MGP INGREDIENTS INC
Form 10-K
September 02, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 0-17196

MGP Ingredients, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Kansas (State or Other Jurisdiction of Incorporation or Organization)	48-0531200 (I.R.S. Employer Identification No.)
100 Commercial Street, Box 130, Atchison, Kansas (Address of Principal Executive Offices)	66002 (Zip Code)

Registrant's telephone number, including area code (913) 367-1480

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, no par value	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes __ No X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes __ No X

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to their Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer, "large accelerated filer" and smaller company: in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ___ Accelerated filer X Non-accelerated filer __ Smaller reporting company ___

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ___ No X

The aggregate market value of common equity held by non-affiliates, computed by reference to the last sales price as reported by NASDAQ on December 31, 2010, was $132,500,169.

The number of shares of the registrant's common stock outstanding as of August 30, 2011 was 18,143,757.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents are incorporated herein by reference:

(1) Portions of the MGP Ingredients, Inc. Proxy Statement for the Annual Meeting of Stockholders to be held on October 20, 2011 are incorporated by reference into Part III of this report to the extent set forth herein.

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The calculation of the aggregate market value of the Common Stock held by non-affiliates is based on the assumption that non-affiliates do not include directors or executive officers. Such assumption does not constitute an admission by the Company or any director or executive officer that any director or executive officer is an affiliate of the Company.

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements as well as historical information. All statements, other than statements of historical facts, included in this Annual Report on Form 10-K regarding the prospects of our industry and our prospects, plans, financial position and business strategy may constitute forward-looking statements. In addition, forward-looking statements are usually identified by or are associated with such words as “intend,” “plan”, “believe,” “estimate,” “expect,” “anticipate,” “hopeful,” “should,” “may,” “will”, “could”, “encouraged”, “opportunities”, “pot negatives of these terms or variations of them or similar terminology. They reflect management’s current beliefs and estimates of future economic circumstances, industry conditions, Company performance and financial results and are not guarantees of future performance. All such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those contemplated by the relevant forward-looking statement. Important factors that could cause actual results to differ materially from our expectations include, among others: (i) disruptions in operations at our Atchison facility, (ii) the availability and cost of grain and fluctuations in energy costs, (iii) the effectiveness of our hedging strategy, (iv) the competitive environment and related market conditions, (v) the ability to effectively pass raw material price increases on to customers, (vi) the ability to effectively operate the Illinois Corn Processing, LLC (“ICP”) joint venture, (vii) our ability to maintain compliance with all applicable loan agreement covenants, (viii) our ability to realize operating efficiencies, (ix) and actions of governments. For further information on these and other risks and uncertainties that may affect our business, see Item 1A. Risk Factors.

AVAILABLE INFORMATION

We make available through our website (www.mgpingredients.com) under “Investors – Investor Relations,” free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such material with the Securities and Exchange Commission.

PART I

Throughout this document, Dollars are presented in thousands unless otherwise noted.

ITEM 1. BUSINESS

As used herein, unless the context otherwise requires, the terms “Company”, “we”, “us”, “our” and words of similar import refers to the combined business of MGP Ingredients, Inc. and its consolidated subsidiaries.

GENERAL INFORMATION

MGP Ingredients, Inc. is a Kansas corporation headquartered in Atchison, Kansas. It was incorporated in 1957 and is the successor to a business founded in 1941 by Cloud L. Cray, Sr.

The Company produces certain distillery and ingredient products which are derived from corn and wheat flour, respectively, primarily to serve the packaged goods industry. The Company has three reportable segments: distillery products, ingredient solutions and other. Our distillery products segment consists of food grade alcohol, along with a minimal amount of fuel grade alcohol, commonly known as ethanol, and distillers feed, which are co-products of our distillery operations. The ingredient solutions segment products primarily consist of specialty starches, specialty proteins, commodity starches and commodity vital wheat gluten. Mill by-products, consisting primarily of mill feeds or “midds,” had also previously been included in this segment but were discontinued with the shutdown of our wheat flour milling operations at the Atchison, Kansas plant in the second quarter of fiscal 2009. Our other segment products are comprised of plant-based biopolymers and wood-based composite resins manufactured through the further processing of certain of our starches and proteins and wood particles. Prior to the sale of our Kansas City, Kansas facility described below, our other segment also included pet-related products primarily consisting of extruded plant-based resins and finished pet treats.

We purchase corn obtained from or through grain elevators. We purchase wheat flour, the principal raw material used in the manufacture of our protein and starch products, from ConAgra Mills. We process flour with water to extract vital wheat gluten, the basic protein component of flour, which we use primarily to process into specialty wheat proteins that possess increased protein levels and/or enhanced functional characteristics. Most wheat protein products are dried into powder and sold in packaged or bulk form. We further process the starch slurry which results after the extraction of the protein component to extract premium wheat starch, a portion of which we further process into specialty starches and a portion of which we sell as commodity starch, and all of which we dry into powder and sell in packaged or bulk form. We mix the remaining starch slurry with corn and water and then cook, ferment and distill it into alcohol. We dry the residue of the distilling operations and sell it as a high protein additive for animal feed.

The principal location at which we make our products as of June 30, 2011 is our plant located in Atchison, Kansas. We also operate a facility in Onaga, Kansas for the production of plant-based biopolymers and wood composite resins. Our line of textured wheat proteins are produced through a toll manufacturing arrangement at a facility in Kansas City, Kansas, which we had previously owned and which we sold to Sergeant’s Pet Care Products, Inc. (“Sergeant’s”) on August 21, 2009. Additionally, in November 2009, we entered into a joint venture with SEACOR Energy, Inc.’s affiliate, Illinois Corn Processing Holdings LLC (“ICP Holdings”), to reactivate distillery operations at our facility in Pekin, Illinois. This facility is now owned and operated by a 50% owned, unconsolidated joint venture entity named Illinois Corn Processing, LLC (“ICP”), which reactivated the plant in the third quarter of fiscal 2010 after we temporarily closed it in the third quarter of fiscal 2009. ICP produces food grade alcohol for beverage and industrial applications, which we purchase, and fuel grade alcohol, which SEACOR Energy, Inc. purchases.

On August 25, 2011 we have changed our fiscal year end from June 30 to December 31, commencing December 31, 2011. The change will be effective at the start of calendar 2012. A transition report will be filed for the period beginning July 1, 2011 and ending December 31, 2011 on Form 10-K.

FISCAL 2011 DEVELOPMENTS

In fiscal 2011, we continued to concentrate our efforts on the development, production and commercialization of value-added ingredient solutions, consisting of specialty, value-added wheat proteins and wheat starches, and high quality beverage and food grade industrial alcohol. We have also realigned our production efforts.

As a result of the measures we have taken, we saw a $45,944, or 22.7 percent increase in sales. Despite this increase in sales, our operating and net margins declined for the year. Our operating results were impacted by significant increases in raw material costs for corn, wheat flour, and natural gas, as well as significant unrealized losses on commodity derivative contracts during the fourth quarter of 2011.

Recent strategic decisions we have made impacting fiscal 2011 include the following:

- As of June 30, 2011, we had substantially completed a capital project designed to provide environmental benefits at our Atchison, Kansas distillery operations. This project, which was approved by our Board of Directors on June 10, 2010, consisted of the installation of a new, state-of-the-art process water cooling system to replace older equipment used to supply water for multiple components of the distillation process. The project began in the summer of fiscal 2010 and was completed during July of 2011 at an estimated cost of $9,356. We financed the project through a capital lease with U.S. Bancorp Equipment Finance, Inc.

- On October 20, 2010, our Board of Directors approved a project to upgrade our protein and starch plant infrastructure. The upgrades primarily involved interior and exterior renovations to the facility, as well as the redesign of certain protein and starch processing equipment, at a cost of $2,500. The upgrades should allow us to maintain high quality standards and increase our production efficiency. The project began in October 2010 and was completed in the latter half of fiscal 2011.

- During the second quarter of fiscal 2011, we implemented an SAP information technology system for accounting, sales, supply chain and manufacturing. SAP was implemented to improve our business processes and deliver enhanced operational and financial information. This implementation is expected to enable us to manage our business and our reporting more efficiently. We spent $1,269 on the SAP implementation, of which $996 was capitalized.

- During the quarter ended June 30, 2011, we entered into contracts with a third party logistics company, that contracts with the transportation companies, who will provide logistics support in managing all truck and rail carriers in servicing our North American customers, as well as improving delivery times of our inbound materials. This is part of our strategic initiative to strengthen our customer service capabilities while also increasing our logistics capabilities, efficiencies and cost savings.

FINANCIAL INFORMATION ABOUT SEGMENTS

Note 12. Operating Segments of our Notes to Consolidated Financial Statements set forth in Item 8 of this Report, which is incorporated herein by reference, includes information about sales, depreciation and amortization, income (loss) before income taxes for the last three fiscal years by reportable segment. Information about sales to external customers and assets located in foreign countries is included. Information about identifiable assets is included for the last two years.

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BUSINESS STRATEGY

We seek to strengthen our profit margins and improve returns on capital over time. To enhance opportunities to achieve our objectives, we have restructured our business and have modified our product portfolio to emphasize a greater mix of higher margin, value-added products, principally specialty food ingredients and high quality food grade alcohol. To this end, we have taken measures to significantly reduce our production and marketing of lower and negative margin commodity type products. Our strategy is focused on the development and marketing of wheat-based specialty protein and starch products and high quality food grade alcohol, as well as plant-based biopolymer and wood-based composite resin products for use in unique market niches. We seek to add value to our customers' major branded packaged goods products by providing product solutions across a range of food and beverage applications, as well as certain non-food product applications, that can ultimately benefit the consumer.

Market trends from which we hope to benefit include health and wellness lifestyle trends in the food area and growing demand for natural versus synthetic products. Increased interest in bio-economy initiatives may also create opportunities for us, particularly in regard to our partially and totally degradable biopolymers.

As a component of our strategy, we have prioritized strengthening our overall operational capabilities and effectiveness through ongoing continuous improvement projects. Simultaneously, we are boosting our efforts to place greater focus on research, development and innovation initiatives, supply chain management, and customer service practices. We continue to concentrate on specific, highly functional ingredient solutions for our customers. We are concentrating our production and marketing efforts on supplying a core base of loyal customers with an array of high quality, premium ingredients that address nutritional, functional, sensory and convenience issues and that can help build value while making more efficient use of our existing capacities.

We continue to be a leading company in the food grade alcohol industry and pursue efforts to maintain highly efficient alcohol production operations. Since early 2004, the majority of our Atchison distillery's capacity has been dedicated to the production of high quality, high purity food grade alcohol for beverage and industrial applications. It produces only a minimal amount of fuel alcohol as a co-product of our food grade production activities. The majority of our former Pekin plant's capacity for several years had been dedicated to the production of fuel grade alcohol. The Pekin plant is now owned and operated by a joint venture, ICP, which produces food grade alcohol, which we purchase, and fuel grade alcohol, which SEACOR Energy, Inc. purchases, as elsewhere described.

We continued to experience generally favorable conditions in the food grade alcohol market in fiscal 2011, providing our customers with what we believe is among the highest quality, high purity alcohol in the world. We have been in the food grade alcohol business since the Company's founding in 1941.

Biopolymers continue to represent an emerging part of our business. Currently, we have two commercial products in the market. The first product comprises plant-based biopolymers in which a large percentage of petroleum-based plastic could be replaced with materials made from renewable sources, specifically wheat starch. These biopolymers, which serve as bio-based alternatives to traditional plastics, may be utilized in a wide range of products, such as disposable cutlery, cosmetic cases and a host of other items. The second product is a wood-based composite resin, which compounds wood and recycled plastic materials. This product is produced for use in the manufacture of deck boarding, toy products, furniture parts and other wood applications in which long-term durability is required. These products are sold directly to producers of finished products. We are also continuing work on the development and commercialization of a fully bio-based, fully compostable resin.

PRODUCT SALES

The following table shows our sales from continuing operations by each class of similar products during the past three fiscal years ended June 30, 2011, 2010 and 2009, as well as such sales as a percent of total sales.

	PRODUCT GROUP SALES Fiscal Year Ended,								
	June 30, 2011			June 30, 2010			June 30, 2009		
	Amount	%		Amount	%		Amount	%	
Distillery Products: (1)									
Food grade Alcohol	$157,486	63.5	%	$118,578	58.7	%	$124,199	42.6	%
Distillers Grain and related Co-products	20,642	8.3	%	14,340	7.1	%	33,060	11.3	%
Fuel grade Alcohol	10,865	4.4	%	7,072	3.5	%	47,445	16.2	%
Total Distillery Products	$188,993	76.2	%	$139,990	69.3	%	$204,704	70.1	%
Ingredient Solutions: (2)									
Specialty Starches	$29,459	11.9	%	$27,978	13.9	%	$32,817	11.2	%
Specialty Proteins	20,918	8.4	%	20,847	10.3	%	21,936	7.5	%
Commodity Wheat Starch	7,228	2.9	%	9,065	4.5	%	12,629	4.3	%
Vital Wheat Gluten	160	0.1	%	1,825	0.9	%	13,684	4.8	%
Mill By-Products	-	0.0	%	-	0.0	%	1,061	0.4	%
Total Ingredients	$57,765	23.3	%	$59,715	29.6	%	$82,127	28.2	%
Other Products: (3)	$1,157	0.5	%	$2,266	1.1	%	$4,981	1.7	%
Net Sales	$247,915	100.0	%	$201,971	100.0	%	$291,812	100.0	%

(1) In February 2009, we temporarily discontinued distillery operations at our Pekin facility. We now only produce minimal quantities of fuel grade alcohol as a co-product of our food grade alcohol production at our Atchison facility. As a result, our production of distillers feed, a principal co-product of our alcohol production process, also has declined. The table includes our sales of food grade alcohol acquired from ICP but does not otherwise reflect distillery product sales of ICP, which now operates our former Pekin plant.

(2) In October 2008, we shut down our Atchison wheat flour mill and began purchasing high quality flour for use as the principal raw material in our protein and starch production processes. As a result, we quit selling Mill By-Products. In November 2008, we discontinued producing protein and starch at our Pekin facility and consolidated production of value-added protein and starch products at our Atchison facility. These actions were driven by our planned reduction in the manufacturing and sales of commodity vital wheat gluten and significantly curtailed emphasis on the production and commercialization of commodity wheat starch.

(3) Other products formerly included personal care products and pet products. We ceased production of personal care products in the third quarter of fiscal 2009 and sold our pet business in the first quarter of fiscal 2010.

Substantially all of our sales are made directly or through distributors to manufacturers and processors of finished packaged goods or bakeries. Sales to our customers purchasing food grade alcohol are made primarily on a spot, monthly, or quarterly basis with some annual contracts, depending on the customer's needs and market conditions. Sales of fuel grade alcohol are made on the spot market. Contracts with distributors may be for multi-year terms with periodic review of pricing. Contracts with ingredients customers are generally price and term agreements which are fixed for quarterly or six month periods, with very few agreements of twelve months duration or more. During fiscal 2011, our five largest distillery products customers combined accounted for 29.1% of our consolidated revenues. Our five largest ingredients products customers combined accounted for 16.1% of our consolidated revenues in fiscal 2011.

DISTILLERY PRODUCTS SEGMENT

Our Atchison plant processes corn, mixed with starch slurry from the wheat starch and protein processing operations, into food grade alcohol and distillery co-products such as fuel grade alcohol and distillers feed.

Food grade alcohol consists of beverage alcohol and industrial food grade alcohol that are distilled to remove impurities. Fuel grade alcohol is grain alcohol that has been distilled to remove all water to yield 200 proof alcohol suitable for blending with gasoline. In fiscal 2009, we decided to reduce our exposure to the fuel grade alcohol market and presently generate and sell only minimal amounts as a co-product of the food grade alcohol production process at our Atchison distillery.

In February 2009, we temporarily discontinued operations at our former Pekin facility. Historically, the Pekin plant had been principally dedicated to the production of fuel grade alcohol. On November 20, 2009, we completed a series of transactions whereby we contributed our former Pekin plant to a newly-formed company, ICP, and then sold 50% of the membership interest in this company to ICP Holdings, an affiliate of SEACOR Energy Inc., for $15,000 cash ($13,951 net of closing costs). ICP reactivated distillery operations at the Pekin facility during the quarter ended March 31, 2010. We purchase food grade alcohol products manufactured by ICP and SEACOR Energy Inc. purchases fuel grade alcohol products manufactured by it.

Food Grade Alcohol. The majority of the Atchison distillery's capacity is dedicated to the production of high quality, high purity food grade alcohol for beverage and industrial applications. New state-of-the-art equipment that was installed in 2004 has resulted in improved alcohol production efficiencies at the Atchison plant. During fiscal 2011, we generally operated at full production capacity for our food grade alcohol at the Atchison plant.

Food grade alcohol sold for beverage applications consists primarily of grain neutral spirits and gin. Grain neutral spirits are sold in bulk quantities at various proof concentrations to bottlers and rectifiers, which further process the alcohol for sale to consumers under numerous labels. Our gin is created by redistilling grain neutral spirits together with proprietary customer formulations of botanicals or botanical oils.

We believe that in terms of fiscal 2011 net sales, we are one of the three largest merchant market sellers of food grade alcohol in the United States. Our principal competitors in the beverage alcohol market are Grain Processing Corporation of Muscatine, Iowa and Archer-Daniels-Midland Company of Decatur, Illinois.

Much consolidation in the beverage alcohol industry has occurred at the customer level over the past two decades. As these consolidations have come about, we have maintained a strong and steady presence in the market due to longstanding relationships with customers and our reputation for producing very high quality, high purity alcohol products.

We sell food-grade industrial alcohol for use as an ingredient in foods (e.g., vinegar and food flavorings), personal care products (e.g., hair sprays and hand sanitizers), cleaning solutions, biocides, insecticides, fungicides, pharmaceuticals, and a variety of other products. Although grain alcohol is chemically the same as petroleum-based or synthetic alcohol, certain customers prefer a natural grain-based alcohol. We sell food-grade industrial alcohol in tank truck or rail car quantities direct to a number of industrial processors.

Historically, synthetic alcohol was a highly significant component of the food grade industrial alcohol market. In recent years, however, the use of grain-based alcohol has exceeded synthetic alcohol in this market. Our principal competitors in the grain-based food grade industrial alcohol market are Grain Processing Corporation of Muscatine, Iowa and Archer-Daniels-Midland Company of Decatur, Illinois. Competition is based primarily upon price, service and quality factors.

Distillery Co-Products.

The bulk of fiscal 2011 sales of alcohol co-products consisted of distillers feed and fuel grade alcohol.

Distillers Feed. Distillers feed is principally derived from the residue of corn from alcohol processing operations. The residue is dried and sold primarily to processors of animal feeds as a high protein additive. We compete with other distillers of alcohol as well as a number of other producers of animal food additives in the sale of distillers feed. In fiscal 2011, distillers feed prices were higher on average compared to the prior year due to increased prices for corn, the basic raw material from which distillers feed is derived.

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Fuel Grade Alcohol. Fuel grade alcohol is sold primarily for blending with gasoline to increase the octane and oxygen levels of the gasoline. As an octane enhancer, fuel grade alcohol can serve as a substitute for lead and petroleum-based octane enhancers. As an oxygenate, fuel grade alcohol has been used in gasoline to meet certain environmental regulations and laws relating to air quality by reducing carbon monoxide, hydrocarbon particulates and other toxic emissions generated from the burning of gasoline ("toxics"). Because fuel grade alcohol is produced from grain, a renewable resource, it also provides a fuel alternative that tends to reduce the country's dependence on foreign oil.

To encourage the production of fuel grade alcohol for use in gasoline, the Federal government and various states have enacted tax and other incentives designed to make fuel grade alcohol competitive with gasoline and gasoline additives. Under the internal revenue code, and until the end of the 2010 calendar year, gasoline that was blended with fuel grade alcohol provides sellers of the blend with certain credits or payments. Until the end of calendar year 2008, these amounted to $0.51 per gallon of fuel grade alcohol with a proof of 190 or greater that was mixed with the gasoline; during calendar years 2009, 2010 and 2011, they amounted to $0.45 per gallon. Although these benefits have not been directly available to us, they were intended to permit us to sell our fuel grade alcohol at prices which generally are competitive with less expensive additives and gasoline. On June 16, 2011 the U.S. Senate voted to allow these credits to expire on December 31, 2011. Additionally, the U.S. Senate voted to allow the expiration of the $0.54 per gallon of fuel alcohol import tariff. The U.S. House of Representatives has yet to debate these issues and it is unclear at this time how either the U.S. House of Representatives or the President of the United States may weigh-in on these issues. Various initiatives have been proposed to extend the blended incentives. However, the outcome and/or extent of such proposals is uncertain. The impact of this change on the market for fuel grade alcohol, if any, and the profitable operations of ICP cannot be determined at this time.

At times in the past, there has been significant volatility in corn and fuel grade alcohol markets, making incremental fuel grade alcohol production decisions difficult. In fiscal 2009, we at times encountered fuel grade alcohol prices below our production costs. With industry capacity in excess of federal mandates, it did not seem likely to us at the time that equilibrium would return to the fuel grade alcohol markets in the short term. Accordingly, we determined to substantially reduce our production of this product and now only produce fuel grade alcohol as a co-product of our food grade alcohol business at our distillery in Atchison. For the year ended June 30, 2011 fuel grade alcohol sales represented approximately 5.7 percent of total sales for the distillery products segment. Although we retain some exposure to the volatility of the fuel alcohol market through our investment in ICP in Pekin, Illinois, we have an opportunity to participate when the economics of that market are good and we believe that the extent of our exposure to bad markets is significantly less than when we operated the Pekin facility ourselves.

Major market participants in the fuel grade alcohol market include Poet Biorefining, Archer-Daniels-Midland Company and Valero Energy Corporation, which together account for approximately a third of the total production capacity. We and our joint venture, ICP, compete with other producers of fuel grade alcohol on the basis of price and delivery service.

INGREDIENT SOLUTIONS SEGMENT

Our ingredient solutions segment consists primarily of specialty wheat starches, specialty wheat proteins, commodity wheat starch and vital wheat gluten. Through the second quarter of fiscal 2009, mill feeds, the principal by-product of the flour milling process, was also included in this segment. With the discontinuation of our wheat milling operations, we have ceased the production and sale of mill feeds. As noted above, we have substantially exited the commodity wheat gluten market and have curtailed the production of commodity wheat starches.

In recent years, our specialty wheat starches and proteins have accounted for a sizeable share of our total sales in this segment. This primarily has been due to the following factors: partnering with customers on product development, increased capacity to produce these products, and increased marketing efforts that have resulted in greater customer

recognition.

Specialty Wheat Starches. Wheat starch constitutes the carbohydrate-bearing portion of wheat flour. We produce a pure white premium wheat starch powder by extracting the starch from the starch slurry, substantially free of all impurities and fibers, and then drying the starch by spray, flash or drum. Premium wheat starch differs from low grade or B wheat starches, which are extracted along with impurities and fibers and are used primarily as a binding agent for industrial applications, such as the manufacture of charcoal briquettes. We do not sell low grade or B starches. Premium wheat starch differs from corn starch in its granular structure, color, granular size and name identification.

A substantial portion of our premium wheat starch is altered during processing to produce certain unique specialty wheat starches designed for special applications. Our strategy is to market our specialty wheat starches in special market niches where the unique characteristics of these starches are better suited to a customer's requirements for a specific use. We have developed a number of different specialty wheat starches, and continue to explore the development of additional starch products with the view to increasing sales of value-added specialty starches. We produce our Fibersym® resistant starch, which has become one of our more popular specialty starches, using a patented technology referred to below under Patents. We sell our specialty starches on a nationwide basis, primarily to food processors and distributors.

Our specialty wheat starches are used primarily for food applications as an additive in a variety of food products to affect their nutritional profile, appearance, texture, tenderness, taste, palatability, cooking temperature, stability, viscosity, binding and freeze-thaw characteristics. Important physical properties contributed by wheat starch include whiteness, clean flavor, viscosity and texture. For example, our starches are used to improve the taste and mouth feel of cream puffs, éclairs, puddings, pie fillings, breadings and batters; to improve the size, symmetry and taste of angel food cakes; to alter the viscosity of soups, sauces and gravies; to improve the freeze-thaw stability and shelf life of fruit pies and other frozen foods; to improve moisture retention in microwavable foods; and to add stability and to improve spreadability in frostings, mixes, glazes and sugar coatings. We also sell our specialty starches for a number of non-food applications, which include biopolymer products, and for use in the manufacture of adhesives, paper coatings, carbonless paper, and wall board.

Our wheat starches as a whole generally compete primarily with corn starch, which dominates the United States starch market. However, the unique characteristics of our specialty wheat starches provide them with a number of advantages over corn and other starches for certain baking and other end uses. Our principal competitors in the starch market are Cargill Incorporated (primarily corn and tapioca starch), Corn Products International Incorporated (corn starch), Manildra Milling Corporation (wheat starch), Penford Corporation (potato starch), Archer-Daniels-Midland Company (wheat and other grain starches) and various European companies. Competition is based upon price, name, color and differing granular characteristics which affect the food product in which the starch is used. Specialty wheat starches usually enjoy a price premium over corn starches and low grade wheat starches. Commodity wheat starch price fluctuations generally track the fluctuations in the corn starch market. As we experienced in fiscal 2010, the specialty wheat starch market usually permits pricing consistent with costs which affect the industry in general, including increased grain costs. However, this is not always the case; during fiscal 2011, 2006 and fiscal 2003, for example, increases in grain and fuel prices outpaced market price increases in the specialty wheat starch market.

Specialty Wheat Starches

- Fibersym® Resistant Starch series. These starches serve as a convenient and rich source of dietary fiber. Unlike traditional fiber sources like bran, our resistant starches possess a clean, white color and neutral flavor that allow food formulators to create a wide range of both traditional and non-traditional fiber enhanced products that are savory in both appearance and taste. Applications include pan breads, pizza crust, flour tortillas, cookies, muffins, pastries and cakes.

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- FiberRite® RW Resistant Starch. FiberRite® RW is a product that boosts dietary fiber levels while also reducing fat and caloric content in such foods as breads, sweet goods, ice cream, yogurt, salad dressings, sandwich spreads and emulsified meats.

- Pregel™ Instant Starch series. Our Pregel starches perform as an instant thickener in bakery mixes, allowing fruit, nuts and other particles such as chocolate pieces to be uniformly suspended in the finished product. In coating systems, batter pick-up can be controlled for improved yield and consistent product appearance. Additionally, shelf-life can be enhanced due to improved moisture retention, allowing products to remain tender and soft over an extended storage period.

- Midsol™ Cook-up Starch series. As a whole, these starches deliver increased thickening, clarity, adhesion and tolerance to high shear, temperature and acidity during food processing. Certain varieties in this line of starches can also be used to reduce sodium content in some food formulations. Such properties are important in products such as soups, sauces, gravies, salad dressings, fillings and batter systems. Processing benefits of these starches also include the ability to control expansion in extruded breakfast cereals. In addition, they provide textural enhancement and moisture management in processed foods, especially during storage under frozen and refrigerated conditions.

Commodity Wheat Starch. As is the case with value-added wheat starches, our commodity wheat starch has both food and non-food applications, but such applications are more limited than those of value-added wheat starches and typically sell for a lower price in the marketplace. As noted above, commodity wheat starch competes primarily with corn starches, which dominate the marketplace and prices generally track the fluctuations in the corn starch market.

Specialty Wheat Proteins. We have developed a number of specialty wheat proteins for food and non-food applications. Specialty wheat proteins are derived from vital wheat gluten through a variety of proprietary processes which change its molecular structure. Wheat proteins for food applications include products in the Arise®, Wheatex®, HWG 2009™ and FP™ series. Our specialty wheat proteins generally compete with other ingredients and modified proteins having similar characteristics, primarily soy proteins and other wheat proteins, with competition being based on factors such as functionality, price and, in the case of food applications, flavor. Our principal competitors in the specialty proteins market are Archer-Daniels-Midland Company (wheat and other grain proteins), The Solae Company (soy), Manildra Milling (gluten and wheat proteins), and various European companies. Although we are producing a number of our specialty wheat proteins on a commercial basis, some products are in the test marketing or development stage.

Specialty Wheat Proteins

- Arise® series. Our Arise® series of products consists of specialty wheat proteins that increase the freshness and shelf life of frozen, refrigerated and fresh dough products after they are baked. Certain ingredients in this series are also sold for use in the manufacture of high protein, lower net carbohydrate products.

- Wheatex® series. This series consists of texturized wheat proteins made from vital wheat gluten by changing it into a pliable substance through special processing. The resulting solid food product can be further enhanced with flavoring and coloring and reconstituted with water. Texturized wheat proteins are used for meat, poultry and fish product enhancements and/or substitutes. Wheatex® mimics the textural characteristics and appearance of meat, fish and poultry products. It is available in a variety of sizes and colors and can be easily formed into patties, links or virtually any other shape the customer requires.

- FP™ series. The FP™ series of products consists of specialty wheat proteins, each tailored for use in a variety of food applications. These include proteins that can be used to form barriers to fat and moisture penetration to enhance the crispness and improve batter adhesion in fried products, effectively bond other ingredients in vegetarian patties and extended meat products, increase the softness and pliability of flour tortillas, and fortify nutritional drinks.

- HWG 2009™. This is a lightly hydrolyzed wheat protein that is rich in peptide-bonded glutamine, an amino acid that counters muscle fatigue brought on by exercise and other physical activities. Applications include nutritional beverages and snack products.

Vital Wheat Gluten. Vital wheat gluten is a free-flowing light tan powder which contains approximately 75 to 80 percent protein. When we process flour to derive starch, we also derive vital wheat gluten. Vital wheat gluten is added by bakeries and food processors to baked goods, such as breads, and to pet foods, cereals, processed meats, fish and poultry to improve the nutritional content, texture, strength, shape and volume of the product. The neutral flavor and color of wheat gluten also enhances, but does not change, the flavor and color of food. The cohesiveness and elasticity of the gluten enables the dough in wheat and other high protein breads to rise and to support added ingredients, such as whole cracked grains, raisins and fibers. This allows the baker to make an array of different breads by varying the gluten content of the dough. Vital wheat gluten is also added to white breads, hot dog buns and hamburger buns to improve the strength and cohesiveness of the product.

Vital wheat gluten in recent years has been considered a commodity, and therefore, competition primarily has been based upon price.

In prior years, vital wheat gluten has sometimes been a principal ingredients product. However, we generally have been unable to compete with subsidized imports and now use it as a base for further processing into our specialty wheat proteins.

OTHER SEGMENT

Our plant-based biopolymers and composite resins, which are produced from the further processing of certain of our wheat proteins and wheat starches (and other plant sources), can be used to produce a variety of eco-friendly products. We formerly manufactured plant-based resins for use primarily in pet treat applications. Our production of the pet-related products was discontinued with the sale of our pet products business and Kansas City facility in August 2009. After giving effect to the sale, our principal products in our other segment consist of our MGPI Terratek® biopolymers and composite resins. The MGPI Terratek® SC starch-based biopolymers are our environmentally-friendly biopolymers that can be molded to produce a variety of formed objects. Applications include disposable eating utensils, golf tees, food and feed containers and similar type vessels, as well as non-degradable hard plastic-like products. We also produce MGPI Terratek® WC wood-based composite resins, which can be used in the manufacture of eco-friendly decking materials, furniture parts, toys and a number of other wood-like products.

PATENTS

We are involved in a number of patent-related activities. We have filed patent applications to protect a range of inventions made in our expanding research and development efforts, including inventions relating to applications for our products. Our most significant patents or patent licenses are described below.

In 2003, we licensed, on an exclusive basis, certain patented technology from The Kansas State University Research Foundation relating to U. S. Patent No. 5,855,946, which describes and claims processes for making food-grade starches resistant to alpha-amylase digestion, as well as products and uses for the resistant starches. The license relates to products derived from plant-based starches and is a royalty-bearing, worldwide license whose term, subject to termination for material, uncured breaches or bankruptcy, extends until the patent rights expire in 2017. Royalties

generally are based on net sales. The patent rights relate to the referenced U.S. patent and any corresponding foreign patent application, which has been filed in Australia. Under the license, we can make, have made, use, import, offer for sale, and sell licensed products within the scope of a claim of the patent rights or which are sold for a use within the scope of the patent rights and may, with approval of the licensor, grant similar rights to sublicensees. We produce and sell our resistant wheat starch under this patent. We have granted sublicenses from time to time under this patent. Under one such arrangement, we granted Cargill Incorporated a royalty bearing sublicense to use the patented process in the production of tapioca-based starches for use in food products. We also have agreements with Cargill that would apply if we determined to use the patented process to make starches derived from other plant sources (other than wheat or potato).

We hold U.S. Patent No. 5,610,277 expiring in 2015 relating to the alcohol-free wet extraction of gluten dough into gliadin and glutenin.

RESEARCH AND DEVELOPMENT

During the last three fiscal years, we have spent an aggregate of $3,765 on research and development activities, principally all in the ingredient solutions and other segments, as follows: 2011- $1,431; 2010-$918; and 2009-$1,416.

SEASONALITY

Our sales are not seasonal.

TRANSPORTATION

Historically, our output has been transported to customers by truck and rail transportation equipment, most of which is provided by common carriers.

We currently lease 357 rail cars, which may be dispatched on short notice. ICP, our joint venture operation in Pekin, Illinois, also has the ability to transport by barge from its site, with barge loading facilities on the Illinois River.

We use third party transportation companies to help us manage truck and rail carriers who deliver inbound materials to us and our products to our North American customers.

RAW MATERIALS

Our principal raw materials are wheat flour, which is processed into our starches and proteins, and corn, which is processed into food grade alcohol and distillery co-products consisting of fuel grade alcohol and animal feed. We purchase corn throughout the year from or through grain elevators. Currently we purchase our corn requirements from a single supplier. Our practice is to order corn for a month at a time. We provide for our flour requirements through a supply contract with ConAgra Mills whose initial term, as amended, expires in October 2015. The supply contract is automatically renewable for an additional term of 5 years unless either party gives at least 180 days written notice of termination. Pricing is based on a formula that contains several factors, including wheat futures prices, mill feed prices and freight costs.

Historically, the cost of grain has been subject to substantial fluctuations depending upon factors such as crop conditions, weather, disease, plantings, government programs and policies, purchases by foreign governments and changes in demand resulting from population growth and customer preference. Variations in grain prices have had from time to time significant adverse effects on the results of our operations in cases where we cannot recoup the cost increase in our selling prices. Fuel grade alcohol prices, which historically have tracked the cost of gasoline, do not usually adjust to rising grain costs. It generally has been difficult for us to compensate for increases in grain costs through adjustments in prices charged for our vital wheat gluten due to subsidized European Union wheat gluten, whose traditionally lower prices are not affected by such costs. We have taken steps to reduce the impact of cost fluctuations on our business, primarily by ceasing and/or significantly reducing our production and marketing of lower and negative margin commodity type products such as gluten and fuel grade alcohol, but we will continue to be affected by cost fluctuations to some degree, particularly when they are volatile.

Historically, we have engaged in the forward purchase of grain and in the purchase of commodity futures and options to hedge economic risks associated with fluctuating grain and grain products prices. Under our current hedging program, we generally purchase commodity futures and options and contract for the future delivery of grain only to protect margins on contracted, and a portion of spot market, alcohol sales. We intend to contract for the future delivery of flour only to protect margins on expected ingredients sales. See Item 1A – Risk Factors and Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Derivative and Hedging Activities. Also see Item 7A - Quantitative and Qualitative Disclosures About Market Risk.

ENERGY

Because energy comprises a major cost of operations, we seek to assure the availability of fuels at competitive prices.

We use natural gas to operate boilers that we use to make steam heat. We procure natural gas for the Atchison plant in the open market from various suppliers. We can purchase contracts for the delivery of natural gas in the future or can purchase future contracts on the exchange. Depending on existing market conditions, at Atchison we have the ability to transport the gas through a gas pipeline owned by a wholly-owned subsidiary. Historically, prices of natural gas have been higher in the late fall and winter months than during other periods.

We have a risk management program whereby, at pre-determined prices, we may purchase a portion of our natural gas requirements for future delivery. However, we intend to enter contracts for future delivery only to protect margins on contracted alcohol sales and expected ingredients sales.

EMPLOYEES

As of June 30, 2011, we had a total of 192 employees, of which 97 were covered by a collective bargaining agreement with one labor union. This agreement, which expires on August 31, 2014, covers employees at the Atchison Plant. As of June 30, 2010, we had 193 employees.

As of June 30, 2011, our joint venture, ICP, had 64 employees, of which 37 were covered by a collective bargaining agreement with one labor union. This agreement expires on October 31, 2016. As of June 30, 2010, ICP had 61 employees.

Although we experienced a brief work stoppage at the Atchison plant from September 27 through October 10, 2008, we consider our relations with our personnel to generally be good. Previously, we had not experienced a work stoppage since 1978.

REGULATION

Our beverage and industrial alcohol business is subject to regulation by the Alcohol and Tobacco Tax and Trade Bureau ("TTB") and the alcoholic beverage agencies in the States of Kansas and Illinois. Such regulation covers virtually every aspect of our alcohol operations, including production facilities, marketing, pricing, labeling, packaging, and advertising. Food products are also subject to regulation by the Food and Drug Administration. TTB regulation includes periodic TTB audits of all production reports, shipping documents, and licenses to assure that proper records are maintained. We are also required to file and maintain monthly reports with the TTB of alcohol inventories and shipments.

We are subject to extensive environmental regulations at the federal, state and local levels. The regulations include the regulation of water usage, waste water discharge, disposal of hazardous wastes and emissions of volatile organic compounds, nitrogen oxides, sulfur dioxides, particulates and other substances into the air. Under these regulations, we are required to obtain operating permits and to submit periodic reports to regulating agencies. For the Atchison, Kansas plant, the air quality is regulated by both the U.S. Environmental Protection Agency ("USEPA") and the Division of Environment of the Kansas Department of Health and Environment (the "KDHE"). The KDHE regulates all air emissions. We also were required to obtain a Class I air operating permit from the KDHE and must obtain KDHE approval to make plant alterations that could modify the emission levels. The KDHE also regulates the discharge water quality at the Atchison plant. This includes process water, non-contact water and storm water. We monitor process water and non-contact water discharge on a daily basis and submit monthly reports to the KDHE documenting the test results from these water discharges. The USEPA and KDHE also monitor hazardous waste disposal for the Atchison plant. We also are required to submit annual reports pursuant to the Kansas and Federal Emergency Planning Community Right-to-Know Acts. Local officials, such as the local emergency planning committee in the Atchison community, also receive copies of these annual reports. We additionally file an Annual Emissions Report and a Toxic Release Inventory annually with the KDHE. The Atchison facility is also required to submit periodic reports pursuant to the Federal Emergency Planning Community Right-to-Know Acts