

EDITORS' PICK | 4,912 views | Sep 22, 2020, 11:40pm EDT

A Rare Bit Of Good News For Oil Refiners: 'Renewable Diesel'



Tim Treadgold Contributor ⓘ

Asia



Valero Energy Corporation's Norco oil refinery in Louisiana. Valero is a leader in the production of ...

[+] © 2018 BLOOMBERG FINANCE LP

There aren't many growth stories in the oil industry as demand starts to decline and the price of gasoline and diesel stagnate, but an emerging specialist sector is starting to attract serious attention; renewable diesel.

Not to be confused with its close relation, biodiesel, the primary appeal of renewable diesel is that it achieves two objectives.

The feedstock for renewable diesel is primarily used cooking oil, animal fat and other waste products which are converted into a colorless, odorless fuel, which promise to generate strong profits in an industry struggling with over-supply and low prices.

Biodiesel, which is widely used in a number of countries, differs in that it uses high quality raw material and is produced through a different process and can vary in quality depending on the feedstock.

Until recently renewable diesel was very much a niche product which failed to attract mainstream investor interest.

Growth Opportunity In A Declining Industry

MORE FOR YOU

Monster Rally: U.S. And Japan Pumping \$10 Trillion Into Asset Bubbles

Billionaire Pallonji Mistry's Family Wants To End Feud By Selling Stake In Tata

China Says It Wants Less Aussie Wine, But Drinkers Say More Please

That could change after a leading investment bank, Morgan Stanley MS -0.9%, took a close look at the opportunities opening up in renewable diesel as U.S. and international oil refiners make early moves to expand business in a declining industry.

“The prospect of higher growth and better returns through renewable diesel is attracting U.S. refiners,” Morgan Stanley said in a research note sent to clients earlier this week.

“We expect carbon reduction efforts to drive incremental demand for renewable diesel, particularly commercial demand.

“Project economics are robust, with returns in excess of 30%-to-40%, supported by government subsidies.”



Full tank. GETTY

A technical explanation of the difference between renewable diesel and biodiesel is that renewable diesel is described as “hydrotreated vegetable oil” , or HVO. It can also be called advanced biofuel.

Traditional biodiesel can be called “fatty acid methyl ester”.

Morgan Stanley said that while both are made from organic biomass they are different products with differences found in their production process, cleanliness and quality.

The bank said the investment case for renewable diesel was compelling given that typical refining and midstream oil industry opportunities offer lower returns and less growth potential.

First Mover Advantage

“While a niche market that will likely be reliant on policy support for the foreseeable future, renewable diesel nonetheless offers an attractive opportunity, particularly for first movers,” the bank said.

The most attractive current entry point for investors are the U.S. oil refiner, Valero, and Neste, a refiner based in Finland.

But other established oil refiners are also moving quickly to snatch a share of the relatively new business, including three U.S. refiners; Philips66, HollyFrontier HFC -4.3% and Marathon Petroleum MPC -1%.

“A flurry of renewable diesel announcements from U.S. refiners is catching attention,” Morgan Stanley said.

Dallas-based HollyFrontier and Houston-based Philips66 recently announced decisions to convert traditional oil refineries into renewable diesel facilities, according to Morgan Stanley.

Ohio headquartered Marathon Petroleum, the biggest U.S. oil refiner, said it was evaluating the potential conversion of its recently idled Martinez refinery in California into a renewable diesel facility.



Neste Oil's renewable diesel plant in Singapore. Photo Roslan Rahman, AFP via Getty Images. AFP VIA GETTY IMAGES

Morgan Stanley said Finland's Neste was its preferred renewable diesel investment because of its first mover advantage. Since hitting a Covid-19 low of \$24.24 in mid-March Neste shares on the Helsinki stock exchange have risen by 134% to an all-time high of \$56.72.

Strong growth is expected in demand for renewable diesel which currently accounts for around 0.5% of the 430 billion gallon a year global diesel market.

“Through a bottom up, State-by-State forecast, we see North American demand growing by an estimated 140% from 1 billion gallons a year in 2020 to 2.4 billion gallons a year by 2025,” Morgan Stanley said.

“Global consumption should more than double from 2.4 billion gallons a year in 2020 to 5.3 billion gallons a year in 2025.”

The bank said that there was room in the market for more supply growth “but the word is getting out”.

Risks to the case for renewable diesel included capacity overbuild, the ability to secure sustainable feedstock, competition from imports and other low carbon alternatives, and changes in government policy.

MORE FROM FORBES

Palladium Discovery In Australia Continues To Grow

By **Tim Treadgold**



Tim Treadgold

I studied geology in the 1960s and worked for a small mining company before getting a start in journalism during the 1969 nickel boom. Since then I've covered repeated...

Read More

Reprints & Permissions
