Low bargaining power has a high cost

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High-priced energy is breaking the eggs in the basket of listed companies reaping the benefits of economic growth.

The impact is being felt across the board, by all companies and also by consumers, but more so in the case of certain energy-hungry manufacturing sectors. Large manufacturers listed on the Italian stock market have to take into account the increase in gas and oil prices that weighs down their balance sheets.

Angelo Meda, head of equities at Banor SIM, says, “At the moment, energy cost is the second factor, after COVID's impact on growth, that we analyse when evaluating equities. For heavy industry companies that produce cement, steel or natural gas, for example, the increase could slash last year's profits by as much as 30-40%”.

However, you have to distinguish between firms that can relay the additional costs onto sales prices and others who have to bear the full brunt of rising production costs, at least for now.

“Sol, for example”, explains Meda, “produces industrial gases and has strong bargaining power because it’s difficult for customers to change supplier. So, it can pass cost increases onto its list prices. Saras, on the other hand, sells petrol, which is a commonly available good, so it cannot easily offload the increase in energy and CO_2 further downstream, and therefore it stays on the balance sheet”.

High energy prices also affect company profits indirectly. First and foremost, there is the increased cost of transport, which for some companies is a primary component of the product’s end value.

“For a company like Buzzi Unicem”, says Lorenzo Batacchi, partner at Assiom Forex and portfolio manager at Bper Banca, “energy costs account for 14% of turnover and transport for about 15%. This is no small detail, but the market often pays little or late attention to it. Right now, however, it is essential to analyse the various production components to try to estimate how margins are changing”.

Oil prices are high, electricity is expensive (depending on how it is produced) and gas has fallen from its December peak but has stayed above €70 — against a historical average of €20. “The latest development”, Batacchi continues, “is the drop in sea freight prices, which have not risen since October and have gone back to 2020 levels. They should therefore be monitored together with pandemic control measures to gauge how they will affect companies' costs in the coming months”.

The soundness of the economic and financial market recovery will, of course, inform the prospects of energy-hungry companies.

For Batacchi, the worst may already be over for some companies. “Many companies, including cement manufacturers, have already discounted the energy cost increases, which are not in any way extreme compared to the historical average. This is assuming, of course, that the economic situation continues to normalise. Then, there are the companies who lead their supply segment. For them, the problem of rising costs is less important because the demand for their goods is so strong. The Danieli steel company, for example, is not energy-hungry because it has low-consumption furnaces and the demand for its products is high. For Ferrari, there might be more problems with car deliveries than with price increases”.

Conversely, if energy prices and inflation continue to go up, the effect would spread from manufacturers to consumers and from costs to company revenues, because of a reduction in purchases that would affect many sectors.

Meda concludes, “In the spring, we’ll get an idea of how much high energy costs have impacted on company revenues, which always lag a bit behind costs”.