

How telecom companies are weathering the impact of rising energy prices

The exposure to high and volatile energy prices is relatively low for telecoms compared to many other sectors. As costs rise, however, many are looking towards alternative and often greener ways to keep the cost base stable for longer



Source: Shutterstock

The cost of volatile energy markets

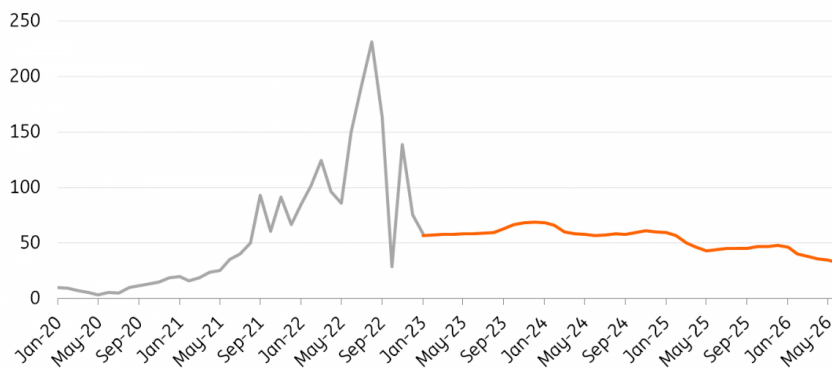
Few sectors emerged unscathed by rising energy prices in 2022. Most telecom operators, however, had largely hedged the cost of their energy needs so this wasn't so much of a big deal. But given that energy charges have remained above their historical levels for some considerable time, it's worth considering how telecom operators could be affected.

The topic dominated telecom companies' earnings calls throughout last year. Historically, wholesale electricity prices have been around €40/MWh, on average. Electricity is frequently generated from natural gas, with an average historical price of around €20/MWh. The recent price history for the benchmark European natural gas price can be found in the chart below. We depict European energy price developments through natural gas price developments because the regional electricity markets in Europe all have their specific characteristics, while European gas

markets are relatively deep.

As you can see, energy was particularly expensive in the middle of 2022, resulting from gas supply problems given the war in Ukraine. Gas prices peaked above €250/MWh, while electricity prices traded on some days above €600/MWh. For the companies that had to purchase electricity on the spot markets, this became a costly affair.

Gas prices are now below the peak (€/MWh)



Source: Refinitiv, Endex

Energy costs are a relatively small cost component for telecom operators

Based on our estimates for the sector, energy costs were a relatively small part of the overall cost base, which includes depreciations. We estimate that around 2% of the total cost was energy-related. This implies that telecom operators should be able to handle a temporary increase in energy costs, not least given general cost reduction programmes and efforts to reduce need. Nevertheless, telecom companies often choose to purchase (hedge) their 2023 energy needs at elevated levels last year.

The price of natural gas with delivery in July 2023 was, on average, €106/MWh, which is somewhat more than twice the average spot price in 2021. We, therefore, estimate that energy costs will at least double for companies in 2023. So energy costs are becoming a larger part of the cost base. Nevertheless, it is not certain that total costs will increase because management teams are focussed on expenditure management.

We also expect that the impact of rising energy prices will be largely transient. As you can see in the chart above, the gas price has declined rapidly from the elevated 2022 levels. The futures curve indicates that companies can now procure their energy needs at prices around €60/MWh for natural gas. This is high compared to the long-term average but within the same order of magnitude as the 2021 price level.

Green energy procurement has offered some additional help

Many telecom companies have offered green bonds and are focused on lowering their greenhouse gas emissions. To do so, companies can procure green energy from wind farms, besides efforts to reduce the energy needs through investments in energy-efficient networks, and we've looked at that in more detail [here](#). As a case in point, Deutsche Telekom signed a large multi-year

Purchasing Power Agreement (PPA) for green energy from an American wind farm.

The long-term commitment to this venture offered the additional benefit that exposure to rising energy prices was well contained. Given the substantial demand for green energy, as well as a desire to avoid volatility from energy prices, we think that more companies could look for such agreements.

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