

IS ENERGY RECESSION PROOF?

Energy markets are typically fast-moving and energy companies and stakeholders are used to rapid responses, but the financial crisis is a potential game-changing event.

Some have argued that the energy sector is recession proof – we at Pöyry do not agree. We see a number of factors that energy companies, financial investors in energy assets, regulators and Governments will need to examine – if the energy sector is to continue to grow and prosper in an optimum way.

At Poyry Energy Consulting we categorise the potential impact of the crisis on the energy sector in four areas:

When and where to invest?

Conventional wisdom suggests that utilities and international oil companies with strong balance sheets will now be able to acquire development pipelines at low prices. With limited access to debt, smaller companies will not be able to develop projects and will be forced to sell and competition for the assets will be low. At the same time capital costs, which have escalated in recent years, will fall over the next year or so, as demand for equipment falls. As a result companies will hold off development until the equipment market bottoms out and EPC costs decline from their very high current levels.

While this seems like a credible outcome, companies and investors need to focus very strongly on where they should spend their limited capital to earn the best returns – will that be in conventional or alternative energy, in the UK or Turkey? And who else from outside the region may be looking to invest in European markets i.e. how strong will competition for assets really be in future?

An investment strategy review and competitor analysis to identify the best opportunities for growth undertaken now could be very beneficial.

What new policy initiatives are needed in the current climate?

Building on the issues above, a major focus for policy makers must be how best to support needed energy investment. With investment in energy now facing a hiatus and with challenging targets for climate change and renewables in place, new policy initiatives are required. Even though demand for energy will be reduced over the coming years, the need to invest to replace assets at the end of their lives and to develop a low carbon energy system will not be materially affected.

A process of consultation with industry, to understand the needs of investors today would help create new policy ideas and keep targets on track.

Investors may need to open a new dialogue with the regulatory authorities and Government to help them better understand the new investment climate and to revise or improve the regulatory framework to encourage investment.

Dealing with bad debt.

The potential is for bad debt to increase in a recession. For smaller utilities facing the combination of recession and a competitive retail market for the first time it is vital that risk management systems recognise the risk of customers failing to pay so that working capital requirements do not spiral out of control.

That means that companies need to carefully monitor the situation and design and implement a risk management business model and system that ideally extends counter-party credit risk to retail customers. The interface with the regulatory authority will need careful handling as the number of customers with payment problems increases.

The impact of falling demand.

Many companies will be basing their business plans on continued growth in demand for their products. The reality may be a long term decline in demand as economic growth falters and energy saving measures begin to bite. The impact will be different for different companies: regulated businesses may be isolated for a number of years, whereas retail businesses will see the impact immediately. For many businesses this makes the need to grow in new areas all the more pressing.

With core growth under threat, a better analysis of demand trends is needed, taking economic and new efficiency measures into account.

If you would like to discuss these issues in more detail and/or find out how Poyry Energy Consulting can help you to protect and grow your business through the recession please contact Matt Brown in the first instance on 0207 494 6403, or matt.brown@poyry.com.