

EMERGING STRONGER - RESTRUCTURING

WHAT CAN BUSINESSES DO ABOUT THE RIPPLE EFFECT OF RISING ENERGY PRICES?

It's been well documented that UK energy prices are rising - but why is that? The answer is supply is down and demand is up. This is a worldwide problem.



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1 WHAT IS THE ISSUE?

The issue is a simple - we are experiencing a chronic imbalance between supply and demand for energy.

In the UK, gas platforms in the North Sea are only just resuming maintenance work that had been halted during the pandemic. Consequently, capacity for production of gas is down on pre-pandemic levels.

Meanwhile, global events such as hurricanes in the US are restricting exports to the UK and Europe.

Previous supplies that had come to the UK and Europe from the likes of Qatar are now going to China to satisfy their increasing demand.

In the UK a fire at the National Grid site in Sellenge, Kent forced a power link to be shut off. The link will only be operating at half capacity until March 2022. Low wind over the summer has meant that coal burning has supplemented the lack of wind power.

China's gas demand has increased by 8.4% since 2020 and generally needs as much coal as there is available.

All of this is leading to the unusual coincidence of higher oil, natural gas and coal prices.

On top of that the price of carbon permits, a central plank in EU plans to cut emissions has almost doubled this year, contributing further to higher energy bills in the future.

2 WILL YOUR BUSINESS BE AFFECTED?

Following rising energy prices, there has been disruption for UK domestic consumers but what is the impact for the wider business community? While UK domestic customers have a price cap in place, there is no such safeguard in place for businesses.

Energy experts state that prices are expected to remain high until late 2022. Businesses that are not on fixed rates with their suppliers may experience significant increases in their rates during that period.

There are some obvious high energy users in the manufacturing, aviation and industrial sector. But it's important to look beyond those initial heavy users.

Some businesses may consider that they have low energy costs but they also need to review their supply chain as may be indirectly affected by their own suppliers needing to increase their prices due to their own costs increasing. For example, some supermarkets are already saying that higher energy bills mean price increases are inevitable for their customers.

The ripple effect of energy price inflation should not be underestimated. Higher bills will hit household budgets and potentially dent consumer confidence, derailing a recovery largely driven by the rebound in consumer spending.

It is important to also think long term - this problem is not going to go away quickly. Businesses may need a financial war chest until they can pass on the additional costs to their customers.

3 WHAT CAN YOU DO ABOUT IT?

There are some obvious self-help measures like reviewing charges and fixing tariffs, and there are consultants that specialise in that market.

We have already mentioned supply chain risk and it's important to consider how your suppliers might be affected by hikes in energy prices. Do you have over reliance on any single supplier or do you have a sufficiently wide supplier base that you would be able to absorb the impact should one of them get into difficulty? Stress test your market.

However, it is of paramount importance that energy costs are reviewed as part of a wider strategy in order to better understand the operational resilience of your business.

Which areas are profitable, and which are not? Are there under performing subsidiaries that are no longer core to your business proposition?

Can you increase liquidity through alternative borrowing structures or sale and leaseback of assets?

Are you able to identify strategic growth opportunities and do you have access to sufficient liquidity to capitalise on them once identified.

For advice on any of the approaches or the key risks to bear in mind, please get in touch.

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If you would like a more comprehensive view of what we're seeing in the current environment and what steps you should take to maximise your chances of success, please get in touch.

Jamie McIntosh, Restructuring Partner
Jamie.McIntosh@addleshawgoddard.com

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