argus
argusmedia.com

Argus Americas Biofuels 2016 News Round-up

Contents:

illuminating the markets

2016 End-of-year Biofuels News round-up

VIEWPOINT: RINS RALLY TO SPILL OVER INTO 2017

Houston, 22 December (Argus) — Corn-based ethanol D6 RIN values breached the psychological $1/RIN barrier on at least nine occasions in late 2016 as wary traders eyed a 300mn RIN deficit going into 2017, representing 2pc of the overall conventional mandate.

Current year D6 RINs values rose by 56pc, or 39¢, since the start of 2016. While the cellulosic D3 and D7 mandates, along with the advanced D5 mandates, will also generate shortfalls this year, record biodiesel and renewable diesel imports will generate a surplus of roughly 164mn credits this year, representing 4.5pc of the overall advanced mandate.

This will serve to lessen the impact of a draw of just under 200mn RINs on banked credits in order to meet this year's biofuel mandates, the bulk of which are tied to at least 178mn in fraudulent RIN credits which must be retired this year.

The EPA estimates the RIN bank will end 2016 at 1.54bn credits, representing a draw of 200mn credits since the EPA's last statement on the 2014 RIN bank balance of 1.74bn credits. Yet as the total renewable fuel mandates grow and the bank sees repeated draws, the RIN bank will represent a dwindling proportion of credits in relation to the size of growing volumetric requirements. A bank of 1.54bn credits, for example, covers roughly 8pc of next year's mandate, providing crucial liquidity to a marketplace facing substantial regulatory uncertainty next year.

Chief among next year's regulatory variables is the likelihood of the expiration of a $1/USG blenders' tax credit (BTC) for biodiesel, which looks unlikely to survive the Trump administration. The expiration of this credit, crucial to the blend economics for biodiesel with petroleum-based diesel, will be particularly bullish for D4 credits. The expiration could add around 25¢-30¢/RIN during the first quarter 2017 and more than 60¢/RIN later in the year if the market becomes more certain of the credit's expiration. Evidence of this can be seen as the B16/E16 spread converges with the surging B17/E17 spread, which stands today at 19.25¢/RIN.

Perhaps more importantly, expiration of the blender tax credit would back out crucial biodiesel and renewable diesel imports, which were one of the principal factors in preventing a larger drawdown on banked credits this year. The US imported record volumes of Argentine biodiesel in August at 1.37mn bl and averaged 694,000 bl per month for the year as the fuel is now eligible for both the BTC and RINs. Around 400mn-600mn D6 RINs come from biodiesel imports each year, an essential blendwall safety valve that would be slammed shut if the BTC expires.

Other variables could have a bullish impact on RINs in 2017. These include a potential tax code change which would further disadvantage imports, ethanol's changing role as a high-octane blendstock as sulfur limits are dropped to 10ppm, relatively cheap global oil prices, and the increased market penetration of battery electric vehicles (BEVs).

Downside risk comes almost entirely from the potential for a trimming, or repeal of biofuel mandates under an Environmental Protection Agency run by well-known biofuel critic and EPA head nominee Scott Pruitt. RINs prices tumbled 20pc in the days following his nomination as spooked traders confronted the prospects of material changes to the RFS. Yet disrupting the delicate balance between big oil and the powerful corn and ethanol lobbies may prove beyond the influence of Pruitt's EPA. Bets on a preservation of this critical balance are already evidenced in the RINs market, where prices are recovered nearly 13pc since Pruitts' nomination.

VIEWPOINT: BARGAINS ABOUND IN NASCENT D3 RIN MARKET

Houston, 23 December (Argus) — Cellulosic RIN trading took off in earnest in 2016 with production of D3 credits surging 43pc from 2015 as an increasing number of biogas producers registered with the EPA for RIN-generation.

Yet the pricing behavior of these niche credits — generated by production of biofuels from materials such as landfill gas and municipal solid waste — during their entry to a wider and more mature RIN marketplace indicates they continue to trade at discounts to the alternative price of compliance (APC). And with a cellulosic waiver credit (CWC) price of $2/credit for 2017, the potential savings from this small sliver of an obligated party's compliance portfolio may become more attractive.

Cellulosic credits are in short supply, with production on pace to reach just over 176mn RINs. That's short of the 230mn mandate by nearly 54mn credits, or 23pc of the overall cellulosic requirement. At least 54mn CWCs will need to be purchased along with a concurrent advanced D5 or biomass-based diesel D4 RIN.

Yet unworkable arbitrage economics with Brazil for the bulk of 2016 has left the market in short supply of D5 credits as well, meaning the relatively cheaper solution of covering with D5 RINs will likely not be utilized by the bulk of obligated parties in 2016. And with poor expectations for the 2017-2018 sugar cane crop, the D5 shortage is likely to persist through all of 2017. This means obligated parties must calculate their cellulosic APC using the more expensive D4 RINs.

Perhaps most important this year has the been upward pull the $2/credit 2017 CWC price has had on D3 pricing, a dynamic that only became clear in November. For the first 10 months of this year, 2016 D3 RINs traded at an average discount of 35¢, or 16pc, to the D4-derived APC. In November, wary traders eyeing the need to make use of the 20pc carry over of 2016 credits to meet their 2017 obligations began to drive demand for 2016 D3 RINs. The current year vintage D3 RINs have since traded at an average premium of over 9¢ to the D4-derived APC, or 104pc of APC value, reaching as high as 30.5¢, a premium of more than 13pc to the 2016 APC.

This dynamic also played out in the 2014 and 2015 vintage D3 markets, which traded as high as 109pc and 108pc of their respective APCs.

Discounts for 2017 D3 RINs have been more substantial at 42.5¢, or 13.5pc of APC, likely as traders weigh the prospect of higher crude and gasoline prices to result in a lower CWC price for 2018. Yet a 35pc increase in the cellulosic mandate for next year coupled with doubts about reinstatement of the biodiesel blenders tax credit (BTC) and a persistent lack of imports of Brazilian sugarcane ethanol should continue to add strength to the 2017 APC and D3 RIN prices.

ICAHN: RINS 'QUINTESSENTIAL' BAD REGULATION

Houston, 22 December (Argus) — Regulators should immediately ban speculation from the market for credits needed to comply with federal biofuel standards, said Carl Icahn, the regulatory adviser to the incoming administration of president-elect Donald Trump.

Icahn compared the regulations governing the US biofuel mandates to mortgage-backed securities that imperiled global markets in 2008, calling them a known problem that was not fixed before damaging the economy. The investor made the remarks in an interview with CNBC a day after Trump named him special adviser on regulatory reform, an unpaid position. Icahn holds an 80pc interest in US midcontinent refiner CVR Energy, a business acutely affected by the policy.

The Environmental Protection Agency (EPA) should immediately end third party "speculator" trading of renewable identification numbers (RINs) needed by refiners, importers and other companies to comply with biofuel mandates, he said. Other changes to the program, called the Renewable Fuel Standard, could come later.

"I believe that, in the EPA, concerning regulations relative to refineries, you really need a rollback almost yesterday," Icahn said. "That's my quintessential example of what's wrong with regulation."

Ethanol RINs generated in 2016 fell by 5.5¢/RIN from yesterday to 80¢/RIN, based on Argus assessments.

Icahn, along with refining executives from Valero, PBF Energy, HollyFrontier and CVR Energy, have advocated for moving more of the burden of complying with annual blending mandates closer to retailers. The current policy transfers money refiners should use to improve facilities to fuel retailers and speculators, Icahn said.

"There's nothing wrong with saying we want to get cleaner air," Icahn said. "But there is something very wrong in our economy and I think we're going to pay a big price for it if we don't have healthy refineries."

The idea does not have universal support from refiners. Many prefer an outright repeal of the RFS in Congress. Retailers have argued refiners already recover RIN costs through higher wholesale prices, and that RINs offset the cost of acquiring biofuels that this year have cost more than conventional, oil-based fuels.

Refiners like CVR pushing for changes to the mandates were simply scrambling to recover from failing to adapt to the mandates like their successful peers, National Association of Truck Stop Operators vice president of government relations David Fialkovtold Argus.

"These less successful companies now want a government bailout to protect them from their own short-sighted tactics, and they are hoping that because Carl Icahn has the president-elect's ear, they can get their bailout," Fialkov said. "Virtually the entire fuels sector — from marketers to integrated refiners to renewable fuels producers — opposes changing the point of obligation because of the market disruption and higher fuel prices that will result."

Icahn's advisory role is informal, not a nomination, and does not impart any direct control over policy. The Trump transition team in a statement said that as such it would not require any divestment by the investor. Icahn was described as influential in the selection of Oklahoma attorney general Scott Pruitt as incoming head of the EPA and has consulted on the selection of a new head of the Securities and Exchange commission.

"Donald has a very strong personality and has other advisers," Icahn said. "It's more or less doing what I do now — talk to Donald from time to time."

TOUGH PATH TO REACH U.S. ETHANOL MAX IN 2017

Houston, 16 December (Argus) — US ethanol producers may never hit the 15bn USG target federal regulators included in biofuel blending mandates next year as they run into infrastructure, demand and regulatory hurdles.

That 15bn USG volume marks the maximum allowed for conventional fuel under the biofuel mandates known as the Renewable Fuel Standard. Ethanol groups hailed the milestone when the Environmental Protection Agency (EPA) issued the final rule in November. The volume provides more confidence that the industry can continue to grow, Renewable Fuels Association chief executive Bob Dinneen said after the rule was passed.

But the pace of that growth will struggle against regulatory, infrastructure and demand hurdles, and EPA expects advanced renewables and biodiesel — not corn-based ethanol — to pick up more of the slack.

"There is no guarantee that the 15bn USG goes to us," Dinneen said.

EPA has repeatedly noted the glacial pace of higher-biofuel availability, particularly outside the midcontinent, as it sets the annual blending requirements. The agency estimates ethanol will make up 14.4bn USG of the 15bn ethanol-equivalent gallons not specifically filled by advanced biofuels. Stores can only sell higher-ethanol blends through authorized dispensers and may need new tanks to offer the fuels. Costs for conversion can run from tens of thousands of dollars to more than $100,000. Retailers have generally added capacity as they expand stores rather than embark on costly retrofits.

Fuel retailer RaceTrac said it would by the end of the year have 70 stores offering an up to 83pc ethanol-gasoline blend called E85 and 20 stores offering E15, a 15pc ethanol product. The privately-held southeastern US retailer operates 600 stores. Sheetz has added 16 locations with E15 across its 500-store chain.

RaceTrac said federal mandates that will next year require blending up to 19.28bn USG of total biofuels would not spur major changes to the pace of its biofuel build out. Murphy USA, which adds E85 at new stores and spread E15 to a very small percentage of its more than 1,200 locations, said it will take mandate stability and strong discounts to improve driver interest in higher-biofuel products.

Retailers can use biofuel blends to discount its fuel against nearby competitors, driving up traffic. But the discounts must be large enough to also account for the lower mileage the blends deliver for customers to stick with the fuel, chief executive Andrew Clyde said.

"What our consumers ask is 'How many miles can I go on a $20 bill?'" Clyde said.

Physical ethanol has traded at a premium to gasoline in every market since mid-2015, when plunging crude costs pulled down gasoline prices. Retail chains that blend their own fuel and so collect credits refiners and importers need to prove compliance under the mandates, called renewable identification numbers (RINs), sell those credits to fund the discounts. Smaller and single-store owners — the majority of the more than 150,000 US retail stations — lack such infrastructure.

Even for stores willing to invest, federal air quality rules that prohibit the sale of E15 in the peak summer driving months may discourage that expense. It could take years more of a stable system of mandates for stores and customers to meet Congressional goals, Clyde said.

The program will need increased biodiesel blending to meet higher mandates, and truck stops have responded, industry officials said. Biodiesel was slow to grow as major fleet operators were wary of creating engine problems for their vehicles, said Mike Lombardi, executive vice president of sales for TravelCenters of America.

The company started out splash blending biodiesel while engine manufacturers became more comfortable with the product. But Travel Centers has begun increasing its blending infrastructure as fleets approve vehicles for up to 10pc biodiesel fuel. Unlike gasoline dispensers, diesel pumps can go up to B20 without significant modification.

Fleet operators were savvier and more responsive to calculating price against fuel mileage in biofuels, Lombardi said. The company was indifferent to the make up of the diesel so long as it was high quality and in demand, he said. “If we are going to have a Renewable Fuel Standard, whatever that ends up being, just want to make sure the consistency of the product is there,” Lombardi said.

The program’s stability hit turbulence earlier this month with the nomination of EPA skeptic and Oklahoma attorney general Tom Pruitt as the future head of the EPA. Ethanol RINs dropped by almost 20pc from the interweek high over the two days that followed Pruitt’s nomination. The industry has prodded president elect Donald Trump repeatedly since his election on support for the program he gave on the campaign trail.

Governors, including Iowa governor and Trump nominee for China ambassador Terry Branstad, sent Trump a letter late last week following the Pruitt announcement, praising his campaign support for the biofuel mandates. And a coalition of 17 agriculture and biofuels companies wrote directly to Trump yesterday, emphasizing biofuels’ use as insulation against foreign energy prices.

“The global market for oil is not free, and oil companies control the infrastructure that delivers renewable fuel to the pump,” the groups wrote.

Sumbit comments to moreinfo@argusmedia.com