Oil, Gas and Transport update Autumn 2022

Notable Insolvencies/ Insolvency data

- **Uniper:** Whilst not insolvent, the German government is set to nationalize Uniper, which is amongst the hardest hit companies after Russia's decision to limit European gas supplies. Shares have plunged nearly 93% this year with losses over €40bn for the first nine months of the year
- **Insolvency rates** for England and Wales - Total company insolvencies in Q2 2022 increased by 13% from Q1 2022 and by 81% from the same quarter in the previous year.

Sector overview

Since oil prices peaked in March, market volatility has continued, and despite some price softening, they remain significantly above those seen in recent years with no real signs of abating. The full sanctions on Russian oil imports are not set to take effect until the end of 2022, so uncertainty around the impact this may on the market remains.

Motorists have seen prolonged periods of high pump prices, impacting both businesses and consumers alike.

The European gas markets have been challenged by Russia restricting the flow of gas through Nord Stream, and soaring gas prices have impacted energy companies across Europe forcing utility providers and traders to secure extra funds from governments and banks to cover margin call requirements.

Whilst storage tanks have been replenished ahead of winter, supply remains a real concern, particularly for the UK due to reliance on imports from Europe over the winter months. The UK government are seeking to secure long term contracts, but high prices and market volatility adds pressure to the long term commerciality of doing so.

Businesses are facing a number of real challenges with concerns over profitability, skilled labour shortages, top line growth and the cost of doing business after what has already been a complex couple of years.

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Strengths

- **Almost half of logistics firms are forecasting acquisitions** in the next 12 months despite challenging market conditions, although the number of private equity deals closed in the UK have fallen by 20% in the last year.
- **Market consolidation** could help businesses streamline and become more efficient. Even without consolidation, businesses are being forced to look at the way they operate in a bid to keep costs under control.
- **EV and greener fuels** are presenting opportunities to diversify, and companies appear committed to their focus on environmental/green targets.
- **Reduction of reliance on Russian oil** is providing opportunities to accelerate alternative energy sources and increase investment in the North Sea (supported by UK Government initiatives).
- **Large haulage firms** usually have several price escalators written into contracts, which helps manage rising cost pressures as they are passed through to customers.
- **Under the Government's new 'national rail contracts'** train operators are shielded from almost all revenue and cost volatility, so strikes have had limited financial impact.
- **Bus Recovery Grant extended to end of March 2023** with another £130m injected into the scheme.

Challenges

- **Bank of England base rate increased to 3% 03/11/2022.** The impact will be varied but many businesses are already carrying high debt levels due to COVID-19, and for many, debt will be far more difficult to service as growing interest payments squeeze cash flow. Funding availability may also decline.
- **64% of freight operators have a driver shortage.** Due to the shortages and national minimum wage increases, wage rises are another cost for businesses to manage.
- **30% of logistics firms** are expecting a drop in profitability in the next 12 months despite 60% expecting their turnover to increase in the coming year.
- **Supply chain issues and soaring input costs** are impacting the haulage and logistics industry confidence.
- **The cost of living crisis and squeeze on wages** is likely to impact consumer spending and therefore online delivery volumes may fall.
- **Despite the Energy Price Relief Scheme,** energy intensive business are facing significant cost increases. The ability to pass on any or all of the increase varies across sectors.
- **Brexit challenges continue** particularly the delay caused by increased border checks. Full post-Brexit import controls are expected to go live late 2023 so further disruption is expected next year.
- **Bus operators face inflation and driver shortages**, and passenger numbers are yet to fully recover to pre-pandemic levels.

Economic data

- **Average Brent crude oil spot price declined to $90bbl in September** from $100 bbl in August ($30 bbl lower than June peak). This was driven partly by global economic slowdown concerns and tightening monetary policies.
- **OPEC+ voted to reduce production by 2 million bpd** from November due to "uncertainty that surrounds the global economic and oil markets outlook". However, due to under production versus existing quotas, the effective reduction is c. 1 million bpd.
- **Covid restriction in China** have continued to dampen demand. Chinese officials have reiterated commitment to strict COVID containment.
- **British Petroleum saw the biggest profit** for 14 years in the last quarter. Significant profits are being seen across the energy sector.
- **Fuel prices increased by 26.5%** in the year to September 2022, however this was down from 32.1% in the year to August. Fuel duty was cut by 5p per litre in the Spring Statement, but prices have remained high and there are calls for further help for motorists.
- **Fuel and Energy costs** continue to contribute to increased inflation with CPI hitting 11.1% in the 12 months to October 2022.
- **Average domestic energy price cap fixed at £2,500 per annum** until April 2022 – still 27% above the summer price cap and 96% higher than the winter 21/22 price cap. There is no price cap on business energy rates but the Government has introduced the Energy Relief Scheme which gives discounted energy rates for 6 months from 1 October 2022.
- **19.2% of transport companies** admitted they had run out of cash in the last month with 28.4% having three months or less left.

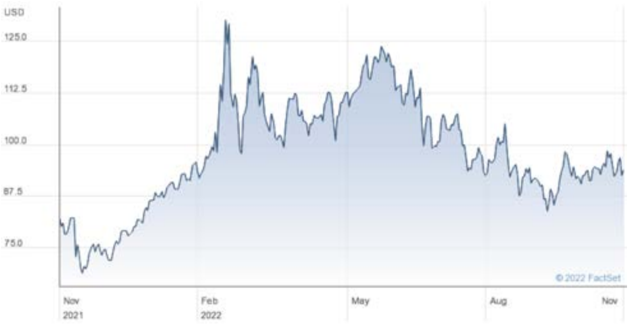
Underwriting approach

> Large logistics firms appear to be managing the challenging environment well, as are those entities which own warehousing facilities which enables them to benefit from increased demand whilst offsetting cost pressures.

> We see challenges for SME businesses operating in the logistics sector, as the margins are very thin and competitive pressures may result in an inability to pass costs on to their customers and access funding.

> We continue to gather up to date information on key risks, supported by regular calls/meetings to understand the intricacies of business models and the challenges they face. We also seek to understand cashflows and financial flexibility of the business when conducting our reviews along with the impact of energy price increases.

Brent Crude Oil Price Chart



SOURCE - https://www.hl.co.uk/shares/trading-commodities/brent-crude-oil

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