

The European Energy Crisis & Next Ofgem Tariff

The European Energy Crisis

In prior reports I flagged how the low natural gas storage might be sufficient to bring us through the winter, but it could cause a drop in profitability for all energy users¹. At the beginning of December it appeared that gas storage levels will only last until the end of April². This trend has now accelerated. In fact, the decline in European gas storage has occurred at double the rate of that in 2019 in December. Kosovo has now had its first blackouts in more than a decade³. Meanwhile, heavy industry is urging EU leaders to act against unbearably high energy prices⁴. While many point the fingers at Russia and fewer supply of natural gas through the existing pipelines, this is not the complete story. In France nuclear reactors were taken offline after faults found⁵, Germany is closing existing nuclear plants by the end of the year and Belgium set to close theirs by 2025⁶. On top of that, a small energy supplier in the UK, Good Energy, confirmed low wind energy generation, as winds were 18% below norm in November and currently 33% below seasonal norms⁷. And if that is not all, UK's political shift against oil & gas has led to oil & gas production in the UK at levels that are 70% of 2019 levels.

What does this translate to in the big picture? While I'm in favour of upgrading our energy grid towards renewable energy and have even spoken out for the potential success of the UK's energy plan⁸, it should not happen by phasing out fossil fuels immediately. If you look at the most polluting energy source, coal is the outstanding leader with 50% more carbon emissions compared to gas⁹. As both energy sources can be used to generate electricity, I believe the most obvious thing to do is to phase out coal first and once completed, tackle the next. However, we try to change the entire energy grid at once and make the same

¹ <https://www.aozorastep.com/UK%20Fuel%20Crisis%20&%20European%20Natural%20Gas%20Storage.pdf>

²

<https://www.aozorastep.com/UK%20Update%20-%20Oil%20Prices%20now%20in%20line%20with%20EURUSD,%20Fed%20can%20stop%20QE%20immediately,%20Low%20EU%20Natural%20Gas%20storage%20levels.pdf>

³ <https://balkangreenenergynews.com/kosovo-imposes-rotating-power-outage-over-high-import-prices-grid-issues/>

⁴ <http://www.euromines.org/news/industrial-energy-consumers-urge-eu-leaders-to-swiftly-act-against-unbearably-high-energy>

⁵ <https://www.reuters.com/markets/europe/edf-extend-civaux-nuclear-outage-shut-down-reactors-chooz-safety-measures-2021-12-15/>

⁶ <https://www.dw.com/en/belgium-to-close-all-existing-nuclear-power-plants/a-60236059>

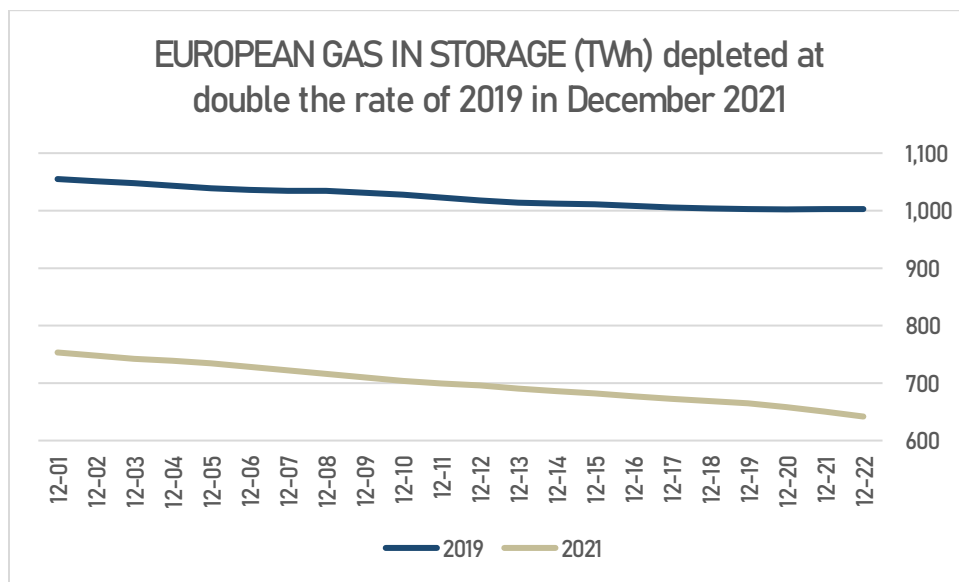
⁷ <https://www.londonstockexchange.com/news-article/GOOD/trading-update/15260797>

⁸

<https://www.aozorastep.com/UK%20Update%20-%20Bulb%20Energy%20fails,%20UK%20EV%20shift%20may%20succeed.pdf>

⁹ <https://group.met.com/fyouture/natural-gas-vs-coal/66>

mistake as in previous attempts, as Peter Thiel laid out in 2000¹⁰. This is why I remain long Hunting (HTG LN), as the supplier for fracking and tubing tools will benefit from the return of shale oil & gas and remains attractively valued. In fact, US fracking is already returning with a higher rig count and LNG tankers now heading from the US to Europe¹¹. Just to add some thoughts about making our energy supply purely reliant on renewables by combining wind energy with storage facilities: Imagine oil production will be 33% below its norm in a single month. In the case of the US, the country consumes around 18.19mio barrels of oil per day¹² and according to the EIA has now around 595mio barrels of oil in storage. If oil production would decline by 33% in a single month, 180mio barrels of oil would need to be drawn down in inventories to close this gap. Just imagine the wild price swings we will encounter in a future where we rely on a combination of renewable energy supply and storage facilities that need to be massive to cope with the unreliable supply.



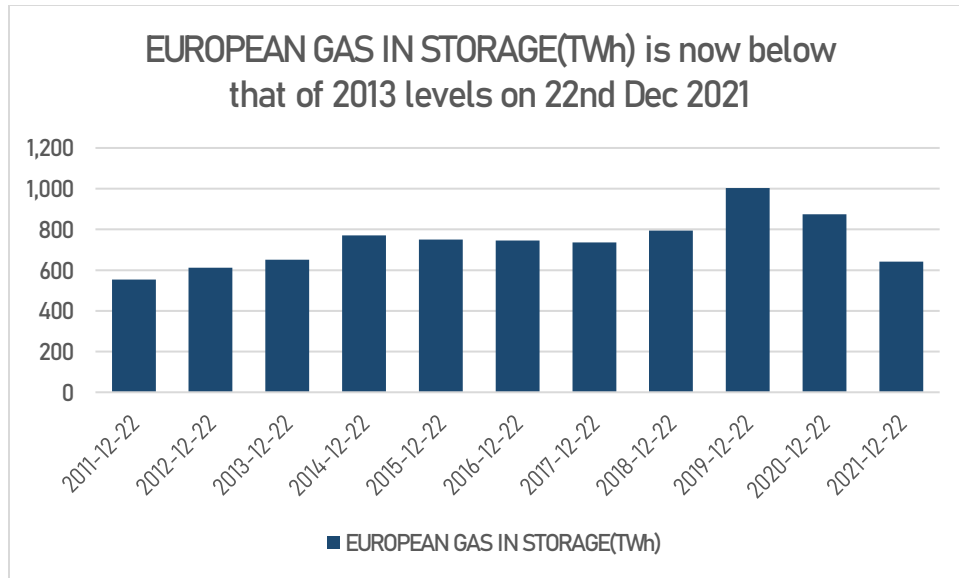
Source: AGSI

¹⁰ <https://www.aozorastep.com/UK%20Daily%20-%20Friday%2022nd%20October%202021.pdf>

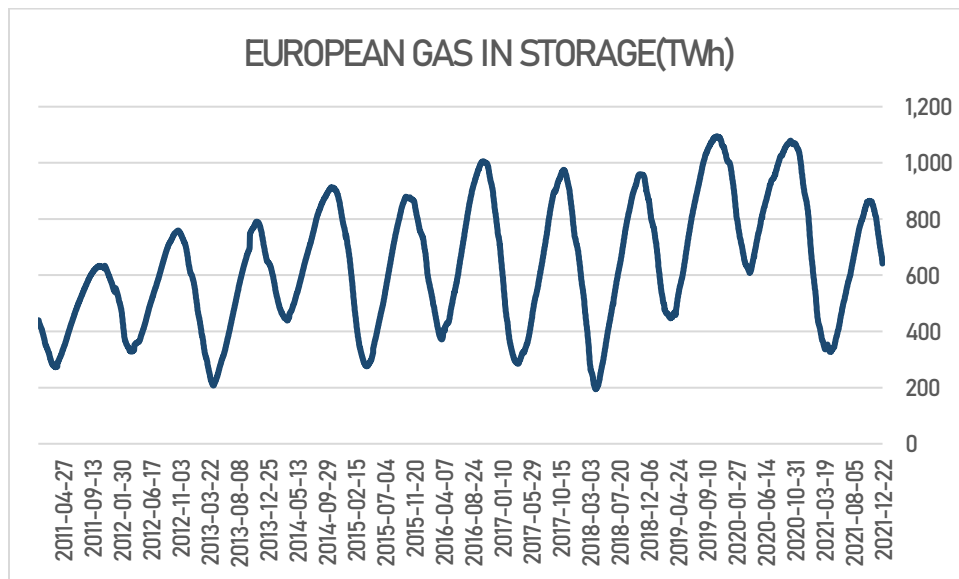
¹¹ <https://twitter.com/SStapczynski/status/1473829467168464900/photo/1>

¹²

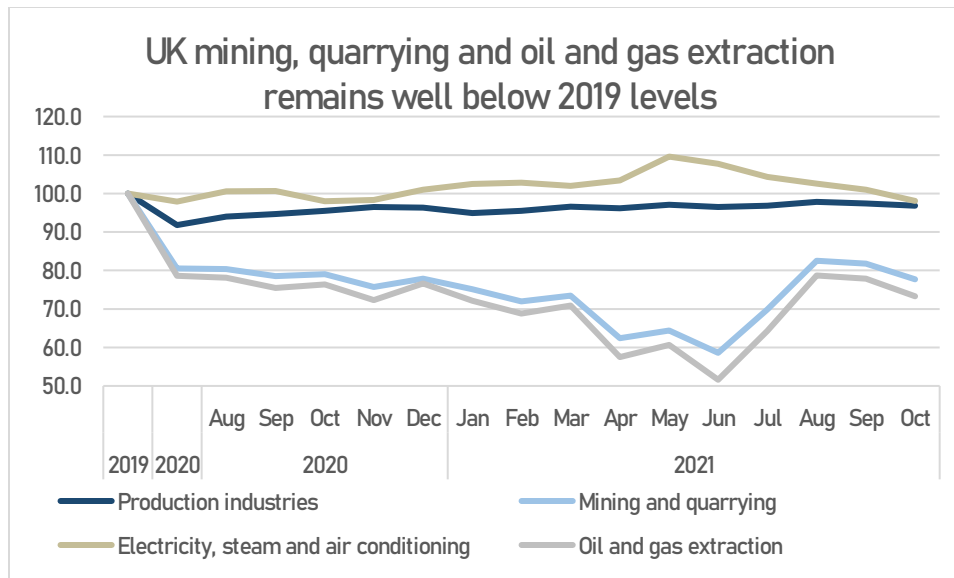
<https://www.eia.gov/tools/faqs/faq.php?id=33&t=6#:~:text=In%202020%2C%20the%20United%20States,6.66%20billion%20barrels%20of%20petroleum.>



Source: AGSI



Source: AGSI



Source: Office for National Statistics

The next Ofgem Tariff

The UK household so far has not really felt much of this energy crisis due to the protective Ofgem tariff. As the tariff is set semi-annually for the periods Oct-Mar and Apr-Sep and hedged eight months in advance, we are currently enjoying gas and electricity prices of around £61 per therm. As per below, wholesale prices have risen between February and August by around 41% from an average of £373 to £528 per average household per year. Natural gas prices have increased by around 54% over these two periods from an average of £39.68 to £61.1 per therm. The average of the current natural gas price taken from September 2021 to February 2022 is set to be above £200 per therm. This alone would increase Wholesale prices from the current £528 towards £1,320 following similar calculations as the changes from the prior to the current period (i.e. $\frac{£200}{£61.1} / 54\% / 41\% * £528$). Assuming that all other costs remain the same (which is unlikely as the number of defaults in energy suppliers will raise bills to make up for their liabilities), we will see the next average Ofgem tariff at over £2,000 per household. An increase of say £723 per year per household with 28.1mio UK households in total would cost the consumer £20.3bn more a year. This is around 1% of UK's GDP or UK's government debt and makes up 2.3% of the UK's median annual income of £31,487.

While this is bad news for all of us, in particular people on lower incomes, it is positive for Centrica/British Gas. As the company makes around 2.9% per household on the average house Ofgem tariff, the company

will earn £58 instead of the current £37 per household. This alone should lead British Gas to report an EBIT of around £580mio based on their 10mio customers. With more suppliers failing, British Gas is likely benefitting with more customers in the future. Currently the company has no net debt and is valued at around £4bn.

The current Ofgem tariff for UK households

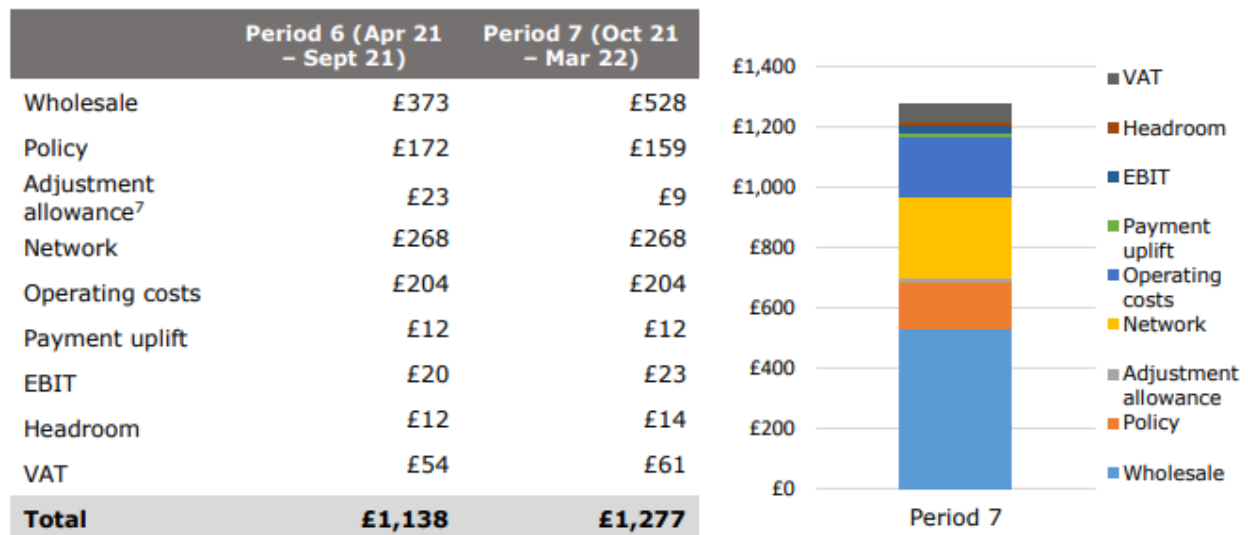


Figure 1: Breakdown of default tariff cap components

Source: Ofgem



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