Investor Briefing on Drax Biomass, 2018:

Drax dependent on subsidy, making unrealistic assumptions. Share price and profits down again.

Shares down 5% Profits down 192%. Earnings down 86% Dividends up 450%...?

**DRAX’S RELIANCE ON SUBSIDIES IS HIGH RISK AND FINANCIALLY UNSUSTAINABLE**

In 2017, Drax made an underlying profit after tax of £3m (and an actual loss of £151m) on a turn-over of more than £3,685m. Not clearly set out in the Annual Report is the share of revenue from public subsidies. **Drax received £729m in renewable energy subsidies in 2017, without which it would be financially unviable.** This equates to £2m a day. It comes from a levy on UK energy bills, amounting to an average of £27 per household. These subsidies are payable only until 2027. £480m was paid under the Renewable Obligation (ROCs) scheme which can be amended by secondary legislation. Indeed, it recently has been. (see **DRAX SUBSIDY CUT** below)

**UNREALISTIC ASSUMPTIONS**

Not only is Drax dependent on subsidies in order to make any profit at all, but its long-term strategy depends on getting even more of them in the form of Capacity Market Payments to build its planned gas power station and after 2027 to continue burning biomass. The Government has made it clear that it wants to reduce the energy sector’s dependence on subsidies and has already cut back biomass subsidies.

Biomass subsidies end in 2027. Drax aims to operate biomass without subsidy post 2027. This is unrealistic, despite increases in self-supply. There is no reason why there would be a “favourable economic environment for biomass generation” after 2027. The global demand for wood pellets is rising steeply so there is no reason why pellet prices should fall.

Drax’s value is based on the ‘expected useful life’ of its assets. Drax expects its biomass units to operate until 2039. This is unrealistic.

**RISKS FROM DRAX’S DEPENDENCE ON IMPORTS**

Earnings per share are down to 0.7p from 5p in 2016. **And yet Drax is paying a dividend of 12.3p compared with 2.7p last year.** Drax actually made a loss attributable to equity holders’ of £151m in 2017 due mainly to 'unrealised losses related to foreign currency hedging'. In 2016 it made £197m profit mainly attributable to successful currency hedging. This shows how vulnerable the business is currency fluctuations since 98% of its biomass is imported. Sterling’s weakness doesn’t help.

**DRAX SUBSIDY CUT ON 4TH UNIT.**

Drax claimed that a government consultation on reducing subsidy costs from biomass enabled them to convert their 4th unit to Biomass. The truth is that Drax’s potential earnings from its 4th unit have fallen from a potential ~£150m a year to only about £6m under the new rules. We know that Drax earned about £3.5m from ‘experimental’ high-level co-firing of biomass in its 4th unit in March 2017 alone.

So 2017’s subsidy total may be the highest Drax

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will ever receive in real terms.

In the consultation documentation, the government admitted that "When compared with [other genuinely low-carbon renewable] technologies, carbon savings from biomass conversion or co-firing are low or non-existent, and the cost of any savings is high." The early closure of subsidy for onshore wind and solar shows that the government is willing to rewrite the Renewables Obligation under which Drax receives the majority of its subsidy.

Both the Committee on Climate Change and the Department for Business, Energy and Industrial Strategy are currently reviewing bio-energy policies.

BIOMASS IMPACTS

In 2017 Drax burned pellets made from 13m tonnes of wood, more than the entire wood harvest of the UK. Much of it is clear-felled from highly biodiverse hardwood forests in the southern US, damaging the carbon sink and sensitive wild-life habitats. UK carbon accounting only requires Drax to declare fossil fuel carbon emissions from producing, processing and transporting the biomass, not the 11.7m tonnes of CO2 emitted from actually burning the trees, (more per unit of energy generated than Drax's coal). Soil carbon emissions and the carbon which is not taken up by the felled trees are also ignored. All this allows Drax to avoid carbon tax but also to claim an 86% improvement over coal and that it is 'decarbonising' the electricity system. In fact it is increasing emissions. Both pellet production and burning also pollute communities with dangerous particulates.

PUBLIC AWARENESS OF BIOMASS IMPACTS

On Monday 16 April Channel 4's Dispatches documentary on Biomass was watched by 800,000 people. If you missed it catch up at bit.ly/DispatchesBiomass. "If the British public understood that we're using public money raised from electricity bill payers to subsidise the clear-cutting of American forests and increasing carbon emissions in the atmosphere then they'd be outraged." The market for biomass electricity is only buoyant as long as people believe it is green.

FIRE AT DRAX

In December 2017, a fire in the pellet feeder system put two biomass units out of action at an expected cost of £10m to earnings.

THE COAL PHASE-OUT IS HAPPENING

April 2017 saw the first of several days where no electricity was generated from coal in the UK. The record was broken with 55 coal free hours last week. The 72% decline in coal-burning since 2011 has largely been made up with off-shore wind and energy efficiency, not biomass.

DRAX GAMBLING ON GAS.

In 2017 Drax spent £358m on acquiring Opus Energy with plans for four new gas power stations, two of which don’t yet have planning consent. Drax admits it will need Capacity Market subsidies to make those viable.. At auctions in February the first two power stations failed to secure any payments.

Drax recently launched a planning consultation on its plans to replace its last two coal units to with gas-powered ones, which, if realised, would make Drax the biggest gas power station in the UK and re-cement its position as the UK’s biggest carbon emitter. Drax is gambling on the coal phase-out being only achievable with a big new build-out of gas capacity which investors are not interested in making happen. They count on the government having to introduce big new subsidies to make it happen. See briefing http://bit.ly/coalphase-out2018

BIOMASS RISKY AND UNNECESSARY.

Recent studies by VIVID Economics show that Drax's biomass capacity is not essential to balancing the grid for more intermittent renewables as Drax claims.

They also show that biomass technology is likely to become a stranded asset beyond 2027, whether or not Drax can succeed in its ambition to run biomass without subsidy. Fossil fuels and biomass are increasingly being outcompeted by wind and solar.

Both the Committee on Climate Change and the Department for Business, Energy and Industrial Strategy are currently reviewing bio-energy policies. Ultimately the government will have to align its practice with its policy to take account of 'carbon impacts of the whole system'. Drax will then not meet emissions thresholds that entitle it to government subsidy.

We invite you to talk to us about your investment in Drax.

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