accounting gain from re-measuring into the local functional currency certain third-party debt of foreign subsidiaries that is carried in currencies other than the functional currency. The gain was $359 million, without which there would have been no "earnings" at all. Meanwhile, operating the business *consumed* $1.4 billion of cash during the quarter. And just as remarkably, and as if the results for the quarter indicated strength in the Company's business, CFO Fouse reiterated the previous full-year guidance, which means earnings per share will have to reach $4.51 in the second half of the year. As Figure 1 below indicates, the guidance implies the Company has quite a hill to climb in the second half.

Figure 1. BG Bi-Annual Earnings per Share (Fully Diluted). Green bars are actual reported earnings, red shaded bar is the guidance issued by the Company for 2H09. Source: BG SEC Filings.



*Figures have not been adjusted for dilution resulting from the recently completed secondary offering.

Indeed, there seems to be no end to the rabbits in Alberto's hat and even we sometimes wonder if a catalyst will ever emerge sufficient to expose the true weakness of the Bunge business and the huge risk in the shares at current prices. We expect future quarters to be equally unpredictable, but in the end, we maintain our stance that a catalyst will eventually materialize in the form of persistent poor cash flow generation (with the attendant needs to constantly raise new capital) until the Company finds itself in a liquidity corner for which Alberto has no more rabbits in his hat.

To this end, this report analyses the interconnection between Bunge's handling of its largest liquid asset, Readily Marketable Inventories (RMI, which are mostly soybeans) and the effect their fluctuations have not only on cash flow but on earnings as well. It is these very assets, and their management thereof, that very likely have provided Bunge the capability of managing its earnings to guidance in so many quarters at the real expense of burning through cash at a pace requiring constant replenishment.

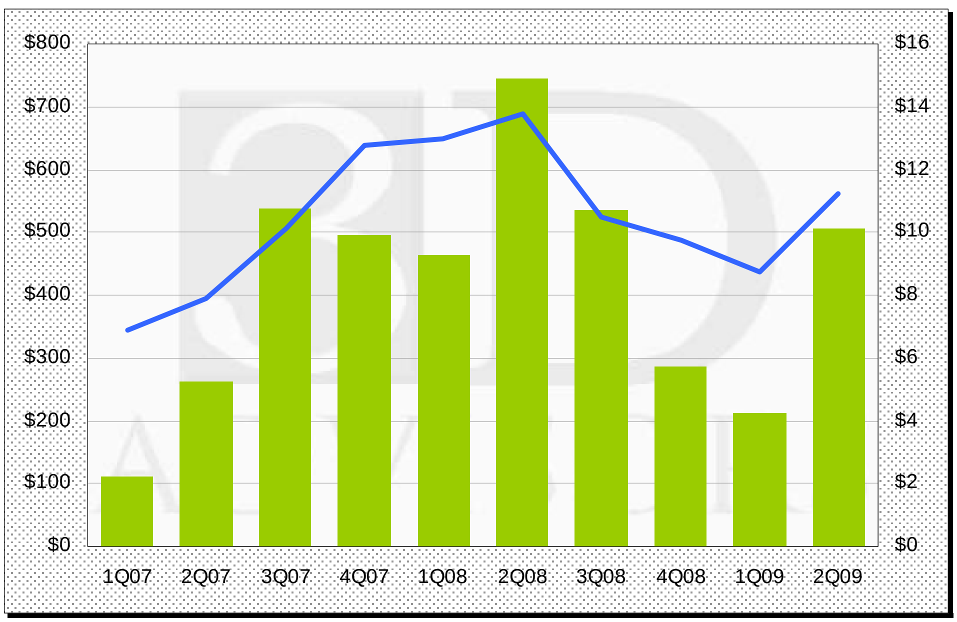
<u>Accounting: How and when Readily Marketable Inventories enhance earnings</u>

Unlike its counterpart ADM, which utilizes LIFO, Bunge marks its Readily Marketable Inventories (RMI) to market based on changes in commodity market prices. This gives rise to write-ups and write-downs of inventory valuations, depending on what is taking place in commodity markets. Consequently, evaluating the Company's quarterly performance is very difficult due to the effects these inventory write-ups and write-downs have on earnings. Based on Bunge's limited disclosure, the following inferences can be drawn regarding the effects of the Company's inventory valuation practices.

When the market price of soybeans rises and soybean inventory on hand is carried at an older, lower price, the inventory is written up to the new market price with a corresponding reduction in cost of goods sold and a benefit to earnings. The benefit has nothing to do with operations, but rather, comes solely from commodity markets price changes. The effect is to pull earnings forward into the quarter in which the write-up occurs. Subsequent quarters will be negatively affected as the beans are placed in production and ultimately charged to cost of goods sold. In the case of write-downs due to negative changes in commodity market prices, the opposite effects occur, with higher cost of goods sold in the quarter in which the write-down is recorded, with the benefit going to subsequent quarters when the beans are placed in production and ultimately charged to cost of goods sold.

The correlation between soybean prices (at each quarter's end) and gross profit for Bunge's Agribusiness segment, by far the Company's largest producer of revenue, confirms the magnitude of the effect inventory valuation changes have on earnings:

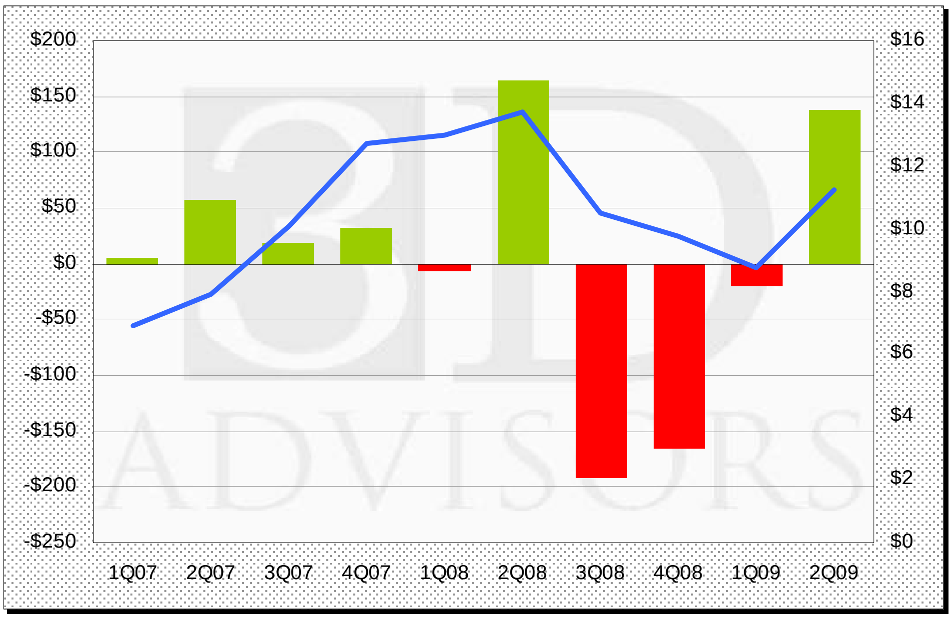
Figure 2. BG Agricultural Segment Gross Profit (Millions of $; Green Bars, Left Scale) and the Price of Soybeans at Quarter End ($/bushel; Blue Line, Right Scale). Source: BG SEC Filings and 3DAdvisors, LLC estimates.



When one considers the fact that RMI, currently at $4.3 billion, represent a material component of Bunge's current assets and that their valuations are quite volatile, when compared to ADM's practice of LIFO valuations for the same assets, it is not too difficult to understand how BG earnings have shown more upside in certain periods than ADM. This was the case during the 2Q08 when beans shot up to over $16 per bushel during the quarter and Bunge's shares, albeit primarily boosted by high fertilizer prices, traded in the $120 area.

Even so, it's no secret that BG gross profits are thin in its Agribusiness segment. When one adjusts those gross profits for foreign exchange effects, gross profits become razor thin or disappear altogether. In fact, without the benefit of FX, profits in this segment would be elusive at best, as is shown in Figure 2, which is the same as Figure 1 after adjustment for FX effects. The picture is not a flattering one as Agribusiness, which is the largest segment by far, has its profits crater during periods of falling soybean prices.

Figure 3. BG Agricultural Segment Gross Profit Net of FX Effects (Millions of $; Green/Red Bars, Left Scale) and the Price of Soybeans at Quarter End ($/bushel; Blue Line, Right Scale). Source: BG SEC Filings and 3DAdvisors, LLC estimates.



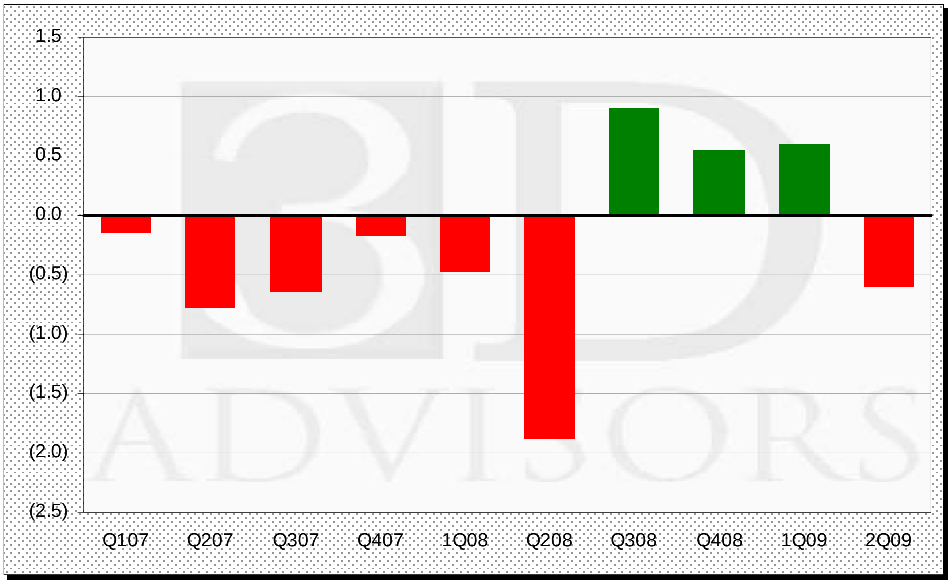
The above correlation helps us understand how rising soybean prices played a role that helped Bunge keep 2Q09 from being a total debacle, this on the heels of a disastrous 1Q09: While Fertilizer reported losses for the quarter, Agribusiness generated Gross Profits of over $500 million, albeit the majority of it FX related.

We expect a reversal in Agribusiness fortunes for 3Q09 however. Due to a strong U.S. crop this year, beans prices have been falling of late. From their August highs of $12.50/bushel, cash beans are trading currently at $9.75 with the longer months trading as low as $9; this not good for Bunge's inventory valuations and their related effects on Agribusiness earnings for the second half of the year.

<u>Accounting: RMI also have significant impact on cash flow</u>

Earnings effects aside, the largest impact of Bunge's Readily Marketable Inventory position is on the Company's cash flow. When beans are going up, Bunge is forced to burn cash to buy them in at the higher prices when adding to its inventories. During such periods the Company shows increased earnings due to inventory write-ups but at the cost of higher levels of working capital consumption. As a result, changes in cash used to build inventories when bean prices are high can have a significant impact on the Company's overall cash flow, as Figure 3 below illustrates:

Figure 4. Cash Used (Red Bars) or Generated (Green Bars) by Inventories (Billions of $). Source: BG SEC Filings.

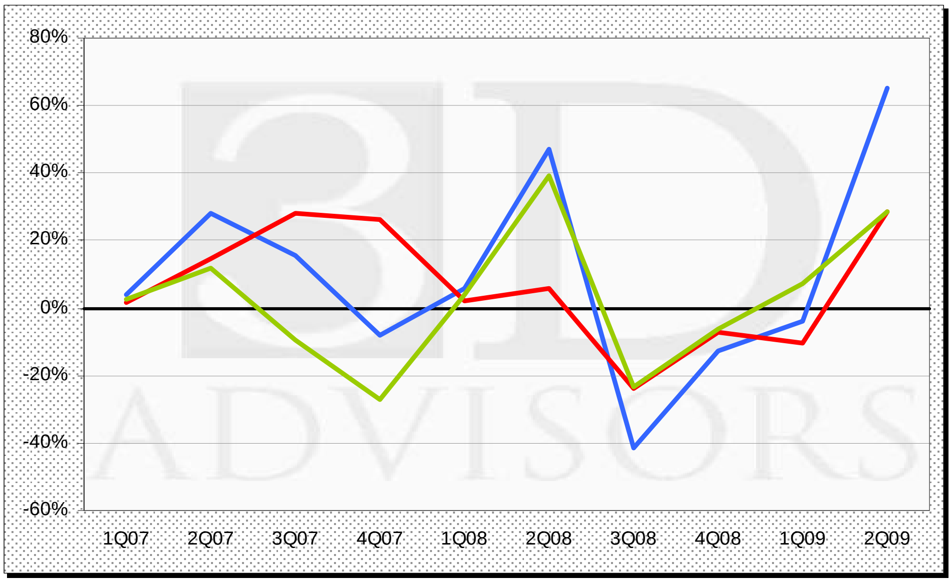


Given the current weakening environment for soybean prices, and the high probability of continuing softness in the months to come, it is likely that Bunge should be able to generate some positive cash flow at least through the 3Q09 and possibly the 4Q as well. As has been the case in past periods, however, such cash flow generation will come at the expense of contracting margins.

Should Bunge continue to report negative cash flow in the 3Q09 related to bean purchases, one must begin to wonder about the liquidity of its RMI inventory. We say this because it is apparent that, for the past three quarters, Bunge has been aggressively building its soybean stocks. To understand this, it is necessary to estimate the Company's physical volume levels of beans. Bunge quotes its RMI in dollar value. Converting dollar value RMI to unit measurement can only be done by estimating, given the fact that Bunge does not provide unit volume detail on its inventories. The lack of this type of detail in its disclosures has frustrated analysts for many years and is part of the reason why many refer to Bunge as a "black box" with very limited visibility into how crucial parts of the business actual work and impact earnings and cash flow. And while our attempts to estimate physical volumes are admittedly crude because the reported dollar amounts for RMI include FX effects, transportation differentials and other distortions, we can nonetheless draw some meaningful conclusions regarding relative changes in RMI physical amounts which can help us understand whether the Company is buying or selling beans during a particular period, and to what extent.

Figure 5 illustrates the percentage changes for soybean prices, the value of RMI and the unit volume of RMI. Clearly, when soybean prices increase (red line), the value of RMI (blue line) also increases for the most part, as one would expect. The important part of the comparison, and one which we have been looking for, is that rises in dollar value of RMI are not simply a factor of higher soy prices but are influenced by RMI unit volumes as well. Changes therefore in the unit volumes not only provide good clues as to where Bunge's physical bean inventories are headed but also any attendant cash flow effect as well.

Figure 5. Sequential Percentage Change in Soybean Prices (Red Line), RMI Volume (Green Line) and RMI Dollar Value (Blue Line). Source: BG SEC Filings and 3DAdvisors, LLC estimates.



Back in the 1Q08, when Company's attempt to sell notes fell through, a concerned analyst asked CFO Fouse on the 1Q08 conference call about liquidity in the following fashion:

Analyst: Would you go outside the debt markets for raising money?

Jackie Fouse, CFO: Not at this time. No.

Analyst: So there's no reason to believe that you would have to raise equity?

Jackie Fouse: No. As I think I've mentioned in other calls that we, given the way that we have put our plan together, we expect to be able to fund our CapEx spending from internally generated funds and we could fund a modest increase in working capital from internally generated funds or financing facilities currently available to us, as well. And the only reason that I would see us needing to go to the equity markets would be potentially if we did a major acquisition or had something that's completely outside of our plans today.

Analyst: So just being clear, in the current business environment you do not need to raise equity because of your cash situation?

Jackie Fouse: That is correct.

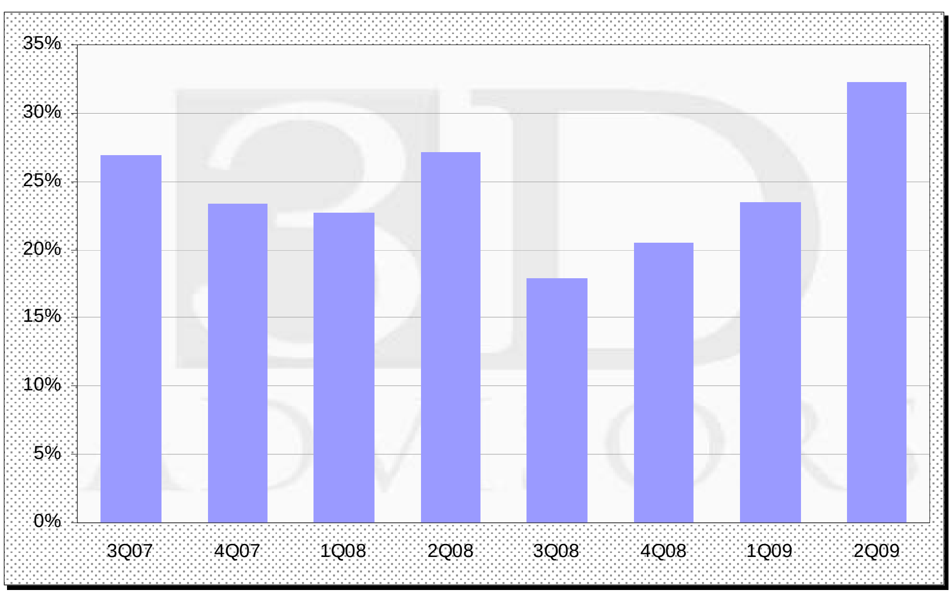
Analyst: That's what I'm looking for. If you were to sell your readily marketable inventories, would you take any charges on it if the price of soybeans went down?

Jackie Fouse: What we would probably do if we got into that situation is we would just stop buying and we would crush everything out, process everything out, and draw the inventories down that way.

The answer is interesting on two fronts. First, even after three successive debt facility reloads in the wake of this 1Q08 comment, and Fouse's oft-repeated claims of being able to satisfy its cash needs from internally generated funds, Bunge found itself needing to come up with additional cash through its 11.5 million share stock offering last month, just two months after completing the last of the three financing rounds. It is also worth mentioning that the offering not only significantly diluted shareholders, but the offering was priced about 50% below where the shares stood in early 2008 when Fouse denied any need of a round of equity financing on the 1Q08 conference call. Fouse seemed to speak the truth with her strategy for crushing out inventories should soy prices move down. This is what they did during both the 4Q07 through 1Q08 drop in soybean prices. Drained of inventory, Bunge then found itself apparently having to buy beans into rising prices in order to re-stock in 2Q08, consuming almost $2 billion in cash during the period. That 2Q08 extreme rise in the price of beans (prices had spiked to as high as $16/bushel) more than likely caught Bunge off-guard.

The 2Q08 soybean spike was short-lived, however, and beans collapsed for good in the 3Q08, trading at annual lows for the next three quarters. Again, instead of heavily buying beans at the lows, cash strapped Bunge seems to have crushed down existing inventories depleting its RMI to very low levels. The result was a three quarter-long bean-related cash infusion as the Company held back on buying until 2Q09 when, as Figure 5 above shows, Bunge bought heavily to replenish its inventories and, of course, once again drained cash reserves in doing so, this time to the tune of over $500 million. No wonder the Company found itself raising cash twice in a two month period.

Figure 6. Percentage RMI is of Total Current Assets. Source: BG SEC Filings.



So where are RMI today relative to where they have been historically and will the Company be in the market purchasing more soybeans anytime soon? At the end of the 2Q09 (June 30), RMI had risen to just over 32% of current assets, far above where they have been, on a relative basis, over the past two years as can be seen in Figure 6 above. Judging from the data, given the fact that RMI now represent the highest percentage of current assets that they have been at during the volatile 2008-2009 period, it would seem that the Company should not have had to buy in more beans during the current quarter (3Q09). Therefore, we would think the Company should disclose a quarter of positive cash flow upon the 3Q earnings release on October 22nd.

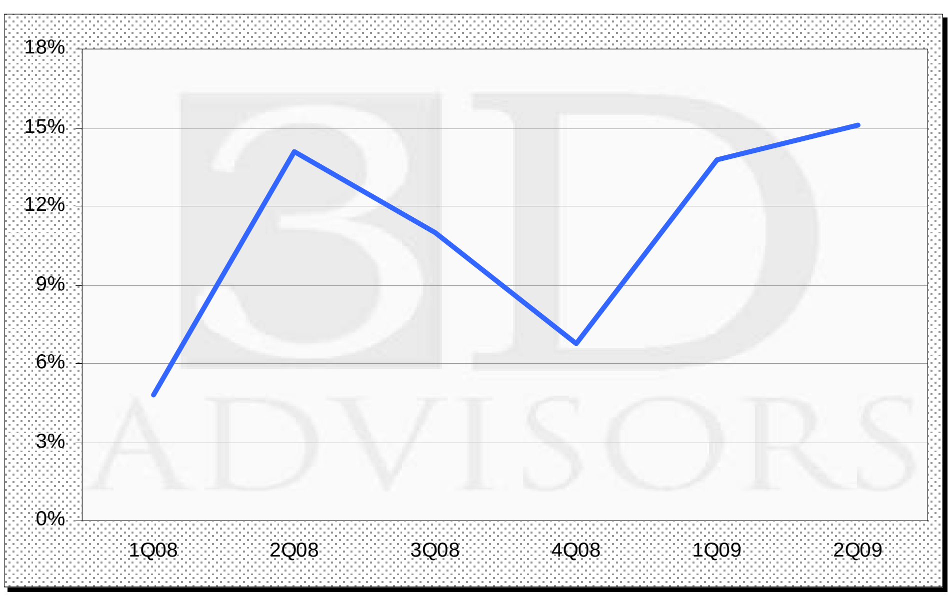
Accounting: Questions concerning liquidity of Readily Marketable Inventories

Should, however, it be revealed that during the 3Q09 Bunge had to continue to buy beans, thus expending further cash in the process, the plot would thicken. In such a case, we would wonder why reported RMI were not enough to support production. Such a scenario could certainly call into question whether Bunge's RMI are truly as liquid as the Company claims they are in this description that is repeated over and over again in each SEC Form 10-Q and 10-K filings:

> Readily marketable inventories are agricultural commodities inventories that are readily convertible to cash because of their commodity characteristics, widely available markets and international pricing mechanisms.

Indeed, in answer to questions concerning Bunge's always-tight cash position, the Company's canned response is that investors should look at RMI as if they were as good as cash, being that they are so easily converted. To this, we would ask however about the growth in Level 3 RMI, which have continued to grow as a percentage of total RMI as shown in Figure 7 below:

Figure 7. The Percentage of Total RMI That Are Classified as Level 3. Source: BG SEC Filings.



As of 06/30/09, Bunge's Level 3 RMI stood at $656 million, or 15% of the total. To us, it would seem that these RMI, labeled such as they have "Unobservable inputs that are supported by little or no market activity", are hardly as liquid as cash.

Then there is the financing expense that Bunge regularly incurs related to its RMI. During F/Y 2008, the Company burned through $112 million in interest expense to finance these inventories. Lower interest rates have eased this a bit in 2009 but the Company has spent $30 million through 2Q09 on such expense nonetheless. It stands to reason that, if its beans were truly "Readily Marketable" and the same as cash as Bunge claims, the Company should be able to mitigate such expense, especially given its tight working capital condition.

We have lingering doubts about Bunge's RMI that relate to the inherent difficulties in accounting for such inventories as their stocks are constantly in motion worldwide. Our doubts date all the way back to comments made by former CFO **Bill Wells** during the 2Q06 earnings conference call (on 07/27/06). At that time, due to scrutiny raised by an article appearing in *The Wall Street Journal* [1], skepticism was increasing concerning the quality of collateral (in the form of soybeans) that Bunge claimed to have to support its large amounts of long-in-the-tooth farmer advances and fertilizer receivables. Seemingly in response to the article the Company disclosed as part of its 2Q06 earnings release the amount of its collateral or "Soybeans available for payment on advances". When asked about these beans, Wells stated that the beans sat in silos and their amount, to be used as payment in the event of default, was way up compared to past periods. This statement we found extremely curious:

> **Analyst:** And your presentation on advances, that does or does not include fertilizer?
>
> **Bill Wells:** That does not include fertilizer. We're just focusing on the advances portfolio there. As you can see in the chart that we put out on the website, our net exposure has declined versus same time last year because there are more soybeans sitting in the silos available for payment of those advances.

We have serious doubts about this statement made by Wells, who said the beans sat in silos. Checking on this claim with our Brazilian sources, however, revealed a high level of skepticism as to just how many beans could be "available" for such payments, especially in silos, as Wells has indicated. The problem with his claim was that there were simply no soybeans sitting in silos in Brazil at that time of the year. There is very little local storage, especially in Mato Grosso, which is in the interior of Brazil and is the country's largest soybean producing state. Instead, the beans are delivered to large centralized storage facilities whose silos were full of corn at that time of year, not soybeans. Mr. Wells would unexpectedly leave the Company in the 1Q07. His position would not be filled until August of that year by the current CFO, Ms. Fouse.

[1] Reilly, David, "Bunge's Fiscal Reports Leave Some Puzzled", *The Wall Street Journal*, July 24, 2006.

<u>Fundamentals: Expectations for improved fertilizer results not supported by data</u>

It is no secret that Bunge's back loaded guidance for the 2H09 is heavily dependent on brisk fertilizer sales and margins in the second half. The bull case supporting the notion of good fertilizer sales is primarily based on the fact that Brazilian farmers held back on their fertilizer purchases in 2008 when prices skyrocketed. Also, concerns about the weakening US dollar vs. the Brazilian real stoked speculation that farmers would pick up their buying pace before further softening in the Greenback. Expectations have remained strong that the Brazilian farmers will take between 22 and 23 million metric tons of fertilizer deliveries in 2009.

Thus far, however, the data does not seem to support any dramatic recovery in fertilizer sales in 2009. Through July, only 10.8 MMT of product had been delivered versus 11.6 and 14.0 MMT through the same period in 2007 and 2008, respectively, according to the National Association for the Promotion of Fertilizers (ANDA). Our sources in Brazil expect, with a high degree of confidence, that the official ANDA figures to be released on 09/15/09 covering July will show only 2.5 MMT having been delivered in the month; not exactly a big gain from the 2.9 and 2.0 MMT delivered in 2007 and 2008, respectively.

Yet ANDA officials continue to make optimistic predictions, saying that they expect a return to more normal seasonal patterns of demand, even if it does mean that the projections for annual demand are now back loaded into the second half of the year. Eduardo Daher, executive director of ANDA struck a confident tone when he said recently, "In July the volume delivered was identical [to 2008] and in August the backlog was strong…and deliveries should rise to 2.5 MMT [in August]." Deliveries in August 2008 were 2.1 MMT.

Our sources in Brazil have very different expectations than ANDA or Bunge. A local Bunge salesman told one of our sources, for instance, that August should be his peak month with the rest of the year downhill from there. But even if fertilizer deliveries in Brazil pick up steam in the 2H09, supply and demand fundamentals may make it difficult or even impossible for Bunge to make any money on the sales as the problem of inventory hangover from the excesses of 2008 have not entirely abated. We are still hearing stories of product being dumped on the market: A regional mixer in Goiania, Brazil, for instance, has been reportedly struggling to keep cash coming in and had recently terminated a key manager and is now undercutting the market, selling product below its cost. Activity such as this has caused local Phosphate prices, which had been $500 per ton just 60 to 90 days ago, to drop to $360 ($1,200 last year). Price pressure such as this is impacting imports as well. Potash imports are coming in at $500 per ton but can only be sold at $650 in Mato Grosso. Our sources indicate that freight, commissions and handling charges wipe out most of the margin at those prices. Another factor affecting the fertilizer market in Brazil is that exports of fertilizer to Argentina, which gets 16% of its fertilizer from Brazil, are down over 90% from 2008 as farmers have dramatically cut their investments in crop inputs in the wake of severe drought conditions.

And if all of the above weren't adding enough uncertainty to the forecast for fertilizer sales and profitability, there is a political overhang on the outlook as well. The government in Brazil, still suffering some lingering effects of the political backlash that resulted from last year's spike in fertilizer prices that caused farmers much pain, has gone so far as to propose it may go into competition with the country's multinational fertilizer suppliers. A senior Bunge executive in Brazil recently criticized the policy of Reinhold Stephanes, the minister of a government agricultural agency that has proposed a strategic agreement to create a state company in partnership with Russia for the production of fertilizers. "This news leaves us shocked", said the Bunge executive, who then went on to complain that instead of asking industry to reduce imports by expanding domestic production, the government was working with Russia to form a joint venture to increase them.

As most things related to Brazilian politics, there could be a method to the agricultural minister's madness: The saber rattling concerning imports of fertilizer (Brazil still imports the vast majority of the commodity), have been quite interesting. Moreover, he has gone so far as to threaten confiscation of certain mineral deposits in Brazil, which have been awarded to corporations but are not being mined, charging that the multinationals, who also own foreign mines, are not investing in the development of domestic [Brazilian] deposits but are instead profiting from their facilities offshore at the expense of Brazilian interests. Should the Government's gambit prove effective, the result could be that companies like Bunge and Fosfertil may have to significantly increase their investment in domestic mines if they wish to stay in the Brazilian fertilizer market.

All of this uncertainty surrounding the Brazilian fertilizer market is interesting to consider in the context of the big 2H09 earnings hurdle Bunge has created for itself. The expectations of Alberto Weisser and ANDA don't seem supported by the data and are definitely contrary to what we are hearing on the ground in Brazil. If fertilizer results come in anywhere near as weak as they were in the 2Q09, we don't see how the Company can avoid trimming its full-year guidance, possible by a significant amount.