COMMENTARY

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The war in Ukraine is creating geopolitical, social, and economic disruption in the energy sector and beyond, just as the world is beginning to recover from the worst of the Covid-19 pandemic. In the energy sector, it is compounding the trilemma of security, affordability, and sustainability. Increasing sanctions on Russian energy exports and moves to reduce dependence, notably by the EU, are limiting access to a previously reliable and low-cost global energy source, and the ripple effects could be felt in the form of higher costs of living and of doing business. There will also be implications for the energy transition. In this commentary, we outline five potentially lasting changes for the energy sector that companies and investors should account for:

1. **Energy security taking primacy in domestic energy agenda.** Governments may increasingly seek energy security by developing more local energy resources and diversifying sources of supply, including low-carbon alternative energy sources. For Western economies, an increased focus on renewables represents the flip side of the same coin as reducing reliance on Russian imports. Meanwhile, it is possible that some Russian energy flows might be diverted to Asia.

2. **Prolonged increase in commodity pricing and volatility.** While global gas resources remain abundant, it will take time for new supply to be developed to offset a reduction in Russian pipeline gas. In the near-term, more expensive LNG could play a bigger role to fill the gap in many jurisdictions, and notably for the EU. As rapid adjustments to energy investment and flows are made, energy prices may remain volatile, although an increasing penetration of renewables (along with storage) over the longer-term should have a dampening effect.

3. **Accelerated transition to net-zero despite near-term spike in emissions.** The economic risks exposed by the war could elicit heightened societal and financial advocacy for policies to phase out fossil fuels. Governments and businesses may dial up investments into renewables, nuclear, batteries, and hydrogen as alternatives, alongside energy efficiency programs. To fill the near-term energy supply gap, there could be a temporary uptick in fossil fuel demand, including coal in select jurisdictions; and the higher commodity prices may drive some actors to invest in new capacity. However, after this temporary relapse, the overall transition is speculated to accelerate into the medium-term.

4. **Diversifying regional energy strategies.** The pace of the energy transition could become more uneven regionally, with an emphasis on different technologies – underpinned by the drive for increased energy independence and regional policy biases. Particularly in the EU where it seeks to reduce reliance on Russian gas, renewable energy is projected to grow in share across every jurisdiction. In other countries, such as the UK and the US, there could be a renewal in nuclear, whereas retrofitting carbon capture and storage and integration of hydrogen and/or ammonia may be a focus in regions where gas for example is viewed as an important bridging fuel. There will be places where fossil fuels remain an important part of the energy system for a long time, and where Russian gas might be redirected, notably China. Such divergence in energy strategies has potential to create significantly higher variance in regional energy costs and may contribute to a shift of economic benefit from the West to East, for example by improving the competitive advantage of energy-intensive industries in China.

5. **ESG becomes more complex and nuanced.** Geopolitical risk will become a more important factor in ESG investing as relates to the energy sector, particularly in Western economies where it is likely to lead to reduced sourcing from and even exclusion of certain jurisdictions that export less expensive energy resources. Combined with the accelerated investment into renewable resources that remain relatively more expensive near-term (e.g., versus Russian pipeline gas), there is a trade-off occurring of affordability for end-users in favor of ensuring clean energy supply, both environmentally and politically.

The war in Ukraine has reminded us of what is possible in terms of externalities and the disruptions such externalities can create. For companies and investors, ensuring business resilience requires broadening the aperture on potential disruptions to the current strategy. View of the future scenario planning can no longer be a one-off exercise but needs to be more tightly integrated into the strategy development process. In turn, insights into future scenarios can inform better portfolio-shaping options to ensure a better mix of business risk exposure and/or diversification benefit. And the increased interdependency of strategy and policy requires doubling down on capabilities for advocacy and navigating policy environments inside and outside the domestic border.

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We help clients achieve their ambitions for sustainable profitable growth through:

- Stronger strategies and advantaged execution based on:
    a. A better understanding of what drives client economics and value
    b. Insight into changing industry dynamics and the context in which clients need to succeed
- A stronger management framework to generate better ideas and link decisions and actions to value
- A stronger organization with a more focused top management agenda and well-aligned resources
- A more confident and effective leadership team that's focused, decisive, and strategic

We have a joint team delivery approach where client ownership and engagement is paramount. Partners are highly engaged in the work product and supported by strong analytical and industry relevant capability. We work as advisers and catalysts in close, trust-based relationships with top management teams.