

# BIODIESEL

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### RISK



## Eyes Wide Open

Hope is not enough. Buying distressed biodiesel assets requires important considerations.

BY RON KOTRBA

**Sticky, gummed-up valves, busted pipes, tanks still partially filled with residues that were never drained at shutdown—these are things you don't want to see when buying a shuttered biodiesel plant.** But these are obvious red flags, unlike other problems that may be

lurking in the crevices of a deal that seems too good to be true. If a biodiesel plant has remained idle in 2013, perhaps something is fundamentally wrong with the asset, such as location, or permitting, or outdated, even unsupported, process technology requiring millions of dollars.

Plenty of considerations, important

business decisions that require experienced legal, engineering and financial counsel, must be given to buying any biodiesel facility, particularly those where an operational history is nonexistent. These include shuttered facilities and partially completed projects. As a seller, without certain elements in the deal, such as a properly shut down plant, an extensive op-

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erating history and data on yield conversions, run rates and even productive capacity, you can expect significant discounts on your asset because the buyer must do rigorous due diligence, a major part of which is risk mitigation.

“Your skill set on the engineering side, your knowledge base, what you bring to the table is fundamental,” says Paul Tantillo, managing partner at Enervation Advisors, which facilitated the purchase of several distressed biodiesel plants now operating under the name W2 Fuel. “Going into a shuttered plant, first, you have to make sure the plant was shut down properly,” Tantillo says. “That could kill you. You could end up spending \$300,000 to \$400,000 in busted pipes, gummed-up works, if they didn’t clean out the tanks of all residual material. Then you have modernization—do you have esterification, the frontend system, capable of variable free fatty acid handling and capability? You have to come in with the knowledge and capacity to do the OSHA requirements and put the safety systems in. Most of them aren’t leaving the recipe book behind—most times you’re buying from a bank. You don’t always have the previous ownership around. You have to make it not so much of a crap shoot and mitigate risk. If it’s a shuttered plant, a lot of times they’re shuttered for a reason.”

### Primary Assessments

“When you think about what drives value from an investor’s perspective, you want to assess the means of that asset to produce a cash flow in the future and the risk factors that could impact its ability to generate that cash flow,” says Kirk Martin, managing partner at Ascendant Partners. “Then you want to assess what kind of capital costs you would expect in the acquisition, the startup and im-

provements that might be necessary. Then you have the two factors you need to evaluate the investment opportunity—that being the ability to generate cash against the cost of producing that cash.” Ascendant Partners facilitated the sale of the large Beatrice, Neb., plant that was built around Axens’ dry process technology. The plant was completed but never fully operated. The process technology provider disappeared, and couldn’t support technology maintenance. Flint Hills Resources and Benefuel bought the 50-plus MMgy plant for \$5 million. It cost \$70-plus million to build.

First, Martin says, you need to understand whether the facility is positioned to be competitive. “Does it have competitive access to feedstock markets, is it located to reasonable access to the downstream markets, does it have the kind of transportation infrastructure that you need to efficiently move products to market?” he says. “If the plant’s not located in a competitive spot, the rest doesn’t really matter.” Erik Endler, senior partner at 321 Capital Partners, says a plant’s proximity to competitors is also important.

“Whether it’s rail, highway or water, everyone wants to have as big a plant as possible given the amount of engineering costs involved, and it doesn’t cost much to make them bigger,” Endler says. “But to make it bigger, you have to be able to move the feedstock coming in and the biodiesel going out. Realistically, if a plant says they can do 8 to 10 MMgy and they’re not on rail or water, it’s going to be tough to do that volume unless they have massive storage capacity and run tanker trucks 24/7,” he says.

Determining a plant’s actual production capacity is another task. “Sellers will tell you my plant can do this many gallons per year,” he says. “The fact is, most of those plants

have never produced, and likely cannot produce, at that capacity.”

The biodiesel business is all about margins, and it’s a long play. “We have to look at gross margins, crush margins, and product margins to understand what you think the potential for profit could be,” Martin says. “If they’re not competitive, you better think hard about whether you want to do any additional research.”

### Discount vs Lack of Information

Once market position and competitiveness have been examined, a much more difficult question, and a much more risky proposition than acquiring an operating plant where real operating data and margins, conversion and yield data are available, is assessing whether the plant can run as intended. “If you have a plant that’s been sitting idle, you’ve got a much bigger challenge to assess the risk that the plant can run, and it becomes a lot more theoretical in determining what kind of conversions, yields, and so forth,” Martin says, “because you don’t have an operating history to give you that confidence. In those cases, what we want to do is bring in additional technical expertise, engineering and construction companies that could come in and actually assess the condition of the equipment.”

Detailed inspections must be done to assess the operability condition so the buyer doesn’t find out later that another \$5 million is needed in capital improvements that weren’t anticipated. For an idled plant, there’s a much greater emphasis on the operating condition of the asset. “Has it been sitting for a series of winters?” Martin asks. “Can we turn the valves? Are the tanks still in good shape?” Lack of an operating history at a partially complete facility or one that was com-

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pleted but never ran, dings the value materially, Endler says. “Three-fourths of the cost of building a biodiesel plant is not in the actual equipment, it’s in the engineering costs, so when you have a plant that has problems, or if the engineering wasn’t right, you basically have to reengineer the whole plant,” he adds. “That’s hugely costly and makes it an untenable situation for a lot of people because you can build a plant cheaper that doesn’t have these problems.”

“Just because it’s a bargain doesn’t mean it’s cheap,” Tantillo says. To get an incomplete project or one that’s never run to operational status, almost always costs more than one thinks, Martin says. “The discount is significant. There’s always unknown factors, it always costs more than you think it’ll cost, and frankly, even with that kind of risk adjustment that they’ll do on the valuation, I’ve seen more times than not they’re still underestimating what it’ll take to get that plant operational,” he says. “Ideally, if you’re a seller, and you have the option, complete the plant, prove the plant’s operations, and you’ll be talking about an order of magnitude difference in the valuation by being able to sell a plant with proven operations versus a plant that’s not operating, or even worse, not been completed.” If a buyer thinks it’ll take \$5 million to \$10 million to complete, be conservative and risk adjust that to \$15 million or \$20 million to be safe.

### Other Considerations

A very detailed assessment of the environmental, legal and regulatory history must also be commissioned to make sure past incidents aren’t going to prevent a buyer from operating the facility. “Are there any permitting issues? Are there outside drivers that resulted in this plant coming into this inoper-

able condition, was that due to regulatory or environmental violations, or were there some legal issues that might need to be resolved?” Martin asks. “You need to assess that there’s no extraneous factors that could prevent you from bringing it back into an operating condition.” If there were any correctable violations or stigma tied to the plant, such as unpaid growers, or a RIN fraud investigation, the new owner will find it valuable to employ an aggressive communications and outreach program with the community and regulatory bodies to establish credibility upfront. “Maybe you risk overcommunicating to some extent, but that’s better than undercommunicating,” Martin says.

Another consideration is the differences between buying at auction and buying through a facilitated sales process. “If there are pieces of equipment you need in that plant to help your operation, it always makes sense to make an offer,” Endler says. “You may end up paying more from an auction house than you would directly through the buyer because of the way the auction world works. They buy something from us for X and they hope to make 2X with all the buying premiums and other add-ons.”

In a facilitated sales process, there is a much greater opportunity to complete a comprehensive and detailed due diligence; there’s more time and typically there’s more availability to meet with management and staff to review data, take tours and procure necessary information. “It’s a much more disciplined and organized process that really facilitates making sure that prospective buyers have the opportunity to fully assess the risk and opportunities of the plant,” Martin says. “In a court-ordered auction, the timeframe is comparatively short for your due diligence. That means people showing up on auction

day have less information available to make that decision and, as a result, they tend to modify their valuation accordingly. They risk-adjust their valuation not necessarily based on known factors, but based on the unknown factors.” He says closings at auctions happen quickly, there are very limited representations and warranties, and there are few options for recourse should something be discovered in the future.

Ultimately, purchasing a distressed biodiesel asset is a big decision that contains a significant amount of opportunity, but also a significant amount of risk. “You can’t shortcut the process,” Martin says. “You get excited about a deal, you think it’s a good price and you want to make it happen, but these deals can take on a life of their own before you’ve done the comprehensive due diligence needed. Make sure you know what you’re getting into, and don’t simply hope it’ll work, but define and tie down at a detailed level the risk factors that could affect your ability to be successful. And go into the acquisition with your eyes open.”

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