

# Biomass Market Continues to Evolve

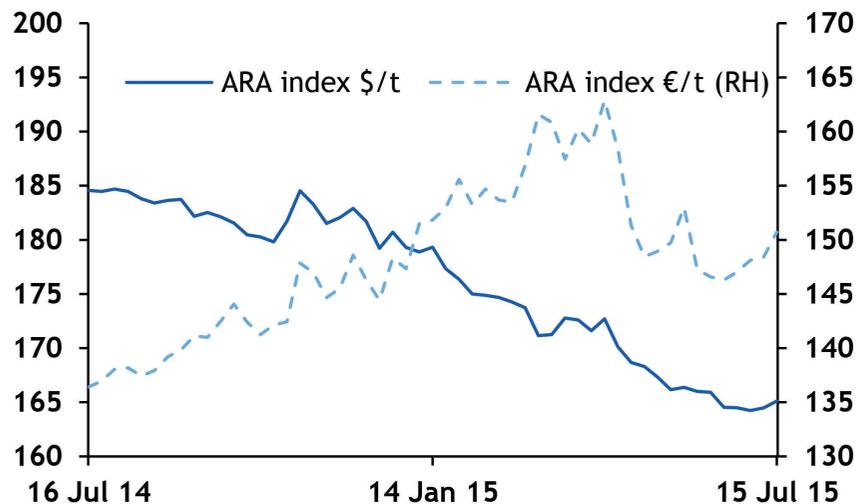
By **Jessica Dell**, Editor, Argus Biomass Markets

**The biomass market has seen significant shifts over the last year — most notably a growing convergence of the industrial and residential markets, and an increased interest in trade outside of the traditional transatlantic routes. Market participants that had traditionally focused attention on the ARA hub began to look further afield to burgeoning demand in Asia-Pacific, while those in the home heating markets were made to sell their supply into the industrial market, owing to mild weather and consequently weak demand.**

Argus Media has been assessing industrial wood pellet prices in the US and northwest Europe since 2009, noting fundamental shifts in supply and demand and tracking short-term movements and longer term developments in the spot markets. The Argus cif ARA spot index brings greater transparency to an often opaque market, helping companies to manage their exposure as well as driving liquidity.

The Argus spot cif ARA price has eased over the last year, but this move has been relatively modest both in a historical context and relative to other parts of the energy complex. The fluctuations we have seen have been the result of events relating to particular power plants going on or off line. Because the existing pool of converted units is so small, every time there is an outage at a sizeable plant — such as at the UK's Ironbridge plant last February, and the Dutch Amer plant — or a plant loses a subsidy and is forced to come off line — as Belgium's Rodenhuize plant did from April to August 2014— this can have a material impact on the spot price. This is likely to be the case going forward until there is a

**Figure 1-** Argus cif ARA wood pellet index in dollars, euros



wider pool of players – something that everyone from the supply and demand side has been calling for. The price falls that we have seen are in part a consequence of continued euro weakness. There was still certainly spot trade that we saw from the southeast US to ARA, but there was much more of a focus on euro-denominated cargoes because of currency pressures as the dollar neared parity with the euro.

With European demand relatively weak this year, other markets – in particular, South Korea, — became increasingly important. In February, South Korean generator Kosep issued sizeable tenders. With buying interest in the European market pretty scant at that time, all eyes were on the South Korean market, with potential for locational swaps trade if the generator had taken North American volumes. There was certainly an expectation in the market that Canadian volumes, with sustainability criteria in place, could supply a decent share of the tender. But the tender, like subsequent ones — was awarded to Vietnamese supply at lower prices than last year— thwarting swaps trade. Although the South Korean tender did not end up being a source of support to cif ARA prices, European participants are still keeping a keen eye on growth in the

Japanese and South Korean markets.

Meanwhile, the importance of subsidies in this market has never been as salient as in the last year. At this time last year we were looking at the Eggborough and Lynemouth plants and three additional units at the Drax plant for coal-to-biomass conversions in the UK. One year on, unit 1 is co-firing and unit 3 converted in October 2014. But the conversion of unit 4 is now less likely. Eggborough has been bought by EPH, and the company has been fairly silent on whether or not it could convert to biomass. And although RWE's Lynemouth conversion is still planned, the project has hit delays because of an EU investigation into the amount of state aid that the project was awarded.

The bottom line is that there is just not enough money in the pot for biomass — and this has frustrated everyone from developers to suppliers. The UK's levy control framework is the total budget for renewables up until 2021, and the UK has for now split off coal-to-biomass conversions in a separate pot and did not allocate any funds for conversions under the contract for difference (CFD) scheme for this year. At the same time, UK energy ministry Decc has decided

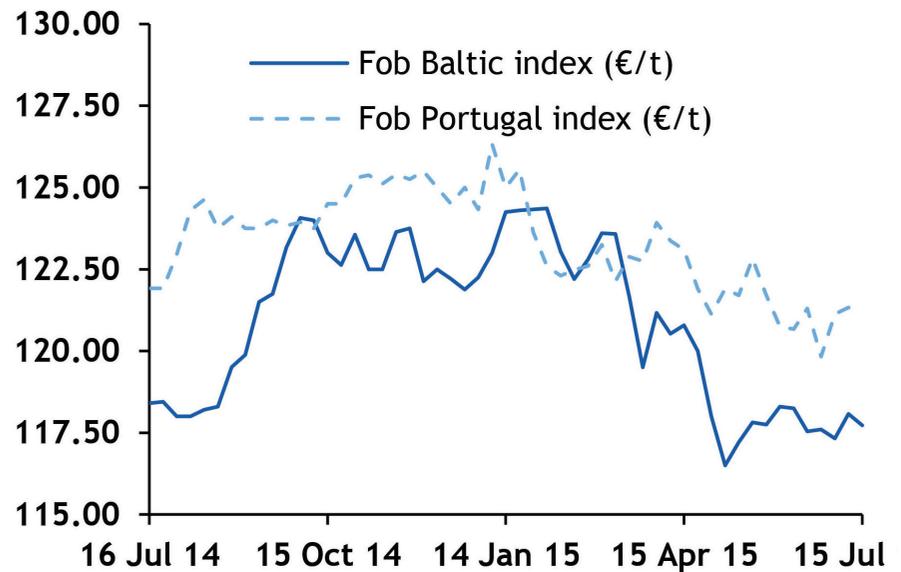
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to scale back subsidy support for grandfathering under the renewable obligation scheme. So coal-fired plants looking to convert to biomass that have not already secured funding under the early CFD scheme, are not left with a great many options at this stage. Drax recently said that unless funds become available for conversions under future CFD allocation rounds, it is unlikely to go ahead with the conversion of its fourth unit. And in July, finance minister George Osborne decided to scrap the climate change levy exemption for renewable power in his budget, cutting into the profitability for biomass burn.

Although there have been delays to UK conversion projects, and uncertainty about just how many more plants can come on line, the demand picture is not bleak if you are a supplier. We will still see increased consumption in the UK, as well as demand ramping up in the Netherlands, Belgium and Denmark. The Dutch market in particular is another clear example of where subsidies completely control biomass burn. In order for biomass subsidies to be awarded under the Dutch government's new SDE+ scheme, energy companies and non-governmental organisations had to reach an agreement on the sustainability of biomass supplies. The two sides finally came to an agreement in March, ending months of impasse. The cap on consumption is 3.5mn t/yr, with Engie — formerly GDF Suez — RWE, Eon and Vattenfall the most likely contenders for co-firing. But that 3.5mn t cap will not be reached this year, and is unlikely to be reached next year. Some companies have already voiced concerns about the business case being under pressure given current subsidy levels and with continued dollar strength. But most market participants anticipate that we will see much more significant levels of biomass burn in the Netherlands by 2017 and 2018.

The flip side to that potential for a tighter market is of course the amount of supply coming on stream, and the market is keenly focused on how quickly several planned production units in Canada and the US can come on line. Production delays are not an anomaly. We have

**Figure 2-** Argus fob Baltic, fob Portugal index (€/t)



already heard cases where sustained dollar strength has posed a problem to new projects, and the exchange rate factor could weigh on producers that have not yet sold most of their planned output under long-term agreements. With a significant level of new capacity planned for this year, cif ARA prices will very much be a reflection of that supply timetable coupled with how quickly demand can ramp up in the UK, the Netherlands and Denmark.

Meanwhile, in the residential market, the big theme of last year is that consumption did not meet expectations. The market continued to grow year on year, but did not meet some of the more inflated growth forecasts that were touted last year. Unlike the industrial market, the residential market is not reliant on government subsidies, so growth will be more organic in nature. But the European market was hit by another mild winter, and depressed oil prices, which narrowed the cost advantage that pellets have over heating oil. Nevertheless, the residential market, and particularly the EN Plus market, is still poised to maintain growth, as consumers look to less costly and more renewable options for home heating, but with biomass burn levels highly dependent on what weather this winter brings.

As always in the biomass market, there are several interesting developments on the horizon. The implementation of the Sustainable Biomass Partnership framework could increase liquidity, and market

participants are expected to profit from the greater ease of trading that its uniform criteria will bring. We are likely to see a continued convergence of the residential and industrial markets within Europe. There used to be a much greater premium for residential pellets, but over the last year, we have seen EN Plus pellets move into the industrial market time and time again, as residential demand has weakened. And finally, Drax moved towards vertical integration with the addition of its pellet plants in the US, while other pellet producers have shown an interest in power plants, in order to avoid the problem of matching up supply and demand in the right timeframes. We could see further moves toward vertical integration as well as consolidation on the supply side in this market.

With various shifts in consumption and production patterns in the international wood pellet market, there is one constant — this market will continue to mature and adapt, as it has since its inception.

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