

# alphaDIRECT MANAGEMENT SERIES

MAY 30, 2018

## IN FOCUS: RENEWABLE ENERGY GROUP INC., ITS BIOMASS-BASED DIESEL, MARKET STRATEGY AND BUSINESS MODEL

This report focuses on Renewable Energy Group (REGI), its market strategy, business model and corporate structure.



REGI's Geismar Renewable Diesel Refinery. Source: [www.regi.com](http://www.regi.com)

### THE alphaDIRECT INSIGHT

With more than 20% market share, REGI is the largest biomass-based diesel producer in the United States, converting low value waste, fats and oils into high quality diesel fuel referred to as renewable biomass-based diesel. REGI differentiates itself by having a strong supply chain with the ability to collect and deliver waste oils and fats to its different facilities. We believe a key competitive advantage is the ability to deliver a quality product meeting all certifications required together with their comprehensive distribution network and facilitating customers supply in many different locations. Furthermore, we believe the company is well positioned to leverage next generation products with a robust technology roadmap. In our view, REGI delivers consistent financial returns by directly aligning economic and environmental benefits and by targeting state markets like California and executing its strategy on a large industrial scale.

### REGI Business Snapshot

**Founded:** 1996  
**Headquarters:** Ames, IA  
**Ticker:** REGI (NASDAQ)  
**Stock Price:** \$17.55\*  
**Market Cap:** \$647.431M\*  
**Website:** [www.regi.com](http://www.regi.com)  
 \*As of May 22, 2018



#### About alphaDIRECT Advisors

alphaDIRECT Advisors (ADA), a division of EnergyTech Investor, LLC, is an Investor Intelligence and publishing firm that creates and implements digital content and programs to help investors better understand a company's key drivers including industry dynamics, technology, strategy, outlook and risks as well as the impact they could have on the stock price. ADA's expertise encompasses a variety of sectors including Clean Transportation, Emerging EnergyTech, Energy Services, Smart Buildings, Solar, Water Value Chain and Industrial. ADA was founded by Wall Street veteran and research analyst, Shawn Severson, after seeing a significant shift in the investment industry that resulted in less fundamental research conducted on small cap companies and a significant decline in information available to all investors. ADA's mission is to bridge that information gap and engage companies and investors in a way that opens information flow and analytical insights.

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## Participants

### **Mr. Randy L. Howard**

#### **President & CEO**

#### **Renewable Energy Group, Inc.**

Randy L. Howard has served as a member of our Board since February 2007 and as our President and Chief Executive Officer since July 2017. From July 2004 until his retirement in September 2005, Mr. Howard served as Senior Vice President of the Global Gas Division of Unocal Corporation, an oil company. Prior to that role, Mr. Howard served as Regional Vice President of Unocal's International Energy Operations - North ASEAN and President with Unocal Thailand from May 1999 to June 2004. Mr. Howard served in various managerial roles at Unocal over 30 years including Vice President, Refining and Vice President, Supply, Trading and Transportation. Mr. Howard participated in the advanced executive program at Northwestern University and holds a B.S. in Chemical Engineering from the University of California Berkeley.

### **Mr. Shawn Severson**

#### **Founder and CEO**

#### **alphaDIRECT Advisors**

Mr. Severson is the founding partner and CEO of alphaDIRECT Advisors (ADA). He has over 20 years of experience as a senior research analyst covering the technology and cleantech industries. Prior to founding ADA, he led the Energy, Environmental and Industrial Technologies practice at the Blueshirt Group. Mr. Severson was frequently ranked as a top research analyst including one of the Wall Street Journal's "Best on the Street" stock pickers and multiple awards as Starmine's top three stock pickers.

## ABOUT REGI

Renewable Energy Group, Inc. (NASDAQ:REGI) is a leading provider of cleaner, lower carbon intensity products and services. REGI is an international producer of biomass-based diesel, a developer of renewable chemicals and North America's largest producer of advanced biofuel.

REGI utilizes an integrated procurement, distribution, and logistics network to convert natural fats, oils, greases, and sugars into lower carbon intensity products. With 14 active biorefineries, a feedstock processing facility, research and development capabilities and a diverse and growing intellectual property portfolio, REGI is committed to being a long-term leader in bio-based fuel and chemicals.



**Shawn Severson:** I'd like to thank you, Randy, for taking the time to speak with us today. Initially, I'd like to cover an overview of Renewable Energy Group with a brief review of your market strategy. Before we get started, I would like to remind investors that this report includes links to supporting documents within the text. Randy, could you start by giving us a brief introduction of yourself?

**Randy Howard:** Yes, Shawn. I was blessed with a diverse 32-year career with Unocal 76, a major oil company. During that career, I held positions as Vice President of Refining, and Vice President of Supply, Trading and Transportation as well as President of Unocal's Geothermal business. I was also the President of Unocal's North Asian upstream business, which was a large natural gas production company based in Thailand. I retired when Chevron purchased Unocal and shortly thereafter, a friend of mine connected me with this small, biodiesel start-up company called Renewable Energy Group (REG).

REG was looking for a board member with some petroleum background. I was aware of renewables. As a chemical engineer by background, I had done my own energy balance that showed that biodiesel gives you approximately 6x the energy in the product that it takes to make it, well in excess of other renewable biofuel options. So, in 2007 I joined the Board of Directors of REG. That year, we made approximately 50 million gallons of biodiesel and ten years later we made nearly 500 million gallons. From a position on the

Board, I've seen REG, with its great management team, grow ten-fold.

In July of last year, our former REG CEO resigned, and the Board asked me to step in as the CEO. At that time, we were in the midst of a major transition to expand our renewable diesel technology, a technology more like that used in an oil refinery. My experience is complementary to help us grow our renewable diesel platform.

**Shawn Severson:** Thank you very much, Randy. Can you start with a general overview of REGI and provide us with an overview of your business model?

**Randy Howard:** Sure, Shawn. Basically, REG converts low value waste, fats and oils into high quality diesel fuel; it's referred to as biomass-based diesel and is typically blended with petroleum diesel. The blending improves the emission qualities of the petroleum diesel. [The biomass-based diesel blend is then sold to a wide range of customers such as trucking fleets, municipal buses, tractors, ships and diesel automobiles.](#) Our fuel can be used in almost any diesel fuel application. Since the beginning, REG has set the industry standard in ensuring that our products are of the highest quality and meet or exceed the required specifications.

Biomass-based diesel also carries environmental credits that help our customers meet a variety of Federal and State regulations. We ensure that these environmental credits have the background tracking, quality and compliance for all of our customers. Overall, this market conversion of

waste fats and oils into renewable biofuels with associated environmental credits has allowed us to generate consistent earnings over several years. [After five years of earning an average \\$100 million in adjusted EBITDA from 2012 to 2016, we were able to record a step change in our performance in 2017 with \\$230 million in adjusted EBITDA.](#)

**Shawn Severson:** Could you please expand on that a bit more? It's interesting to look at the feedstock sourcing, refining capabilities, marketing and logistics because it sounds very similar to a conventional petrochemical business. Can you talk about what those aspects mean for REGI, specifically in terms of feedstock and refining and then what happens on the marketing and logistics side?

**Randy Howard:** I'll be happy to. Let's start with our supply chain and procurement team, which sources a variety of feedstock both locally and from around the world. [These include used cooking oils that we purchase from a variety of companies that collect it, fats from renderers, and inedible corn oil, which is a bi-product of ethanol production.](#) These waste fats and oils typically represent about 80% of our feedstock. The other 20% is referred to as crude degummed or super degummed vegetable oil; either soy or canola oils that have not been purified for use in food. Usually we call these vegetable oils "crude vegetable oils". All these waste fats and oils are collected and transported to our biorefineries – so we are truly a waste to energy company that is adding value to waste products that previously carried

economic and environmental costs. [Our business model proves that economic and environmental benefits can be directly aligned and deliver consistent financial returns when executed on a large industrial scale.](#)

[We have thirteen biorefineries in total, eleven in the United States and two in Germany.](#)

Eleven of those thirteen refineries, have the capability of converting waste fats and oil into high quality biomass-based diesel with the other two refineries running on more traditional vegetable oils. Overall, the mix of these feedstocks are collected and optimized using dynamic mathematical models and programs to decide the best mix of feedstock to deliver to each of our plants to produce the highest margin. The specific markets for these products are optimized again, based on the feedstock mix, to get the highest compliance value, after they are delivered to the market.

[A good example is getting products with the calculated lowest carbon reduction or "CI score" to markets like California where they are rewarded with low carbon fuel credits.](#)

The 11 plants that can process waste fats and oil are referred to as 'multi-feedstock plants' and have feedstock costs that are up to 45 to 50 cents a gallon lower than typical crude vegetable oil feed stocks. The cost of refining can be higher for these 'multi-feedstock plants' because it's more difficult to convert the waste fats and oils into bio-diesel than the crude vegetable oils. However, the net result of delivering a waste oil derived diesel fuel to a low carbon market is a net margin that can

be up to 40 to 60 cents per gallon better than biodiesel derived from crude vegetable oil.

It is a major advantage to be have a supply chain like ours that can:

- 1) collect a variety of waste fats and oils
- 2) process them in to high quality biomass based diesel
- 3) deliver this high quality product to the right market.

[In this case, our business model also includes getting products directly to our customers, which includes a variety of local and national trucking fleets from companies looking to add sustainability to their fuel mix.](#) Our business often involves delivering a blended fuel or mix of petroleum diesel and our emission-reducing biomass-based diesel in order to meet our customers' requirements. We are the largest biomass-based diesel producer in the U.S., with greater than 20% market share. [We have been able to consistently expand our distribution network to meet the needs of the "fleet customers" that want to see a renewable biomass-based diesel in their fuel mix.](#)

**Shawn Severson:** How would you describe your business to an investor in terms of commodity versus differentiated products and services?

**Randy Howard:** I would say that it is defined by two areas. First, on the feedstock side, there is no "Saudi Arabia" of waste oils and fats that you can go pick up a tanker load. So, our Procurement Team or supply chain differentiates us with the ability to collect

these feedstocks from literally around the world and deliver them to our facilities. This is one of our competitive advantages and differentiates us from a typical commodity business where feedstocks are already aggregated and easily accessed.

The second is on the product side with our ability to meet the customers' needs, whether it be a customer who wants 100% renewable fuel or a blend. A critical aspect in our business is quality - not only the quality of our physical products, but the quality of our compliance. We have an excellent technical services department that serve our customers as well as an excellent compliance department that ensures that the credits included with our products meet all of the certifications required.

Overall, I think these are probably the two distinctive areas that set us apart from a commodity business. We were recently awarded the contract to provide a 100% renewable diesel to the city of New York to fuel their vehicles, which is a great example of our ability to react and meet the needs of a key market.

**Shawn Severson:** Thank you, Randy. Can you please expand a bit in terms of the diversified customer base and address who your customer base actually is, what they look for and how important your scale and global presence is?

**Randy Howard:** [In the last couple of years, we have been able to meet the demands of the end-user customer by establishing the](#)

[distribution networks that give the customers supply in a large number national locations.](#)

Many national fleet customers want a contract that provides a high quality blend of renewable fuel in multiple locations. Our scale has allowed us to build out this distribution network and access this type of end-user fleet customer. With our presence in Germany and an office in Amsterdam, we are also able to identify and serve the highest margin markets around the world. Our biodiesel process yields 90% diesel fuel and 10% glycerin from the feedstock input. Our international presence allows us to market glycerin globally to help increase our coproduct margins. [Overall, our scale and international presence makes a significant difference.](#)

**Shawn Severson:** Does the larger customer profile change the predictability of the business in terms of more consistent uptakes and consistency in the business?

**Randy Howard:** Domestically, we have a large concentration of plants in the Midwest with two plants located in Illinois, one in Wisconsin, one in Minnesota and three in Iowa. We also have two plants in Texas and one in Washington State, as well as our renewable diesel refinery in Louisiana. Feedstocks are generated near our plants and we are able to access and optimize the local feedstock markets by providing the right product mix to the right plant as well as getting the right low carbon credits for the right market, resulting in a consistent offtake. Because we are able to give our suppliers a consistent offtake, we are able to negotiate

a contract that provides consistency to them, as well as the value we need.

**Shawn Severson:** How material is the large scale purchasing in terms of better pricing? When we look at one of the advantages of having the scale you do from procuring feedstock, should we would expect a relative cost advantage?

**Randy Howard:** It is about 10%-15% and varies by season. During winter in our feedstock market, soy and canola oils are typically more in demand because of the better cold-flow performance of the resulting biodiesel product. During summer, the waste fats and oils are more in demand. With our scale, we run fairly consistently, are able to use added 'distillation' to improve the product quality and can store and sell at different times of the year. We use dynamic models that allow us to optimize the whole thing, and at the end of the day, that's about a 10%-15% advantage.

**Shawn Severson:** Let's talk about the importance of biomass-based diesel imports for a moment. It's certainly increased in the past five years and created some disruptions in the industry and compressed margins. How should investors view the current state of that and how it is affecting REGI?

**Randy Howard:** Subsidized imports have had a dramatic impact on US biomass based diesel producers. [From 2014 to mid-2017, imports of highly subsidized biodiesel from Argentina and Indonesia began flooding into the US, because Europe had imposed tariffs.](#)

[By early 2017, Argentine biodiesel was coming in at roughly 600 million gallons per year, or about 25% of the U.S. market.](#) This kept margins for US producers very low. The National Biodiesel Board and others filed anti-dumping and countervailing duty complaints with the International Trade Commission. The ITC imposed significant countervailing and anti-dumping penalties on Argentine and Indonesian fuel, which halted the subsidized imports. Margins for the US producers have since improved, and allowed us, and the industry, to expand run rates. If you compare the typical margins from last year with this year's numbers, you can clearly see how much they increased. For REG, the first quarter of last year, we barely broke even, whereas in the first quarter of this year, we made \$17.5 million in adjusted EBITDA – which highlights a very different margin environment.

**Shawn Severson:** Clearly the global demand for cleaner fuel exists, but how would you define the current domestic political environment as it is impacting REGI?

**Randy Howard:** I think we have seen the EPA concerned about blending limitations in the gasoline market with ethanol, but still be supportive on biomass-based diesel. The Renewable Fuels Standard established by Congress is clear and calls for a continued increase in the renewable fuels volumes through 2022.

In addition, a big driver for us tends to be the emerging state incentives and state markets. If you look at California, they have a low

carbon fuel standard that is driving demand through 2020 and with the anticipation that the standard will be extended to 2030. We also see other states, like Minnesota, that recently implemented a 20% bio-diesel mandate during the summer months, which alone increased the annual demand there by 30 million gallons - a volume equivalent to one of our normal sized plants. We are also seeing Canada and Washington State following California's lead and working to adopt low carbon fuel standards, as did Oregon. [Although you read a lot in the news about the current EPA administrator and his perspective about renewable fuels, we see some good tail winds from the known public policy and those under consideration.](#)

**Shawn Severson:** Let's talk a bit about your refinery in Geismar, Louisiana, which produces renewable diesel versus traditional biodiesel. Can you explain to investors what the difference is between those two products and also talk a little bit about what they mean to you in terms of next-gen fuel and what your viewpoint is on R&D spending for REGI?

**Randy Howard:** Our renewable diesel plant in Geismar is different from the rest of our biodiesel fleet because the feedstock goes through a more petroleum-like refinery process. This high pressure, hydrogen environment that converts it to a renewable fuel that looks and performs just like petroleum diesel. It's still derived from these waste fats and oils, so, it gets all the bonus credits for being a low carbon fuel, but has the advantage that it could be fully

substituted for petroleum diesel. We've recently gained California Air Resources Board's (CARB) approval for a unique patent pending blend of our renewable diesel with our biodiesel. We can deliver a 100% renewable product to our customers called REG Ultra Clean™ Diesel. As we look at expanding our production to meet these growing customer demands, much of our capital deployment is aimed at renewable diesel expansion because the margins are much higher.

**Shawn Severson:** Let's take a look at some of the risks in the business. I'd like to look at this in two different ways: the revenue or growth risk and then the operational or execution risk. Could you address what you think that investors need to be aware of in terms of these challenges?

**Randy Howard:** Let me talk about operational risk because I think that REG as a company is the best in the world in the way that we operate our plants and in the consistency of our operations. We typically run all of our plants at well over 90% of nameplate capacity and our recent renewable diesel plant in Geismar just completed a nine-month run at 97% of nameplate. Therefore, operationally, we are world class and I'm very proud of that.

We strive to provide continued growth to meet the increasing demand for high quality, low emission, renewable diesel fuel. Looking back to 2012 – 2016, through a huge variety of different margins scenarios, markets and regulatory changes we averaged \$100

million of adjusted EBITDA each year for five years. That is consistency! Last year, we turned in record level performance of \$230 million adjusted EBITDA and we think you'll continue to see us continue to grow. We expect production to grow 10% year over year.

I would ask investors to watch us improve our key metrics and broaden our distribution network. Last year, we added ten terminals, ending the year with 46 terminals and we will likely add another ten this year.

**Shawn Severson:** Great, thank you. Lastly, when you look at the valuation of the stock, what are your thoughts in terms of what the market is missing or what you're planning to do to eliminate that discount?

**Randy Howard:** There are three key things I would call your attention to:

1) First is what I just talked about, which is the consistency of our earnings and the step change we've made in performance. Investors are realizing that, despite the confusion over all of the government regulations, they are seeing that our business model delivers consistent results.

2) Another aspect is that our focus is on shareholder value. Last December our board gave us approval to repurchase \$75 million of both our shares and our convertible bonds. We are currently in the process of executing on those repurchases. We think that the return of value to our shareholders is also helping us get a better valuation, and

3) Is that we have been much more transparent on sharing our key financial metrics, so they can see our focus on return on invested capital, which has returned to where we were in 2013 and 2014 before oil prices crashed. On a rolling 12-month average, we are back to 20% return on invested capital and shareholders are seeing not only our focus, but also our results.

**Shawn Severson:** Thank you very much for your time today, Randy. This has been extremely helpful and a great introduction to REG. We look forward to talking to you again on our next subject.

**Randy Howard:** Thank you, Shawn.

## SHAWN SEVERSON FOUNDER AND CEO

Mr. Severson founded *alphaDIRECT* Advisors (ADA), a division of EnergyTech Investor, LLC, in 2016 after seeing a significant communication and information gap developing between companies and the financial community. Mr. Severson has over 20 years of experience as a senior research analyst covering the technology and cleantech industries. Previously, he was Managing Director at the Blueshirt Group where he was the head of the Energy, Environmental and Industrial Technologies practice. Prior to the Blueshirt Group, Mr. Severson was at JMP Securities where he was a Senior Equity Research Analyst and Managing Director of the firm's Energy, Environmental & Industrial Technologies research team. Before joining JMP, he held senior positions at ThinkEquity, Robert W. Baird (London) and Raymond James. He began his career as an Equity Research Associate at Kemper Securities. He was frequently ranked as a top research analyst including one of the Wall Street Journal's "Best on the Street" stock pickers and multiple awards as Stamine's top three stock pickers.



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