

US Sees Mileage In Biodiesel

By Anuj Gangahar

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Biodiesel could be "this year's ethanol" in the view of Leigh Goering, portfolio manager for the natural resources fund at Chilton Investment Company.

The appeal to investors stems from several developments. Alternative fuels such as biodiesel represent one plank of President George W. Bush's plan to make the US less dependent on imported oil.

The growing popularity of and investment in ethanol was one of the biggest global commodities stories of last year and the Bush administration recently committed \$179m in its fiscal year 2008 budget for research into producing ethanol from a variety of sources.

A recent survey by an energy and utilities research firm suggests that biodiesel could soon join ethanol as one of the most important alternative fuels, saying the global market for biodiesel is poised for explosive growth in the next 10 years.

The Emerging Markets Online survey predicts that the fuel could represent as much as 20 per cent of all on-road diesel used in Brazil, Europe, China and India by the year 2020. Although Europe currently represents about 90 per cent of global biodiesel consumption and production, the US is ramping up capacity at a faster rate than Europe, while Brazilian production is expected to surpass both by 2015.

Biodiesel is a clean-burning direct substitute for traditional oil-derived diesel and is produced from renewable resources such as soybeans, which can be grown domestically.

In the US, demand is growing quickly. Just 70 major plants are already struggling to fulfil requirements. The number of retail outlets for biodiesel in the US has rocketed from 300 in 2005 to more than 950 in 2006 and upwards of 50 new, larger-scale production plants are under construction.

All the activity has made biodiesel a key area of investment for fund managers and other investors. They have been funding the growing number of plants and refineries as well as driving robust merger and acquisition activity within the sector.

Goldman Sachs, for example, last year invested more than \$1.5bn in alternative energies and clean technologies worldwide. As part of this effort, the bank arranged \$217m in debt financing for Northeast Biofuels. And Gartmore's UK small-cap Alphagen Volantis hedge fund recently increased its stake in biodiesel producer D1 Oils

Troy Rillo of Cornell Capital says that from a fund manager's viewpoint, biodiesel could be more attractive than ethanol as the investment opportunity is less crowded. He adds that his firm had invested in companies that extract fats from ethanol, as this fat can be used in the production of biodiesel.

Biodiesel can be blended with petroleum diesel. It can be used in diesel engines with little or no modifications, meaning demand is driven by commercial vehicles such as lorries, tractors and even tug-boats. Biodiesel is biodegradable, non-toxic, and essentially free of sulphur and Aromatic pollutants.

According to a study by the US Environmental Protection Agency, burning biodiesel instead of petroleum diesel decreases hydrocarbon emissions by nearly 70 per cent and carbon monoxide and particle emissions by nearly 50 per cent.

Overall, according to the Union of Concerned Scientists, the production of biodiesel creates approximately 95 per cent less hazardous waste than petroleum diesel production, but more than double the amount of non-hazardous waste.

Although production avoids the big refineries needed for petroleum products, biodiesel depends on the ability of the agricultural sector to grow enough of the crops used as feedstock. This dependence is already changing the traditional dynamics of crop pricing. For example, the US Department of Agriculture estimates that every 50m gallons produced raises soybean prices by 1 per cent.

And the sheer potential volume of raw materials needed is cited by many as a possible barrier to the future expansion of the market. A recent estimate illustrated the scale of the task by suggesting it would require planting twice the land area of the US in soybeans for biodiesel to meet all the country's heating and transportation needs.

Beyond these challenges, some say the lack of a national standard for biodiesel could hamper automobile manufacturers' efforts to produce diesel vehicles capable of running on the fuel.

These hurdles are, however, unlikely to stop biodiesel becoming big business. But even then there are other risks, including a fall in the price of oil - something that could make biofuels less financially competitive. Asia's big producers are already starting to hedge against falling oil prices and rising biofuel feedstock costs using the derivatives markets.

Such tactics may, however, carry substantial risks, according to analysts. Producers can hedge using derivatives based on commodities such as palm oil or sugar, as well as end products like ethanol and, of course, oil. But the market currently lacks liquid instruments tracking biodiesel prices, for example, making crop growers with little experience of financial derivatives wary.