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## Big Plans for Biodiesel Stall in Southeast Asia

Costlier Palm Oil, Europe Oversupply Cast Cloudy Outlook

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JAKARTA, Indonesia -- Plans to invest billions of dollars in biodiesel refineries across Southeast Asia have been put on hold as the prices of key raw ingredients -- particularly palm oil -- have shot up amid surging food demand in China and India.

An oversupply of biodiesel fuel in Europe thanks to a wave of heavily subsidized U.S. imports and growing concern in the West about the adverse environmental impact of oil-palm cultivation have added to the bleak outlook, Asian producers say.

### EVERY DROP

- **The Mania:** Asian firms poured millions of dollars into biodiesel plants over the past two years.
- **The Slump:** Many projects have stalled because of the rising cost of raw materials, especially palm oil.
- **The Outlook:** Many firms are instead cashing in on growing demand for food in China and India by exporting more cooking oil.

That is an unexpected reversal of fortune for the industry. Just a year ago, Asian companies were rushing to build biodiesel plants to take advantage of subsidies in Europe and the U.S. aimed at promoting the consumption of cleaner-burning fuels.

Projects being built or planned were forecast to pump out five million metric tons of biodiesel a year upon completion, or about half of Europe's total refining capacity in 2007. The Indonesian government boasted that \$12.5 billion in new biofuel investments were in the pipeline for that country alone.

Biodiesel, refined from vegetable oils, is mixed with regular diesel and sold at the pump in Europe and the U.S. In theory, the blended fuel reduces greenhouse-gas emissions by stretching how far a vehicle can travel on gasoline or regular diesel.

The planned outlays on refineries seemed to make sense when crude-oil prices began rocketing last year. But the price of palm oil -- produced widely in Southeast Asia -- has climbed even more steeply, making biodiesel plants that use the commodity commercially unviable.

At the same time, the European Union -- by far the world's largest consumer of biodiesel -- is tightening its subsidy program to specifically exclude biodiesel produced from palm oil grown on recently destroyed natural forest. Razing forests to plant palm oil -- a common, if often illegal, practice in places like Indonesia -- releases huge amounts of greenhouse gases into the atmosphere, negating any benefit from cleaner-burning fuels, recent studies have found.

Biodiesel makers in Asia are also complaining that U.S. exporters have flooded the European market with biodiesel fuel up to 30% cheaper than they are able to produce. U.S. producers of soybean-derived biodiesel get a \$1 per gallon tax credit and then export their product to Europe, benefiting from subsidies there as well. Last week, an association of European biodiesel producers filed an official complaint to the European Commission claiming the U.S. export of subsidized biodiesel constitutes unfair competition.

The result: Some Asian palm-oil producers have scrapped their plans for biodiesel refineries, and only a few new plants have come on line. In Malaysia, for instance, the industry produced just 80,000 metric tons of biodiesel last year, much lower than the country's annual capacity of one million tons, Malaysian Commodities Minister Peter Chin said last week.

"At current high palm-oil prices, palm biodiesel is not viable," says Au Kah Soon, a spokesman for Wilmar International Ltd, a Singapore-based palm-oil plantation owner. Last year, Wilmar completed Southeast Asia's largest biodiesel plant on the Indonesian island of Sumatra. But the plant, which has the capacity to produce around one million tons of biodiesel each year, is running only to meet current contracts. "We foresee a very small percentage of our revenue coming from biodiesel this year," Mr. Soon says.

Sinar Mas Agro Resources & Technology Ltd., an Indonesian palm-oil company, has also suspended plans to invest \$5.5 billion to build a huge biodiesel complex in Indonesia's remote Papua province with China National Offshore Oil Corp., says a Sinar Mas Agro spokeswoman. The plan to develop one million hectares of virgin rainforest for the plantations has drawn complaints from environmentalists.

Biodiesel producers who don't own oil-palm plantations have been hardest hit because they must fork out ever higher prices for their raw materials. Crude-palm-oil futures on the Malaysian Derivatives Exchange have climbed 12% so far this year after jumping 50% in 2007.

Mission Biofuels Ltd., which runs a refinery in Malaysia and is listed in Australia, warned investors recently that core earnings for its financial year ending June will be less than half an earlier forecast. Swaminathan Mahalingam, the company's managing director, says the 100,000-tons-per-year plant is operating at only 40% capacity. "We're only producing biodiesel if we have an order which makes sense," he says.

To be sure, biodiesel could still play an important role if fossil-fuel output is unable to keep up with growing world energy demand. Many biodiesel producers in Southeast Asia say they might kick-start production again if crude-oil prices remain above \$115 per barrel.

Goldman Sachs estimates that palm-oil-derived biodiesel exports to the EU can break even at current prices if crude remains above \$100 a barrel. To be commercially viable, similar biodiesel exports to the U.S. would require crude oil to trade at above \$120 a barrel, Goldman estimates.

Some biodiesel producers that buy palm oil from third parties say they can still make their expansion plans work. Finnish company Neste Oil Corp., for example, is moving ahead with an \$800 million biodiesel plant in Singapore, which is expected to start operations in 2010.

Simo Honkanen, a vice president at Neste, says sales of the company's high-performance biodiesel are strong. Neste is confident it will be able to pass higher palm-oil prices to customers. "Those that survive will be companies that have a superb product," he says.

Meanwhile, some Southeast Asian palm-oil producers are refocusing on more traditional products and markets. Palm oil is still much more widely used to make cooking oil, margarine and cosmetics than it is for biodiesel. With diets improving in China and India, cooking-oil demand has soared, driving up prices. With subsidized U.S. and European soybean oil still flowing into biodiesel, some palm-oil producers, including Wilmar, have switched gears and are trying to exploit the opportunity to supply China and other Asian markets with cooking oil.

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