What is the Impact of the Strengthening Dollar on Utility and Producer Margins?  
(Includes an updated dashboard)

By William Strauss, PhD, President, FutureMetrics  
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The dollar has been strengthening against many of the world’s currencies including the British pound and Euro. Since most long-term offtake contracts for supply of industrial wood pellets from US producers are paid in dollars, as the pound and Euro weaken, the cost per tonne in pounds or Euros increases. Some currency risk can be hedged; but over the medium-term if the dollar continues to strengthen this will challenge profit margins.

The UK’s contract for difference (CfD) support scheme guarantees the pellet fueled utility a rate of £105 per MWh (in 2012 pounds indexed to inflation). So if fuel costs increase and top line revenues are fixed within the CfD scheme, margins have to shrink.

The major UK buyer of industrial wood pellets is Drax. Drax's consumption of wood pellets exceeded 19,000 metric tonnes per day in December, 2014¹. That equates to an annualized consumption of 5,840,000 tonnes per year. So increases in the cost per tonne translate into significant declines in operating cash flows.

The interactive dashboard² on page 4 shows the impact of changes in the pound/dollar exchange rate on a utility’s margins (shown by EBITDA/tonne).

² If you see a blank page, make sure you have Adobe Flash installed on your computer. You can also download this pdf document and open it in Adobe Reader rather than in your browser.
Based on the default assumptions in the dashboard, the weakening in the £/$ rate over the last six months, shown in the chart above, has caused a decline in the utility’s EBITDA per tonne of $37.12.

The strengthening of the pound during the big build up in Drax’s demand for pellets in 2013 and part of 2014 insulated the utility and its pellet suppliers from inefficiencies in the supply chain.

The result of the weakening pound is pressure back through the supply chain to lower the dollar price of pellets. The dashboard on page 4 illustrates how a lower dollar price per tonne for pellets will help the utility mitigate margin shrinkage.

This pressure to lower the dollar price per tonne will impact existing and proposed US pellet production projects.

New projects in development should be rigorously vetted to prove out input costs, process design, operator training protocols, and product delivery logistics costs. Only those projects with optimal cost profiles should be built. Lowest cost production starts with wood fiber prices but also depends on woodyard operations and feedstock management, conversion process design, operator training and expertise, mill-to-port-to-ship costs, and shipping costs to the foreign port.

Existing operating projects will need to be optimized at every step to lower the operating cost per tonne, and increase reliability, consistency, and projection volumes.

The strong dollar is not limited to the pound. As the chart on the previous page shows, the Euro is also weakening at a similar rate. With the dollar strong, and many indicators suggesting a continued strengthening, the US pellet export sector that supplies UK and EU buyers will require optimal best practices to be a part of the projected growth shown in the chart below.
FutureMetrics LLC
8 Airport Road
Bethel, ME 04217, USA

FutureMetrics has the skill sets to evaluate project efficiency from the woodyard, to the conversion process, to the logistics for moving the product to market.

FutureMetrics provides independent analysis and advice that helps investors and/or lenders considering a new project to determine if the project can produce with operating costs that can survive a strong dollar and generate margins sufficient to remain competitive in a global market.

FutureMetrics provides operations optimization advice to existing operations that need to lower operating costs and increase output to keep margins at levels that support the return on investment that the project projected when it was being financed.

FutureMetrics produces early stage feasibility studies for project developers to prove (or not!) the viability of their project development strategy.