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Decarbonization Drives Pick Up in Low-carbon, Renewable Fuels Activity

All types of energy companies are getting more active in the space or thinking about it, experts say.

By Velda Addison, Hart Energy Tue, 05/03/2022 - 10:00 AM

Biogas is a renewable fuel produced by the breakdown of organic matter. A biogas plant is shown near a corn field. (Source: Wolfgang Jargstorff/Shutterstock.com)

Activity is heating up in the low-carbon fuels space as the decarbonization movement drives strategic investments with sustainability and profitability in mind, according to attorneys for a law firm active in the M&A space.

Traditional energy companies are envisioning how their companies will look in a decarbonized economy and seizing opportunities, said Josh Bledsoe, counsel with Latham & Watkins.

“There’s both sort of a push and a pull—the push being regulatory requirements, which are already happening in certain jurisdictions, and then the pull being a desire to ensure that companies are going to be sustainable and profitable in the long term,” Bledsoe said.

Unlike traditional fossil fuels such as gasoline and diesel, renewable and low-carbon fuels—which include forms of natural gas; biogas produced by the breakdown of animal

2021 North American Biofuels M&A						
Date Closed	Target	Acquirer	Industry	$ / Gallon	Plant Capacity (MGPY)	Transaction Value ($M)
March	Green Plains	GreenAmerica Biofuels	Ethanol	$0.98	65	$64.0
March	Heron Lake	Granite Falls	Ethanol	$0.65	65	$14.0[1]
March	Invigor	Canary Biofuels	Biodiesel	N/A	19	N/A
May	Alto Ingredients – Madera	Seaboard	Ethanol	$0.36	40	$14.3[2]
June	Flint Hills	POET	Ethanol	N/A	800	N/A
July	Prairie Horizon	Summit Ag	Ethanol	N/A	40	N/A
July	Scott Petroleum	C&S Fuels	Biodiesel	N/A	20	N/A
August	Sinclair's RD Unit	HollyFrontier	Renewable Diesel	N/A	153	N/A
November	ADM – Peoria	BioUrja	Ethanol	N/A	135	N/A
November	Alto Ingredients – Stockton	Pelican Acquisitions	Ethanol	$0.40	60	$24.0
Total					1,397	

Source: Company information and Ocean Park analysis.
[1]Reflects a partial ownership acquisition of equity. $/Gallon includes $0.21 in net debt per gallon.
[2]Solar assets estimated at $14.05M were excluded from transaction total of $28.3M.

Non-Operating

waste and food; renewable natural gas, the byproduct of decomposed organic matter; ethanol and hydrogen among others—release less CO_2 when burned. Their use could move the world closer toward hitting net-zero goals and lowering emissions in hard-to-decarbonize sectors.

Low-carbon fuels is of many solutions to reduce carbon intensity in transportation particularly aviation and shipping, said Justin Stolte of Latham's energy and infrastructure industry group. Another potential solution is electrification; however, low-carbon fuel is probably the most logical, he said.

All types of energy companies are getting more active in the space or thinking about it.

"You see strategics, super major/big oil and gas companies making very significant investments this year in low-carbon fuel areas," Stolte said. "We've seen private capital/private equity sponsors make investments in these areas, a number of infrastructure funds. … I think the number of opportunities will only increase."

Electric, gas and public utilities are also investing in low-carbon fuel projects, while state and federal governments get in on the action by offering incentives, Bledsoe added.

Making Moves

Latham's corporate deal team recently advised Chevron Corp. on the creation of a joint venture (JV) with Bunge North America Inc. to create renewable feedstock. The JV will leverage "Bunge's expertise in oilseed processing and farmer relationships and Chevron's expertise in fuels manufacturing and marketing," Latham said in February.

Other activity this year has included advising Ara Partners, a private equity firm that specializes in industrial decarbonization investments, on its move to create the European biomethane platform called CycleØ Group Ltd. through the acquisition of FNX Liquid Natural Gas S.L., a biogas capture and conversion specialist.

In 2021, Latham represented Alder Fuels, a sustainable aviation fuel (SAF) tech company that converts biomass into low-carbon fuel, in its multimillion-dollar venture with United and Honeywell.

"In terms of where I'm seeing the most activity today, certainly a lot is happening around renewable natural gas and sustainable aviation fuel or SAF," Bledsoe said. "We're also seeing a lot of activity in the renewable diesel space, and of course, biodiesel is very important too. … I think those are the leading contenders. Ethanol was one of the first major low-carbon fuels being built into the gasoline supply chain, and so we're still seeing ethanol deals. But the others that I've mentioned are coming on really strong recently."

By year-end 2022, Latham & Watkins expects it will have worked more than two times the number of low-carbon fuel transactions it did last year, Bledsoe said.

Low-carbon fuels are part of the burgeoning low-carbon energy space.

Globally, 140 low-carbon energy transactions—each valued at more than $50 million—were completed during the first half of 2021, according to data from Deloitte. The transactions included solar and wind, which accounted for two-thirds of all transactions.

At 22, most of the deals were made in the U.S., followed by China where 19 deals were completed. Rounding out the top five were Spain, 16; the U.K., 11; and India, 10.

Activity in the U.S. biofuels space was especially robust last year "as ethanol producers pursued mergers and acquisitions, and renewable diesel firms built and expanded plants, the biofuels industry increasingly focused on securing feedstocks," according to Ocean Park, a California-based boutique investment bank. The firm said seven ethanol M&A transactions closed in 2021, marking the most since 2013.

Adding Value

Low-carbon fuels are adding value not just environmentally but also economically. Though some projects depend on support from governments for favorable economics, there is potential to make significant returns on investments, Stolte said.

"When investors are making investments in these areas, they are ones that are made with the intention of making profit for their respective institutions," he said, noting the economic criteria is no different than other deals or investments. "These are profit-bearing investments."

However, capital being invested may be "patient capital."

"There may not be an immediate day one return. You may need to develop a technology or you may need to develop a market for a low-carbon fuel," he added. "In most of these cases, investors are fairly patient in understanding that there may not be immediate significant returns, although in some cases there are. But there's more patient capital in this space than probably what you see in the traditional energy space."

How risks are assessed is not all that different than the traditional energy sector investments, Bledsoe said.

"I guess the primary difference would be the fact that a lot of the revenue from low-carbon fuel projects is derived from monetizing the environmental attributes of that fuel," he said.

"The reliability of that credit stream moving forward in time is probably the major risk for low-carbon fuel projects, and it's the question that we get most often from all players in the low-carbon fuel space is what happens if one of these regulatory programs is not around in five years."

Seeking Advice?

Any company looking to enter or grow in the low-carbon fuels space should do a deep dive on regulations and understand what drives most low-carbon fuel revenue, Bledsoe said.

It's also essential for companies to evaluate the timeline of particular technologies when considering investments. In many cases, the technology risk phase has passed but commercial risk remains.

"There are risks that are present in both, but the structure of investments is typically done differently when you're looking at a more infant stage than something that's been more proven and now you're just trying to develop proven technology," Stolte said.

There's tremendous pressure on policymakers in the U.S. and globally to incentivize industry to move to a low-carbon future, he added, noting some uncertainty comes with any regulatory program. "I think there is also some comfort that investors take in that policymakers understand the need to keep these regulatory incentives in place so that we get to net zero as we are all hoping is the case."