Zacks Small-Cap Research

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May 14 , 2012
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FutureFuel Corp. (FF-NYSE)

FF: First quarter 2012 revenue above expectations. Tax rate increased.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (05/11/12)	$10.08
Six- Month Target Price	**$16.00**

OUTLOOK

FutureFuel is a profitable manufacturer and seller of specialty chemicals and chemical services and has significant revenue from production and sale of biofuels and petroleum based diesel. Production of carbon anode material for lithium ion batteries for automobiles will result in modest revenue in 2012. The company has a strong balance sheet, no debt and will pay a $0.40 per share annual dividend.

Our recommendation remains as Outperform with a price target of $16.00.

SUMMARY DATA

52-Week Closing High	**$13.69**
52-Week Closing Low	**$9.62**
One-Year Return (%)	**-17.8**
Beta	**0.2**
Average Daily Volume (sh)	**43,410**
Shares Outstanding (mil)	**41.3**
Market Capitalization ($mil)	**$**
Short Interest Ratio (days)	**14.3**
Institutional Ownership (%)	**32.6**
Insider Ownership (%)	**59.4**
Annual Cash Dividend	**$0.40**
Dividend Yield (%)	**3.52**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**10.6**
P/E using N4Q Estimate	**10.7**
P/E using 2013 Estimate	**10.1**

Risk Level	**Average,**
Type of Stock	**Small-Value,**
Industry	**Biofuels**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	**$47.8 A**	**$51.7 A**	**$66.1 A**	**$53.5 A**	**$219.1 A**
2011	**$55.2 A**	**$74.7 A**	**$90.3 A**	**$89.6 A**	**$309.9 A**
2012	**$85.7 A**	**$80.0 E**	**$82.0 E**	**$85.0 E**	**$332.7 E**
2013	**$87.0 E**	**$92.0 E**	**$96.0 E**	**$100.0 E**	**$375.0 E**

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	**$0.12A**	**$0.07A**	**$0.16A**	**$0.25A**	**$0.62A**
2011	**$0.07A**	**$0.22A**	**$0.31A**	**$0.26A**	**$0.86A**
2012	**$0.17A**	**$0.23E**	**$0.26E**	**$0.23E**	**$0.88E**
2013	**$0.22E**	**$0.26E**	**$0.27E**	**$0.25E**	**$1.00E**

Zacks Projected EPS Growth Rate - Next 5 Years % **20**

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RECENT NEWS

Futurefuel Corp. reported its first quarter 2012 results on May 9, 2012. Revenue was ahead of our forecast due to an increase in regular diesel fuel sold that moved biodiesel sales ahead of our estimate. Chemical revenue was close to our estimate.

Pretax income was $12.0 million (Our estimate was $12.5 million) and adjusted EBITDA was $16.6 million as compared to $4.0 million and $8.9 million in 1Q11. Cash, cash equivalents and marketable securities increased to $157 million.

Since the tax credit on blending biodiesel into diesel fuel had expired the tax rate on earnings increased from 31.3% to 40.6%, we had estimated a 35% tax rate. The EPS was $0.17, slightly below our estimate of $0.19. We have adjusted our estimates for 2012 and beyond for the higher tax rate. Also (see below) Futurefuel has exercised its rights to terminate its contracts for the herbicide and its intermediates so it is probable that there will not be any sales of these products effective in 2013.

	1Q11	3Q11	4Q11	1Q12
Dollars in millions				
Chemicals Revenue:	$44.7	$42.2	$44.5	$38.4
Gross profit margin:	17.4%	30.1%	33.2%	30.4%
P&G and Arysta:	$26.7	$28.0	$30.7	$18.9
Other chemicals:	$18.0	$14.2	$13.8	$19.5
Biodiesel & Unblended Diesel:	$7.8	$48.1	$45.1	$47.3
Gross profit margin:	N/M	18.6%	10.1%	2.4%
All Revenue:	$52.5	$90.3	$89.6	$85.7
Gross profit:	$5.0	$22.0	$19.3	$12.8
Corporate expenses:	$1.8	$2.6	$3.0	$2.2
Pretax income:	$4.0	$20.0	$15.5	$12.0
Net income:	$2.7	$12.7	$10.6	$7.1
EPS:	$0.07	$0.28	$0.26	$0.17
Cash, cash equivalents and marketable securities, millions	$136.1	$158.8	$146.0	$157.1

The improved margins for chemicals and reduced margins for biodiesel are, in part, due to the allocation of certain expenses based on that groups proportion of revenue

The tax credit ended on December 31, 2011. We have assumed that the reduction in tax credits is matched by an increase in income from trading RINs.

The chemicals business was impacted by the decline in both the P&G bleach activator (down 19% Y/Y) and the herbicide products for Arysta LifeScience (down 50% Y/Y). These declines were anticipated, and expected to continue. Over the last three quarters the gross profit margin has remained over 30%. The gain in profits from the 2011 first quarter was due to the absence of non recurring expenses.

FutureFuel has been discussing the terms of the contract with Arysta regarding prices and volumes of the herbicide and its intermediates. They have been unable to reach an agreement and FutureFuel has exercised its right to terminate the contracts effective September 1, 2013 for the herbicide and October 1, 2013 for the intermediates. It is possible that Arysta may purchase these products after that but this is not certain. Revenue from this business was worth $30 to $38 million a year from 2009 to 2011. We have assumed that this will decline to $5 million in 2013 and will be zero after that.

The company had announced that it will produce carbon anode materials for lithium ion batteries in electric automobiles. The recent problems of EV battery companies and some EV cars has affected this business. Some revenue was generated in the first five months of 2012 but we have assumed that this will not be significant in 2012.

The biodiesel blenders credit expired in December 2011. This may have pulled some revenue into 2011 that would have occurred in 2012 to take advantage of the credits. The RIN trading may generate profits in 2012. Revenue from diesel and biodiesel sales continued at the level reported in the second half of 2011, as seen in the table above. The company continues to improve the plant productivity that was affected by the switch to low grade feedstocks and this should result in higher revenue as the year progresses. A substantial portion of the biodiesel produced was sold to one major refiner in the first quarter of 2012.

KEY POINTS

- FutureFuel is a profitable specialty chemicals and biodiesel manufacturer with production facilities in Batesville, Arkansas. Operating cash flow is positive and net income covers capital expenditures and dividend payments. The balance sheet is very strong, with cash, cash equivalents and short term investments of $157 million, current assets of $250 million and no debt as of March 31, 2012. FutureFuel is expected to pay a regular dividend of $0.10 per share per quarter through 2012.

- The production of chemical intermediates for several significant customers has been a stable business for several years. The cash generated and derived scientific expertise has supported expansion into the biodiesel fuel business. Revenues from the production of a detergent additive and a post emergent herbicide may not be a growth factor in the future.

- Revenue from other specialty chemicals is growing and the production of carbon anode material for lithium ion batteries could add to that growth.

- Sales of biodiesel are somewhat dependent on government subsidies and mandates. The loss of these subsidies would have a material effect on revenue and profits as it did in part of 2010. However, the mandated level of biodiesel in petrodiesel is due to increase in future years, which could drive biodiesel revenue higher. In addition Renewable Identification Numbers (RINs) are assigned to each gallon of biodiesel, and these can be separated and traded independently in an active market. As mandated levels of biodiesel increase, these RINs increase in prices as discussed later in this report.

OVERVIEW

FutureFuel Corp. was incorporated in Delaware on August 12, 2005 as Viceroy Acquisition Corporation. The company was formed as a blank check offering in order to acquire companies in the oil and gas industry. On July 12, 2006 the company completed an offering of 22.5 million units, each unit was one share of stock and one warrant (to acquire one share), for $8.00 per unit, and the shares and warrants were listed on the Alternative Investment Market (AIM) of the London Stock Exchange. On July 21, 2006 FutureFuel entered into an agreement to acquire Eastman SE, Inc. a subsidiary of Eastman Chemical Company. Shareholders approved the acquisition on October 27, 2006, and the acquisition was consummated on October 31, 2006.

Due to limited trading on the AIM the company cancelled its listing there on July 14, 2008 and began trading on the OTCBB on July 12, 2008. On March 8, 2011 the company's stock was approved for listing on the New York Stock Exchange under the symbol FF.

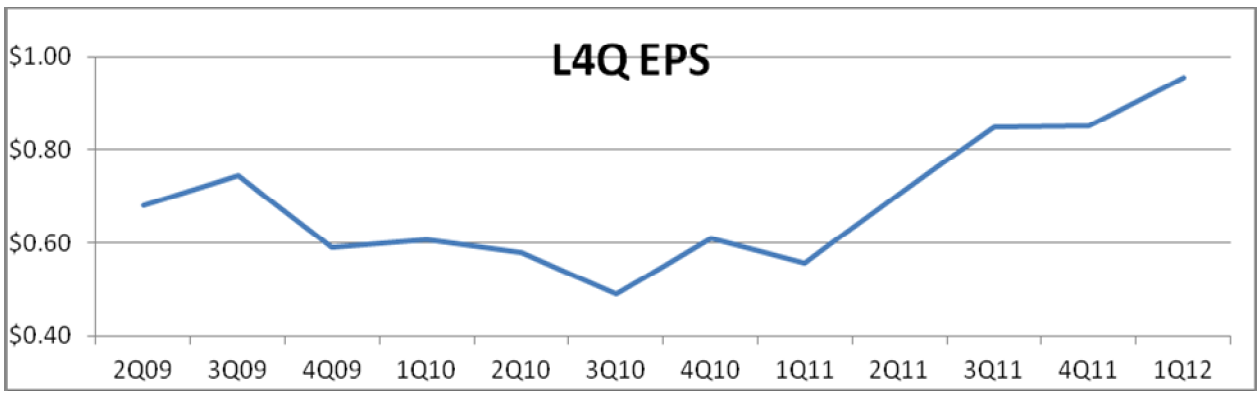
On June 27, 2009 the company was added to the Russell 3000 index.

Eastman Chemical was part of Eastman Kodak (Kodak), and provided Kodak with many of the chemicals and chemical intermediates needed by Kodak. In 1994 Eastman Chemical was spun off from Kodak, and in 2006 Eastman Chemical spun off part of its operations, Eastman SE, which was acquired by FutureFuel. Eastman SE subsequently changed its name to FutureFuel Chemical Company.

Part of the acquisition was approximately 2,200 acres of land fronting the White River six miles southeast of Batesville in north central Arkansas, including about 500 acres used for chemical manufacturing, laboratories, water treatment facilities and other infrastructure that was built in 1975. More than 300 different specialty chemicals have been manufactured at this site. FutureFuel has improved the operations following the acquisitions and has added truck and rail infrastructure with the use of grants from federal, state and county governments aimed at facilitating growth at the Batesville site. There is ample room and sufficient infrastructure for expansion at Batesville The company also owns a granary in Marianna, Arkansas.

Financial fundamentals:

The company has a strong balance sheet, with $157 million in cash, Current assets of $250 million, $40 million in current liabilities and no debt. FutureFuels now pays a regular dividend of $0.10 a quarter.



The chemicals segment:

The company's chemical segment manufactures specialty chemicals and chemical intermediates for specific customers under long term contracts. These include a bleach activator for Proctor & Gamble, a post emergent herbicide for Arysta LifeScience North America, an antimicrobial intermediate made in a plant expansion costing $10 million in 2008 as well as chlorinated olefin polymers that promote polymer adhesion. FutureFuel's chemical segment also manufactures performance chemicals that are sold to a variety of customers, including nylon fiber intermediates and many small volume specialty chemicals that employ the company's sulfonation expertise.

FutureFuel has a long term relationship with Proctor & Gamble. The bleach activator is those small blue specks you can see in powdered detergents. FutureFuel is the only supplier of this product to Proctor & Gamble. Unfortunately while solid detergents are popular in developing countries, they are losing market share in the US to liquid detergents and Proctor & Gamble has informed FutureFuel that purchases of the bleach activator will be reduced from the current level. FutureFuel has not announced the extent of the reduction. The post emergent herbicide made for Arysta has come under significant pressure from generics from South Korea. Revenue from this product may not grow from the current level.

The annual revenue for the chemicals segment is shown below:

Dollars in millions:	2008	2009	2010
Proctor & Gamble	$84.0	$73.5	$79.5
Arysta LifeScience North America	$34.2	$31.6	$36.5
Other chemicals	$37.4	$38.7	$62.3
Total chemical segment:	$155.6	$143.8	$178.3

Quarterly Results

FutureFuel Corp.												
Dollars in millions.		1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
Chemicals revenue		$35.86	$27.86	$39.03	$41.01	$43.60	$40.26	$47.21	$47.12	$44.70	$36.09	$42.18
Gross profit		7.375	6.331	7.929	11.372	$9.2	$8.7	$13.3	$10.2	$7.8	$7.1	$13.1
Gross profit margin %		20.57%	22.73%	20.32%	27.73%	21.16%	21.65%	28.15%	21.67%	17.39%	19.59%	30.97%
P&G and Arysta						$28.3	$26.4	$31.4	$29.9	$26.7	$23.7	$28.0
Other chemicals						$15.3	$13.9	$15.8	$17.2	$18.0	$12.4	$14.2
All Chemicals.						$43.6	$40.3	$47.2	$47.1	$44.7	$36.1	$42.2

4Q revenue is based on the 10K full year data less the nine month results from the 10Q.

The growth in revenue from chemicals excluding the bleach activator and the herbicide has significantly increased except in the second quarter of 2011 which was due to the loss of one client. Third quarter revenue was down slightly from a year ago but was up sequentially. We are assuming that this business will continue to grow in 2012 at an above average rate as compared to the overall chemical industry.

The carbon anode material:

The makers of electric and hybrid cars have often been quoted as needing a better battery, since current EV cars are restricted to less than 100 miles before needing a recharge. Current batteries are heavy, which has an impact on the fuel consumption of a hybrid car.

The DOE has awarded FutureFuel a $12.5 million grant for the construction of a facility to produce carbon anodes for lithium ion batteries. The company received the only award offered by the DOE. The customer, a major petroleum company in the US, will be receiving product late in 2011. FutureFuel has delivered production samples of the material, which has passed the required qualifications of this customer. This material will need to be qualified by the battery producer. The material contract is on an annual take-or-pay basis.

The biodiesel segment:

				2006	2007	2008	2009	2010
Biodiesel				$1.8	$25.3	$42.8	$53.0	$40.9
Gross profit including blenders credit:				(3.1)	(9.8)	7.7	1.4	(0.1)

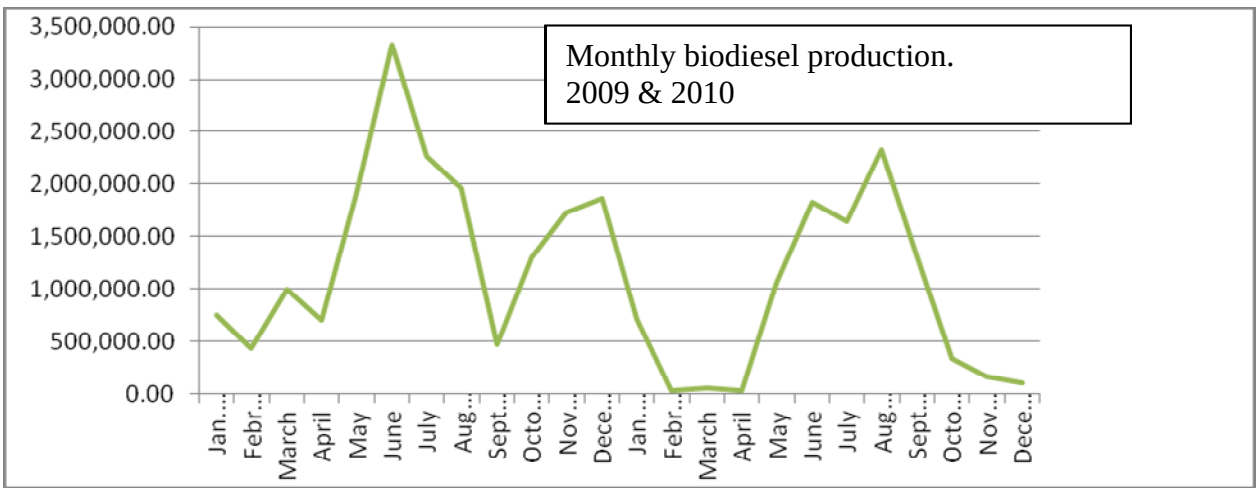
FutureFuel started selling biodiesel in October 2005 using a low fatty acid triglyceride feedstock. The company was able to run its production line at close to 80% of the 59 million for sustained periods of time before the plant was redesigned to use high free fatty acid feedstock. Much of the current feedstock is waste vegetable oil and inedible fats, and FutureFuel is still in the process of optimizing the continuous production line, which is currently running at about 50% of its 59 million gallons a year nameplate capacity.

Under the current regulations a biodiesel producer can claim an extra $0.10 a gallon credit if the plant capacity is less than 60 million gallons a year and certain feedstock requirements are met. This credit applies to the first 15 million gallons produced.

Biodiesel can contain different types of fatty acid esters (see page 10) depending of the feedstock. Biodiesel must meet ASTM D 6751 specifications to be eligible for the $1.00 per gallon federal blenders credit and generate the RINs. (see page 13).

Diesel fuels, including biodiesels, tend to increase in viscosity when the temperature drops in winter or overnight. Each biodiesel has to meet certain standards before it can be added to petrodiesel. Some of the standards may not be reached in cold weather. FutureFuel is reducing the seasonality of its biodiesel by improving its quality and improving fuel formulations.

Past sales of biodiesel are seasonal, as shown below for 2009 and 2010 in gallons per month (data estimated from charts in the FutureFuel 2010 10K):



The company sold 17.7 million gallons in 2009 and 9.1 million gallons in 2010. In the fourth quarter of 2010 the company received $10.47 million in blenders and other credits, which equates to $1.12 a gallon. Data for other periods is not available.

From the quarterly data for 2009 and 2010 the approximate selling price before the blenders credit can be estimated (the credit is used as a reduction in costs). However, this can only be useful when the revenue does not include the sale of other materials such as petrodiesel or revenue from another source:

FutureFuel Corp.	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
Biodiesel as reported	$3.88	$13.98	$13.23	$21.87	$4.16	$11.46	$18.88	$6.40	$10.55	$37.88	$48.12
Gross profit as reported *:	(1.02)	(0.46)	5.72	(2.81)	(1.29)	(2.41)	(1.41)	4.96	(2.78)	8.36	8.93
Assumed blenders credits*	2.18	5.93	4.70	4.90				10.79			
Adjusted gross margins.	-3.20	-6.39	1.02	-7.71	-1.29	-2.41	-1.41	-5.82	N/A	N/A	N/A
*Assumed tax credit is estimated from the volume sold each quarter times $1.00								4Q10 includes $10.785 in blender credits			

Revenue in the third quarter increased on a sequential basis but margins declined from the second quarter levels. Corporate and indirect manufacturing expenses are allocated based on a proportion of total revenue and since biodiesel has generated higher revenue than the chemicals section the margins were impacted with a higher loading of expenses.

In the third quarter the company received $1.9 million under the USDA Section 9005 Advanced Biofuel Producers which was treated as a reduction in expenses.

FutureFuel's Biodiesel production and revenue:			
Revenue per gallon per quarter			
			Revenue per
	Revenue	Gallons	gallon
1Q09	$3.88	2.18	$1.78
2Q09	$13.98	5.93	$2.36
3Q09	$13.23	4.70	$2.82
4Q09	$21.87	4.90	$4.46
1Q10	$4.16	0.81	$5.17
2Q10	$11.46	2.92	$3.93
3Q10	$18.88	5.28	$3.58
4Q10	$6.40	0.61	$10.47
Dollars and gallons in millions.			
Source: Company 2010 Form 10K			

FutureFuel has stated that continued production of biofuels is uncertain and depends on the relative prices of crude oil and bio feedstock, maintenance of government mandates and a continuation of the federal and state credits on biofuels, especially the $1.00 per gallon federal blenders tax credit which ends on December 31, 2011.

In our opinion, at the current time biodiesel from FutureFuel needs both the federal and state subsidies, mandates and acceptable RIN values for the plant to be profitable.

INDUSTRY OUTLOOK

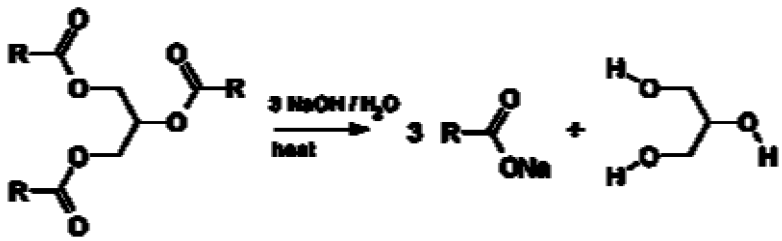
Chemicals:

In general specialty chemicals (fine chemicals) are higher-priced and higher-margined products as compared to commodity chemicals and demand is less affected by economic changes. For specialty chemicals there are usually fewer manufacturers and therefore less price competition. Producers generally compete on the basis of expertise and service rather than price and may even have some exclusive chemical knowledge or process technology. Specialty chemicals are usually produced in small quantities (relative to bulk chemicals) and are often used in the pharmaceutical and biocide industries. The growth of the specialty chemicals industry is usually several multiples of GDP growth.

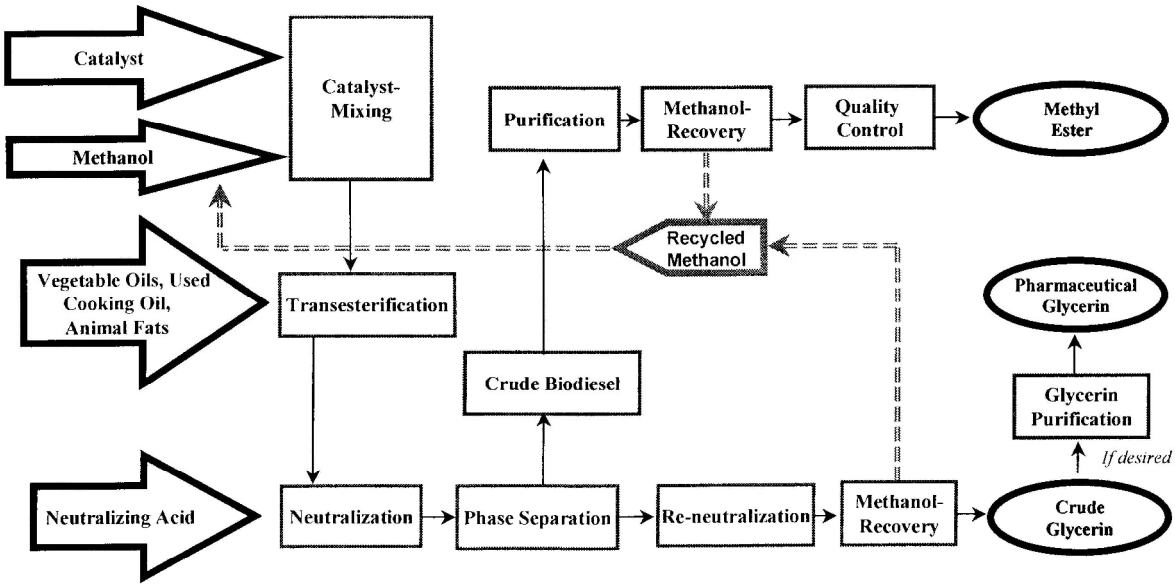
Biodiesel:

The US biodiesel industry started in the early 1990s as a way for farmers to enhance the return on soybeans, and soybean oil is still the most significant feedstock for biodiesel plants.

Biodiesel is produced from fats and vegetable oils, which are esters of glycerol, (also called glycerin and glycerine) which is 1,2,3 tryhydroxypropane. As a by-product of biodiesel production the price of glycerol has been depressed and glycerol from biodiesel has supplanted nearly all other mean of production. The reaction of a strong base (sodium hydroxide) with a triglyceride and an alcohol such as methanol, heated to about 150 degrees Fahrenheit at 20 psi pressure for between 1 to 8 hours, results in swapping the long chain fatty acid with methanol and producing methyl esters of the fatty acid plus glycerol.



The result shown above is a mixture of glycerol and the sodium salt of a free fatty acid. If this reaction were carried out in the presence of methanol or ethanol, the result would be an ester and the process is called transesterification.



There are also monoglycerides and diglycerides which are used in the baking industry, and these can also be used to produce biodiesel.

There are alternative methods of producing biodiesel. Glycerin-Free Biodiesel can be produced, supposedly at a lower cost, using a special enzyme (produced using a genetically engineered bacterium) and triglycerides. The purity of the biodiesel is improved and the glycerol removal stage is not needed. (http://www.license.umn.edu/Products/Biosynthesis-of-Biodiesel-without-Glycerin-By-Product__Z07163.aspx)

Different sources of fats and vegetable oils contain different fatty acids attached to the glycerol molecule. Some are unsaturated containing a C=C bond. There are short and long carbon chains, and the amount of each is different according to the origin of the oil or fat. Below is a table showing the amount of each major acid in some fats and oils. Stearic acid is the most common acid. As can be seen, animal fats are higher in Stearic acid than are oils whereas oils contain more Lineolic acid than do animal fats.

Each acid-ester has a different set of physical characteristics. The smaller the carbon chain, the lower the cloud point (that temperature where the ester begins to freeze). Biodiesel is required to meet the ASTM D 6751 standard for B100, see www.astm.org. All biodiesel produced must be registered with the EPA under 40 CFR part 79.

The cost of production:

In 2009 approximately 317 million gallons of biodiesel and 49,000 million gallons of petrodiesel were consumed. Biodiesel production decreased to 310 million gallons in 2010. At that time there were an estimated 158 plants in operation in 42 states, many of them very small plants of less than 20 million gallons per year. According to the same source, the cost of producing biodiesel from soybean oil is $1 a gallon plus the cost of the soybean oil. Using waste feedstock, such as animal fat, is cheaper only because such feed stocks are less expensive. http://www.pew.org/technology/factsheet/biodiesel.

The Federal Register, Volume 75,No. 58 of March 26, 2010 shows estimates for the cost of production of biodiesel.

The estimated allocation by category in the cost of production was:

Soy Oil	85%
Other Materials	6%
Capital and facilities cost	6%
Labor	2%
Other	2%

The cost of biodiesel varies by raw material input. The EPA estimates that yellow grease sells at about 70% of the cost of soy oil and calculates the cost of biodiesel as follows:

	$/pound feedstock price	Production cost $/gallon
Soy Oil	$0.33	$2.73
Yellow grease	$0.23	$2.43

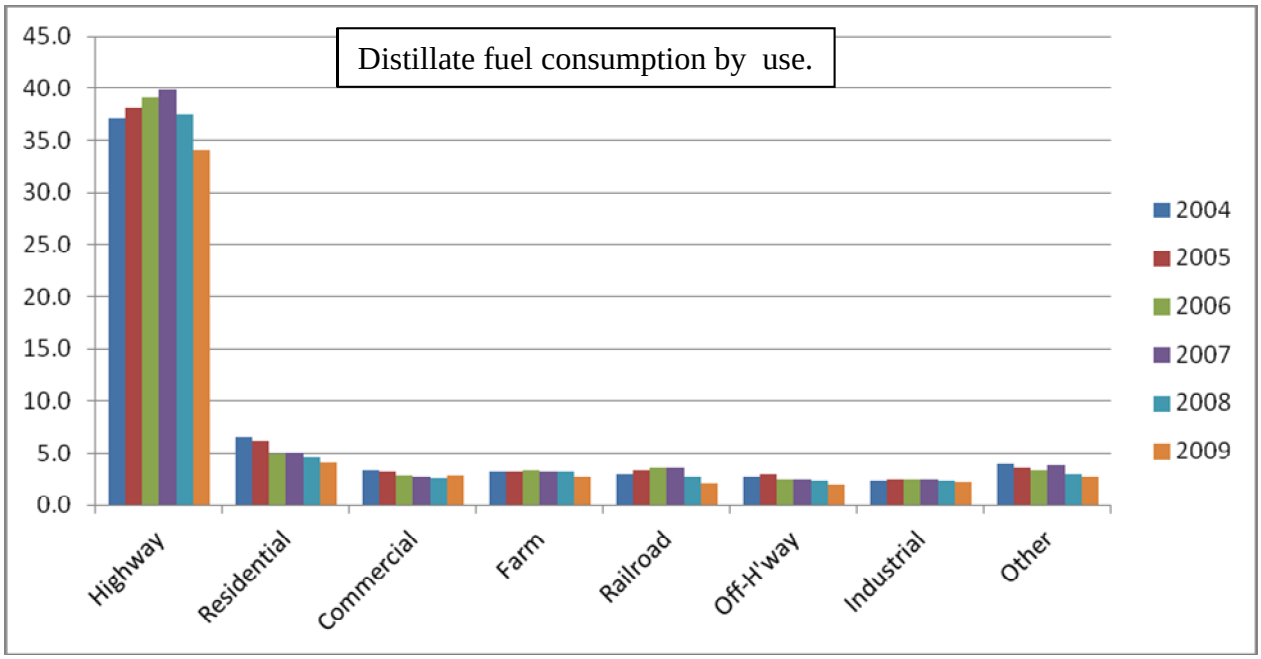
Other sources estimate that there were 170 biodiesel plants, and 52 were idled in 2010 (US Environmental Protection Agency), and others cut back on production. The US Department of Energy estimates that half of the biofuel capacity is based on soybean as a raw material and the other half is flexible towards the raw material source. Currently the Biodiesel Board estimates that capacity exceeds 2.69 billion gallons a year.

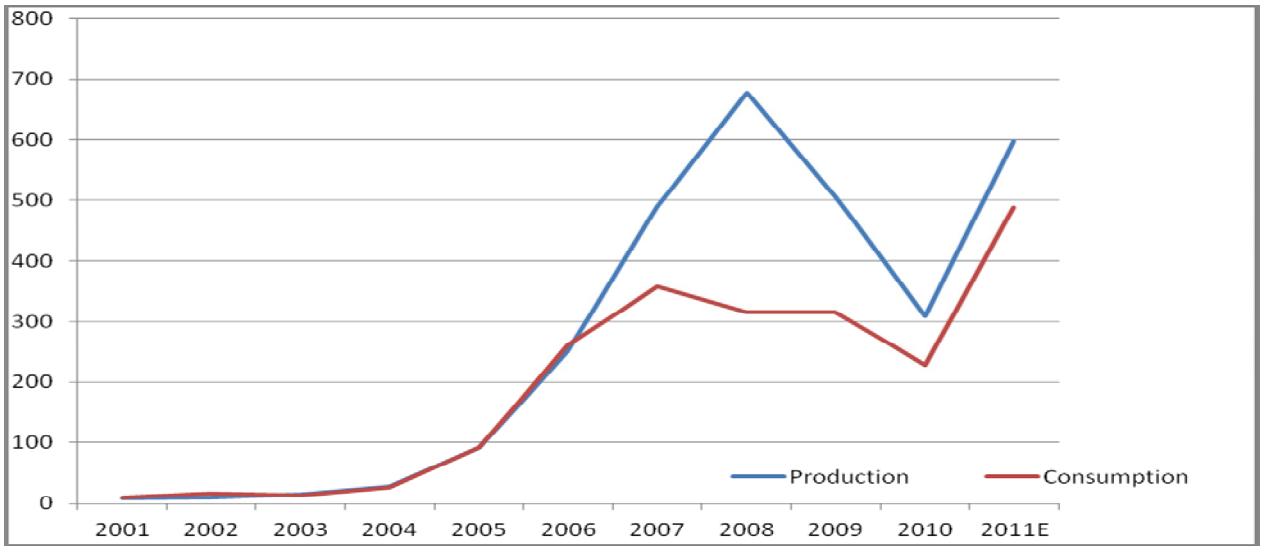
Other cost estimates suggest that it is difficult to make a profit without the subsidy. Iowa State University published a study in 2008, http://www.card.iastate.edu/iowa_ag_review/winter_08/article3.aspx, that suggests that the operating cost, before capital costs and return on investment, averages about $0.59 a gallon before feedstock costs. At that time the National Biodiesel Board estimated capacity at 1.85 billion gallons with another 1.4 billion gallons under construction. It takes about 7.6 pounds of soybean oil to produce a gallon of biodiesel.

Oil or Fat	**Saturated fats**					**Mono**	**Poly**	
% by weight of fatty acid in Oil or Fat						**Unsaturated**	**Unsaturated**	
In order of increasing molecular weight								
	Capric		**Myristic**		**Stearic**		**Lineolic**	
		Lauric		**Palmitic**		**Oleic**		**Alpha Lineolic**
Beef Tallow			**3**	**24**	**19**	**43**	**3**	**1**
Butterfat (cow)	**3**	**3**	**11**	**27**	**12**	**29**	**2**	**1**
Canola oil				**4**	**2**	**62**	**22**	**10**
Chicken fat						**45**	**20**	
Cod liver oil			**8**	**17**		**22**	**5**	
Corn oil				**11**	**2**	**28**	**58**	**1**
Pork fat (Lard)			**2**	**26**	**14**	**44**	**10**	
Palm oil			**1**	**45**	**4**	**40**	**10**	
Soybeen Oil				**11**	**4**	**24**	**54**	**7**
Number of Carbon atoms	10	12	14	16	18	18	17	17
Capric Acid		CH3-(CH2)8-COOH			Oleic Acid		CH3-(CH2)7 (CH=CH)-(CH2)7-COOH	
Lauric Acid		CH3-(CH2)10-COOH			Lineolic and Alpha Lineolic Acid			
					CH3-(CH2)4-CH=CH-(CH2)7-CH=CH-COOH			
Myristic Acid		CH3-(CH2)12-COOH						
Palmitic Acid		CH3-(CH2)14-COOH						
Stearic Acid		CH3-(CH2)16-COOH						

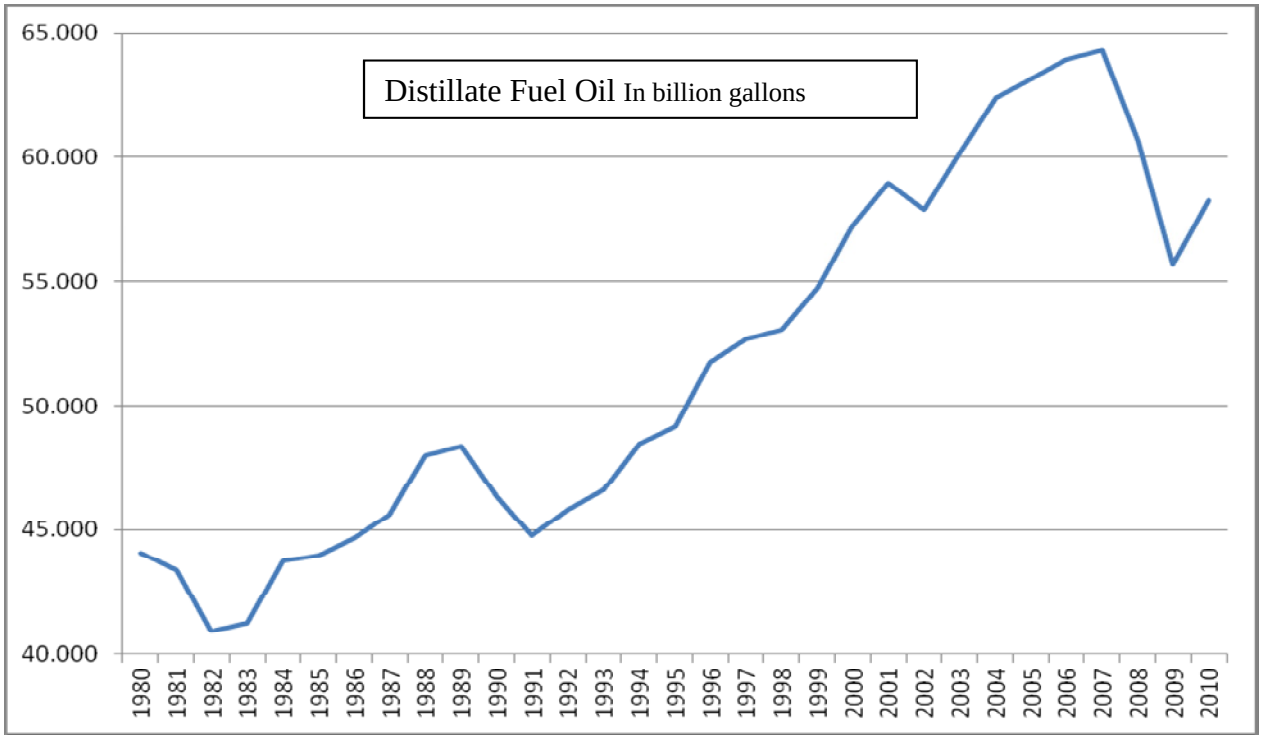
Within the biofuel group ethanol is added to gasoline, and fatty acid esters (biodiesel) are added to diesel fuel. Diesel fuel, broadly defined, is part of the distillate fuel oil category, which also includes some home heating oil as well as highway (including buses), stationary, marine mining, and rail use of diesel fuel but excludes jet fuel, kerosene, or #2 fuel oil. In 2007 the use of distillate fuel oil peaked at 64.3 billion gallons. Most of the distillate is subject to Renewable Fuel Standards regulations.

http://tonto.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MDIUPUS1&f=A
and http://205.254.135.24/totalenergy/data/monthly/#petroleum.





Biodiesel production and Consumption 2001 to 2011 in million Gallons. 2011 Estimate by Zacks Investment Research.



Other countries have significant biofuel industries, notably Brazil with ethanol from sugar and Europe with biodiesel from canola oil. Europe has a significant diesel automobile population. As diesel cars increase in the US there are three factors to consider. There will be an increase demand for diesel (and Biodiesel), seasonal fluctuations will become less important and diesel fuel economy will be an easy way for auto makers to meet the new corporate fuel economy standards. Plus, the US exports biodiesel to Europe.

Regulations:

Many government agencies are involved in legislation of the energy industry, its production and consumption of oil products, alternative fuels, tax credits, blending credits, tax incentives at the Federal and State level. The acceptance of alternative fuels is, in the most part, driven by government subsidies and tax credits. Examples of such legislation are the following:

The Energy Policy Act of 1992 established a goal of replacing 10% of motor fuels with non-petroleum alternatives by the year 2000 and 30% by 2010. This act forced government fleet operators to operate a certain number of alternatively fueled vehicles, and now 75%of all new light-duty vehicles have to have alternative fuel capability. Light duty vehicles are usually cars and small pick-ups running on gasoline.

The Energy Conservation Reauthorization Act of 1998 allows federal and state agencies to use biodiesel in conventional vehicles to meet their requirements under the Energy Policy Act of 1992. Fleets must purchase and use 450 gallons of biodiesel (or its equivalent) per vehicle in a minimum of a 20% blend (B20) for a credit against their alternative fuel vehicle requirements.

Part of the American Jobs Creation Act of 2004 was a federal excise tax credit of one cent for each percentage point of biodiesel blended into petrodiesel fuel. If the biodiesel was produced using recycled restaurant oils, the credit was one half cent. The credit was to expire in 2006 but was extended to 2008 and then to 2009.

In August 2005 Congress passed the Energy Policy Act of 2005. Part of the act was to stimulate the production and use of biodiesel by including biodiesel in the volume of renewable fuels required in the nationwide gasoline and diesel pool (the renewable fuel standard or **RFS**), and the EPA was tasked with

allocating the share to biodiesel each year. The RFS specifies the amount of renewable fuels to be used each year. In 2006 the amount was four billion gallons, increasing to 7.5 billion gallons in 2012. The EPA released the final rules in April 2007. The volume of alternative fuels was 4.7 (billion gallons) in 2007, 5.4 in 2008 (later changed to 9 billion),11.1 for 2009, 12.95 in 2010 and increasing to 36 billion gallons in 2022. Starting in 2010 certain percentages blended into transportation fuels have to be cellulosic based, biodiesel or advanced biofuel. Each type of biofuel is classified, and separate volume requirements were set for each class. The act also created another tax credit for small agro-biodiesel producers with production capacity of less than 60 million gallons a year for $0.10 a gallon for the first 15 million gallons.

The RFS regulations were expanded in December 2007 under the Energy Independence Act of 2007. This is known as RFS2. Under RFS1 the biofuels requirement could be met with ethanol (a gasoline additive) and RFS2 breaks out a requirement that, beginning in January 2009, 500 million gallons of biodiesel be produced, increasing to 800 million gallons in 2011. The consumption data for 2008 was 315 million gallons; 2009, 316 million; and in 2010, 229 million.

The Emergency Economic Stabilization Act of 2008 qualified all biodiesel for a $1.00 per gallon tax credit and extended the credit to include used oils and fats such as "yellow grease", which was double the previous credit.

In the American Recovery and Reinvestment Act of 2009 (enacted February 17, 2009) monies were appropriated for investments and incentives projects related to energy independence, renewable energy technologies and alternative fuels. This included $2 billion for the Dept. of Energy to provide grants for advanced lithium ion battery systems to support US manufacturing of such systems.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 reinstated the $1.00 tax credit that had expired on December 31, 2009 and made the credit retroactive to January 1, 2010 but with an expiration date of December 31, 2011.

Under the prior acts the EPA has the authority to grant a temporary waiver of the volume mandates.

http://www.farmdocdaily.illinois.edu/2011/09/epa_mandate_waivers_create_new_1.html

	Million gallons	
	Production	Consumption
2001	8.577	10.213
2002	10.484	16.168
2003	14.21	13.533
2004	27.982	26.878
2005	90.787	90.827
2006	250.439	260.584
2007	489.825	358.156
2008	678.106	315.796
2009	506.275	316.549
2010	309.362	228.77
2011E	596.95	487.798

Renewable Identification Numbers:

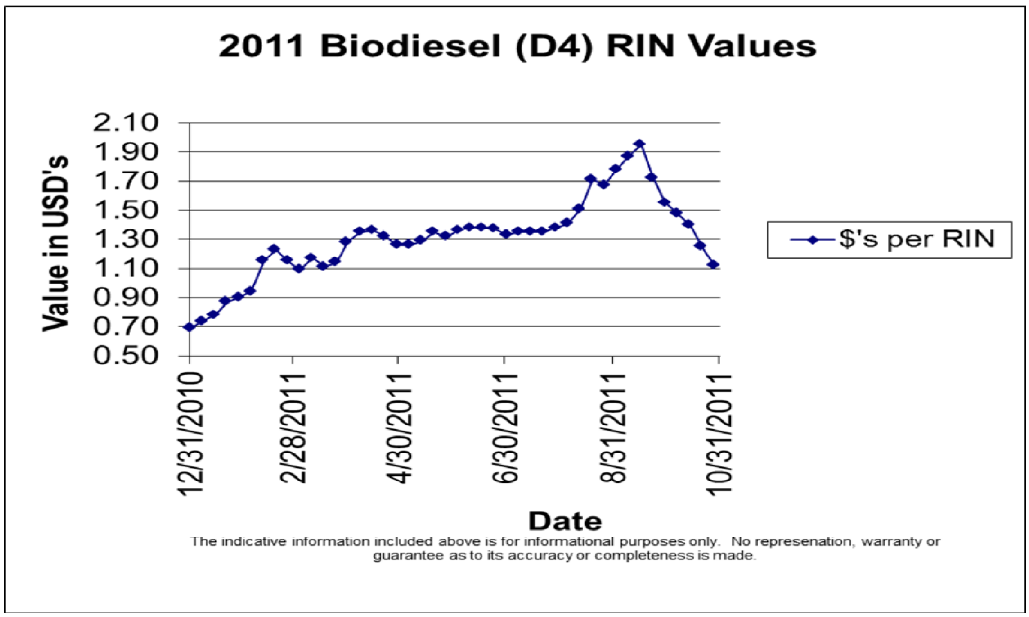
Under the provisions of the 2005 Energy Policy Act the EPA established a system for administrating and paying credits for the production and blending of alternative fuels. The essential part of this system is the Renewable Identification Number (**RIN**).

The RIN is a 38 character numeric code generated by the producer (or importer) of the renewable fuel that is attached to batches (in gallons) of the fuel. The RIN is transferred from the producer to the blender and serves as a tracking number and tax credit number for the blender of the renewable fuel. The RIN stays with the fuel until it is blended. The blender files the paperwork with the government to receive the tax credit, and this fills the compliance mandate. Assigned RINs are transferred when ownership changes. Upon change of ownership and the transfer of the RIN, a Product Transfer Document is filed.

When the blended fuel is sold, the RIN stays with the blender and can be used as a credit against mandated levels of biofuel for compliance of the regulations. The RIN is valid for product sold in the current year and the prior year, and then it is worthless. If a blender has not met the mandated blending requirement, as for example selling petrofuel without the full amount of biofuels, it can purchase RINs to make up the difference.

RINs can be transferred with a change in ownership of the biodiesel or it can be separated if the biodiesel is blended into petrodiesel and then sold at retail. This allows for an active market in RINs, and the prices of RINs could increase if blenders are unable to meet mandated usage levels.

The RIN has a value as shown below:



INDUSTRY POSITION

FutureFuel is a significant factor in the biofuels business in a regional market, although with its new rail and bulk storage facilities the company can market products anywhere in the United States.

Without the subsidy there are many small biodiesel plants that will not be profitable. However, there are probably plants that are used to add value to a waste product (such as a fat renderer, slaughter house, local restaurant chain where raw material costs are zero) or have excess crops or product that cannot be sold.

VALUATION

The valuations of specialty chemical companies are higher than that of commodity chemical companies.

FutureFuels sustained earnings growth has come more from the chemicals group than from biodiesel. The near term prospects for biodiesel depend on the tax credit or substantial RIN values and profits could return to zero. Assuming the current PEG ratio of 0.7 remains the same, EPS growth of 20% and 2012 earnings of $1.09, our target price is $16 a share.

COMPARISON TABLE	Ticker	Price	Mkt	ROE	P/E	P/E	P/B	P/S	EV/Sales	EV/EBITDA	PEG	Inst.
		5/14/12	Cap	(%)	L4Q	N4Q	LQ	L4Q	L4Q	L4Q		Ownership %
			(in million)									
Future Fuels Corp.	**FF**	**$10.08**	**416.5056**	**13.50%**	**10.55**	**10.73**	**1.42**	**1.22**	**0.76**	**5.37**	**0.53**	**32.6**
Air Products & Chemicals Inc.	APD	$83.48	17260	19.66	15.00	13.12	2.81	1.75	2.19	8.80	1.95	86.5
Amyris Biotechnologies Inc.	AMRS	$1.89	93.9	N/A	N/A	N/A	0.77	0.74	0.50	N/A	N/A	29.1
Archer Daniels Midland Co.	ADM	$33.02	21670	7.54	16.54	10.35	1.18	0.24	0.36	10.12	2.32	11.0
Calgon Carbon Corp.	CCC	$14.07	802.6	10.36	20.74	14.84	2.09	1.47	1.50	10.29	3.02	90.0
Cereplast Inc.	CERP	$0.58	11	N/A	N/A	N/A	0.96	0.46	1.34	N/A	N/A	18.5
Codexis Inc.	CDXS	$3.22	116.8	N/A	N/A	N/A	1.23	0.95	0.55	N/A	N/A	36.3
Cyanotech Inc.	CYAN	$10.25	55.7	26.95	17.13	N/A	4.01	2.35	2.17	13.13	N/A	19.1
Eastman Chemical Co.	EMN	$48.58	6690	32.01	11.23	8.48	3.39	0.95	1.08	6.32	1.31	80.4
E.I.D Parry (India)	EIDPARRY.BO	$181.10	31460	16.74	10.06	N/A	1.28	0.25	0.53	4.97	N/A	N/A
Green Plains Renewable Energy	GPRE	$7.37	218	3.74	14.04	5.26	0.49	0.06	0.23	6.89	8.01	43.1
Koppers Holding Inc	KOP	$37.12	771	37.11	17.82	9.06	7.00	0.50	0.68	6.89	0.49	94.6
Huntsman Corp.	HUN	$14.75	3540	16.78	10.22	6.76	1.85	0.31	0.63	5.52	6.40	65.5
New Britain Palm Oil	NBPO.L	$834.00	1210	7.54	N/A	6.22	N/A	N/A	N/A	N/A	0.39	N/A
Originoil Inc.	OOIL	$1.72	15.2	NM	N/A	N/A	N/A	N/A	N/A	N/A	N/A	23.3
Poly One Corp	POL	$13.85	1240	13.44	15.58	10.12	2.06	0.43	0.61	11.22	0.93	0.4
Mean				16.24	14.36	10.29	2.28	2.20	1.98	8.56	2.41	
Median				16.74	14.52	10.24	1.96	0.74	0.68	6.89	1.31	

RISKS

- Loss of a significant customer. FutureFuel has two very significant customers as outlined in this report. The loss of either customer would have a significant impact of revenue and profits. At this point both customers continue to take delivery. The P&G contract ends in March 2013.

- Loss of subsidy. When the $1 a gallon biofuel credit was eliminated in December 2009, FutureFuel biodiesel revenue dropped from $53 million in 2009 to $41 million in 2010. The volume of biodiesel sold declined 47%, but the blended product volume increased 21%. Then, when the subsidy was reinstated, the revenue more than doubled, and in the second quarter, 2011, the plant was very profitable. On the upside many marginal plants would again close down. If the mandates issued under the renewable fuels standards (RFS) were not enforced, most of the biodiesel plants would probably close.

INSIDER TRADING AND OWNERSHIP

Excluding transactions by the Revelation Special Situations Fund Ltd. (a 10% beneficial owner), there have been 11 buy transactions totaling 74,023 shares by officers and directors. There have been no sell transactions.

Major beneficial owners are (as of 07/15/2011):

Paul A. Novelly	17,560,100	43.9%
Mr. Novelly is executive chairman of the board of directors.		
Lee E. Mikles	2,313,350	5.8%
Mr. Mikles is chief executive officer, president and member of the board of directors.		
SOF Investments	3,600,000	9.0%
Revelation Special Situation Fund	5,957,114	14.9%
David K. Knott	2,204,380	5.5%

PROJECTED INCOME STATEMENT & BALANCE SHEET

FutureFuel Corp.																	
Consolidated Statements of Operations																	
(Dollars in millions except per share data)																	
...	**2009A**	**1Q10**	**2Q10**	**3Q10**	**4Q10**	**2010A**	**1Q11**	**2Q11**	**3Q11**	**4Q11**	**2011A**	**1Q12**	**2Q12**	**3Q12**	**4Q12**	**2012 E**	**2013**
												Act.				Est.	Est.
Chemicals revenue	143.76	43.60	40.26	47.21	47.12	178.28	44.70	36.09	42.18	44.51	167.47	38.41	30.00	30.00	30.00	128.41	144.00
Segment gross margin	33.01	9.23	8.72	13.29	23.00	40.94	7.77	7.07	13.06	14.78	42.68	11.67	10.00	11.50	13.00	46.17	0.00
		21.16%	21.65%	28.15%	48.81%	22.96%	17.39%	19.59%	30.97%	33.20%	25.49%	30.38%	33.33%	38.33%	43.33%	35.95%	0.00%
Biofuels revenue	52.95	4.16	11.46	18.88	6.40	40.90	7.80	37.88	48.12	45.10	138.90	38.44	40.00	40.00	40.00	158.44	172.00
Segment gross margin	1.43	-1.29	-2.41	-1.41	4.96	-0.15	-2.78	8.36	8.93	4.55	19.07	1.13	5.00	5.00	5.00	16.13	0.00
0					77.54%	-0.36%	-35.60%	22.07%	18.56%	10.10%	13.73%	2.95%	12.50%	12.50%			
Revenue	194.217	47.763	51.714	66.093	53.52	219.09	52.216	73.963	90.1	80	296.279	80	80	85	90	335	372
Change Y/Y	0.39	22.96	23.63	26.46	-12.66	12.81	9.32	43.02	36.32	49.48	35.23	53.21	8.16	-5.66	12.50	13.07	11.04
Other revenue	2.494	0	0	0	10.785	0	5.774	0.765	`	0	6.539	8.88	10	12	14	44.88	60
FutureFuel Corp.																	
Consolidated Statements of Operations																	
(Dollars in millions except per share data)																	
Fiscal Year Dec 31.	**2009A**	**1Q10**	**2Q10**	**3Q10**	**4Q10**	**2010A**	**1Q11**	**2Q11**	**3Q11**	**4Q11**	**2011A**	**1Q12**	**2Q12**	**3Q12**	**4Q12**	**2012A**	**2013A**
Total revenue	**$196.71**	**$47.76**	**$51.71**	**$66.09**	**$53.52**	**$219.09**	**$55.24**	**$74.73**	**$90.31**	**$89.61**	**$309.89**	**$85.73**	**$80.00**	**$82.00**	**$85.00**	**$332.73**	**$375.00**
% Change												55.19	7.05	(9.20)	(5.14)	7.37	12.71
Cost Goods	151.36	37.49	43.48	52.46	36.34	169.78	45.39	56.96	67.45	70.28	240.07	72.93	61.60	61.50	66.30	262.33	288.74
Distribution & other exp.	10.92	2.33	1.93	1.76	2.01	8.03	4.86	2.34	0.86	0.00	8.06	0.00	0.00	0.00	0.00	0.00	0.00
G & A Compensation expense	3.61	0.73	0.73	0.81	1.23	3.50	0.81	1.32	0.83	2.05	5.00	1.38	1.50	1.50	1.50	5.88	8.00
Other expenses	1.83	0.53	0.44	0.73	0.43	2.14	0.22	0.59	0.81	0.00	1.62	0.00	0.00	0.00	0.00	0.00	0.00
R&D	4.17	0.90	0.89	0.80	0.91	3.49	0.75	0.86	1.00	0.90	3.51	0.84	0.90	0.90	0.90	3.54	4.80
Depr. & Amort.	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Op Income GAAP	24.84	5.78	4.24	9.54	12.60	32.16	3.22	12.66	19.36	16.38	51.62	10.58	16.00	18.10	16.30	60.98	73.46
Interest Expenses	0.03	0.01	0.01	0.01	0.06	0.07	0.13	0.04	0.01	0.00	0.18	0.06	0.07	0.07	0.08	0.28	0.00
Interest Income	0.40	0.12	0.22	0.31	0.48	1.14	0.78	0.81	0.96	0.00	2.54	0.00	0.60	0.60	0.60	1.80	0.00
Non Op Income	0.00	0.00	0.01	0.00	0.00	0.01	0.00	0.00	(0.24)	0.00	(0.24)	1.45	0.00	0.00	0.00	1.45	0.00
Other	0.23	0.02	0.00	0.17	0.76	0.95	0.09	(0.06)	(0.07)	(0.93)	(0.97)	0.00	0.00	0.00	0.00	0.00	0.00
Calc.Pretax	25.45	5.92	4.47	10.00	13.79	34.18	3.95	13.37	20.00	15.45	52.78	11.98	16.53	18.63	16.82	63.96	73.46
Taxes	8.45	2.26	1.71	3.45	3.67	11.08	1.24	4.93	7.27	4.83	18.27	4.87	6.94	7.82	7.06	26.70	11.75
Tax Rate	33.22	38.18	38.22	34.50	26.58	32.43	31.28	36.89	36.34	31.26	34.61	40.62	42.00	42.00	42.00	41.74	16.00
Other Income	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Pro-forma adj.	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.50	0.00	0.00	0.50	0.00	0.00	0.00	0.00	0.00	0.00
Net Income	16.99	3.66	2.76	6.55	10.12	23.09	2.72	8.44	12.73	10.62	34.51	7.11	9.59	10.81	9.76	37.26	42.61
Net For Common	16.99	3.66	2.76	6.55	10.12	23.09	2.72	8.44	12.73	10.62	34.51	7.11	9.59	10.81	9.76	37.26	42.61
Shares Used, millions	29.25	30.96	37.52	40.03	40.05	37.19	40.13	40.44	41.48	41.48	40.60	41.49	42.00	42.00	42.00	42.30	42.50
Earnings Per Share																	
EPS	**$0.58**	**$0.12**	**$0.07**	**$0.16**	**$0.25**	**$0.62**	**$0.07**	**$0.21**	**$0.31**	**$0.26**	**$0.85**	**$0.17**	**$0.23**	**$0.26**	**$0.23**	**$0.88**	**$1.00**
Pro Forma EPS	**$0.58**	**$0.12**	**$0.07**	**$0.16**	**$0.25**	**$0.62**	**$0.07**	**$0.22**	**$0.31**	**$0.26**	**$0.86**	**$0.17**	**$0.23**	**$0.26**	**$0.23**	**$0.88**	**$1.00**

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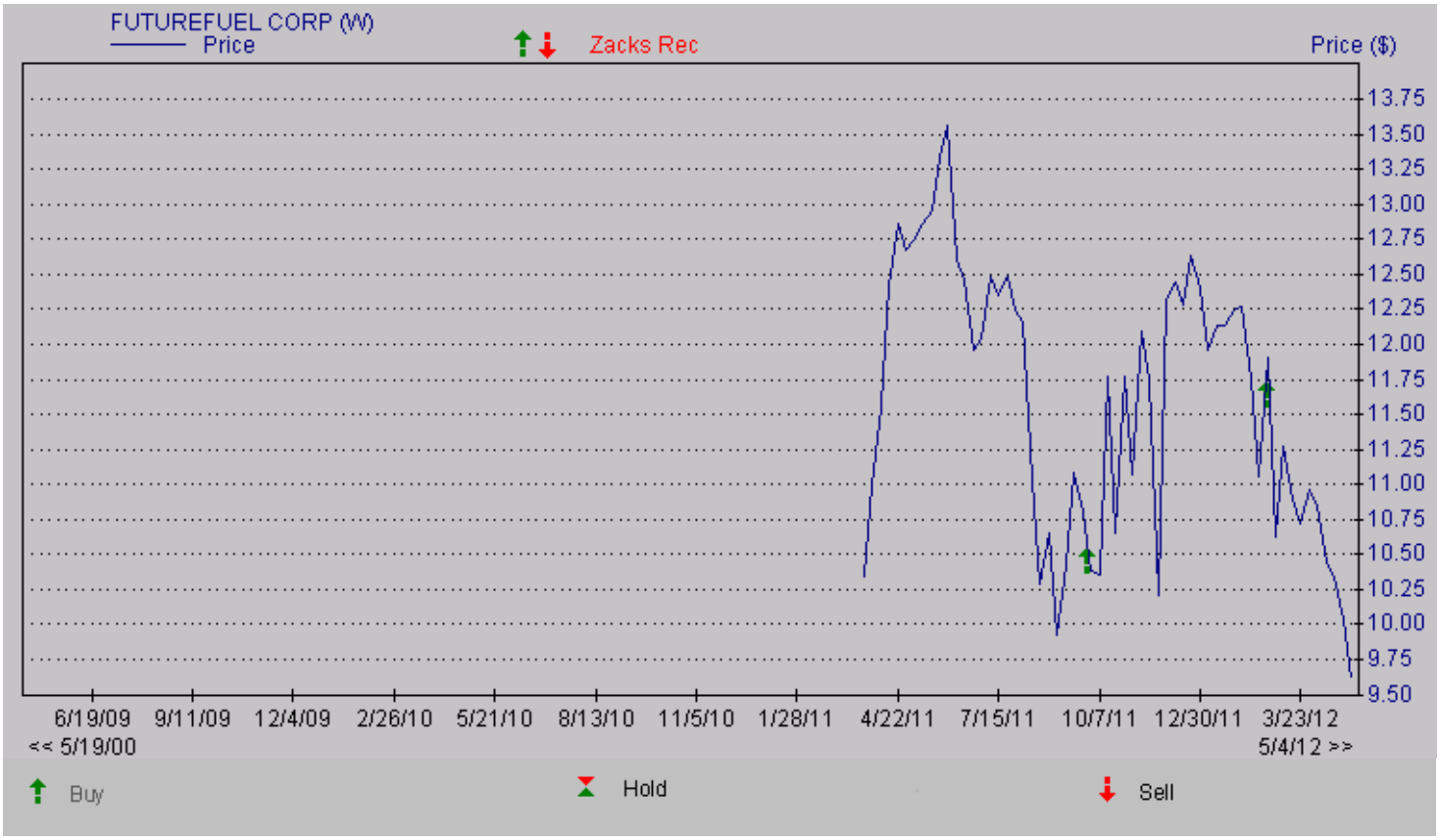
FutureFuel Corp.								
Consolidated Balance Sheet (in $ millions)								
…								
	4Q08	**4Q09**	**4Q10**	**1Q11**	**2Q11**	**3Q11**	**4Q11**	**1Q12**
ASSETS	Act.				Act.			
Cash & Equiv.	73.87	72.32	130.29	136.06	147.28	158.83	146.04	157.08
A/R	20.05	21.76	26.85	27.07	30.50	25.85	35.68	22.12
Inventories	27.59	26.44	31.30	41.20	40.38	43.72	57.44	67.95
Other	6.84	3.06	2.62	2.31	2.52	2.21	3.37	3.38
Total current assets	**128.34**	**123.59**	**191.06**	**206.65**	**220.68**	**230.60**	**242.53**	**250.53**
Gross Plant	106.32	119.25	121.61	131.82	137.61	138.95	140.52	139.95
Acc. Deprn	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Def. Revenue	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Intangibles	0.32	0.21	0.12	0.07	0.04	0.01	0.00	0.00
Other	3.15	2.97	2.41	2.25	2.22	2.18	2.20	2.17
All Assets	238.13	246.01	315.20	340.78	360.54	371.73	385.24	392.66
LIABILITIES AND NET WORTH								
Debt Due 1 Yr	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Notes Payable	0.00	0.00	0.00	2.58	0.00	0.00	0.00	0.00
A/P	13.75	14.83	12.62	22.96	14.68	15.51	21.69	21.77
Taxes	4.15	3.17	4.33	5.30	1.85	4.57	0.00	0.00
Other	4.21	2.90	6.09	4.91	11.76	12.12	14.11	18.12
Total current liabilities	**22.11**	**20.90**	**23.04**	**35.75**	**28.29**	**32.19**	**35.80**	**39.89**
Deferred Revenue	9.99	9.35	13.51	23.16	29.71	30.12	29.26	28.37
L.T.Debt & Convert.	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other LT	1.24	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Def. Taxes & ITC	23.14	24.12	25.46	26.59	26.95	28.65	31.95	31.97
Other	0.00	1.38	2.89	3.21	3.38	3.39	0.00	0.00
All Liabilities	56.49	55.74	64.90	88.72	88.33	94.37	97.01	100.23
Pref.Stock	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Common Stock	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Paid in Capital	167.52	67.60	237.09	237.16	253.42	253.42	253.51	253.59
Retained Earnings	14.10	22.63	12.55	13.39	17.83	26.43	32.93	35.91
Other	0.02	0.04	0.66	1.51	0.96	-2.49	1.80	2.93
Treasury Stock	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net Worth	181.64	90.27	250.30	252.06	272.21	277.37	288.24	292.43
Total liabilities & stockholders' equity	**238.13**	**146.01**	**315.20**	**340.78**	**360.54**	**371.73**	**385.24**	**392.66**

FutureFuel Corp.				
Condensed Consolidated Statements of Cash Flows				
…				
	2008A	2009A	2010A	2011A
Cash flow from operations:				
Net (Loss) Income	22.68	16.99	23.09	34.51
Depreciation & amortization	5.80	7.52	7.56	9.10
Amortization of goodwill				
Stock issued for services				
Stock based compensation	0.02	0.87		
Impairment of machinery				0.50
In-process R&D				
Other	7.78	0.50	-12.82	6.32
Net cash provided by (used in) operating activites	**$36.27**	**$25.88**	**$17.84**	**$50.43**
Cash flow from investments:				
Purchase of PP&E	(16.35)	(21.91)	(9.67)	(23.21)
Proceeds from disposal of PP&E				
Other	(35.66)	43.34	(21.10)	(28.16)
Net cash provided by (used in) investing activities	**($52.01)**	**$21.43**	**($30.77)**	**($51.37)**
Cash flow from financing activities:				
Proceeds from issuance of common stock	8.17		70.74	15.87
Payment of dividend	(19.71)	(8.46)	(31.05)	(16.25)
Proceeds from debt - related parties				
Proceeds from debt		15.42		
Payment on debt - related parties				
Payment on debt				
Other	0.08	(16.22)	(1.21)	0.01
Net cash provided by (used in) financing activities	**($11.46)**	**($9.25)**	**$38.47**	**($0.37)**
Increase (decrease) in cash and equivalents	($27.19)	$38.06	$25.54	($1.31)
Cash & equivalents at beginning of period	$54.66	$27.47	$65.53	$91.07
Cash & equivalents at end of period	$27.47	$65.53	$91.07	$89.76

HISTORICAL ZACKS RECOMMENDATIONS



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