TRANSCRIPT

Europe’s Dependence on Russian Gas and Online Gambling

Featuring:

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Mike Disabato:

What's up everyone and welcome to the weekly addition of ESG Now, where we cover how the environment, our society, and corporate governance effects and are affected by our economy. I'm your host, Mike Disabato, and this week we have two stories for you. The first, we discuss how dependent the west is on Russian natural gas, and the second is about the proliferation of online gambling in the US. Thanks as always for joining us, stay tuned.

Mike Disabato:

The beginnings of the conflict between Russia and Ukraine lie relatively far back in time. And the sounds that the current conflict are making have echoes of a long and complicated past involving Russia and Western Europe. As tensions continue to rise and threats of invasion by Russia loom, what further complicates it for the west is the EU's reliance on Russian natural gas. How reliant, you wonder? I say this without hyperbole, astounding reliant.

Elchin Mammadov:

Russia accounts for between 38 and 41% of gas that Europe consumes, so it's a big chunk. But, even within that range, within the EU, some countries are much more reliant on Russian natural gas, and that's the likes of Finland, but mostly countries in Southeastern Europe like Bulgaria and Slovakia. So, they imported between 70 to 95% of all the gas that they use from Russia.

Mike Disabato:

That was Elchin Mammodov, my colleague, who covers the natural gas industry for us. You might remember listening to him a couple weeks ago when we had him on the pod to discuss the implications of the EU labeling that natural gas is a sustainable transition fuel in its green Bible, the EU Taxonomy. Well, now we're looking at where that natural gas is going to come from that Europe will use as a sustainable transition fuel. And it's coming from Russian companies and Russian natural gas fields.

Elchin Mammadov:

But even the likes of Germany and Poland and Italy, they import between 40 and 50% of Russian gas goes towards their domestic consumption. And those countries don't really produce much gas on their own. The biggest producers are the likes of Netherlands, where the domestic production is actually dwindling because of the earthquakes in Groningen field, among other reasons. And the only other supplier to Europe that is friendly and nearby is Norway, which is a big supplier, but there, we don't see a huge increase in production in the coming years. If things continue as they are Europe's reliance on gas from Russia will probably be around 40% or so, and could actually increase over time.

Mike Disabato:

So, hypothetically, Russia stops sending gas to Europe. What do utilities do then?

Elchin Mammadov:

The biggest thing that the utilities can do is import more LNG, liquified natural gas, from places like US and Qatar. Then they will be competing with the likes of China and Japan and Korea and even Brazil, who are also importers of LNG. So if Putin tomorrow shuts the pipes, unfortunately, the best thing you can do is shut immediately all the gas fired power plants in Europe, burn much more coal and consume less gas. Some of the industries will have to shut down, not to use any gas, and you might have to ration it to households. There might not be enough gas to go around. So, it's pretty dire situation if that happens.

Mike Disabato:

Basically in total, the 27 countries that make up the EU produced only 9% of the natural gas they use. And it's not easy to scale that number up quickly because most of the major gas fields in Europe are running at capacity. Now, the reason this is an important story for the ESG realm is twofold. First, according to our data, a lot of European utilities have significant carbon reduction targets that rely, sometimes and partly, on natural gas as a transition fuel. And secondly, it is what happens to a power utility that doesn't have natural gas to burn, to make its energy. Where does it go then? Well, it gets dirty. It goes to coal and listen to what Elchin said when I told him that the situation seems like one of those cruel environmental ironies, in that Russian gas is helping the EU go green.

Elchin Mammadov:

It is. So, basically Russian gas is helping Germany pivot away from coal. There's a lot of coal that is planned to shut down in Germany, and Russia is the biggest supplier to the country. Yes, Germany is thinking about building liquified, natural gas import terminals, but the capacity there is not huge. So yeah, Russian gas is trying to clean up the power mix for Germany, but also many countries in Eastern Europe and Central Europe.

Elchin Mammadov:

On the flip side, if the current uncertainty persists, perhaps it will push politicians to accelerate the shift towards renewable energy in the long term because that way you're not dependent on Russian and other gas exporting nations for your fuel, at least not to the same degree as they are now. So, in a way, it could accelerate that green transition.

Mike Disabato:

There is historical precedent for that, not green historical precedence, but historical precedence nonetheless. The disastrous foreign policy decisions that the US government pursued in the Middle East in the early alts, meant that the US government had to find out how to make their energy system more independent. So came the shale gas boom. Now that's in addition to new technology that allowed companies to get the gas easier, but still that change seems analogous to the new technology that could allow companies to scale up renewable energy production. So might this conflict prompt European nations like Germany to push for even more investment in energy independence as the troubled wars in Afghanistan and Iraq did for the US? And what could happen to investors in European gas utilities if Russia invades and NATO aggressively sanctions the Russian energy sector. These are questions only time can answer, but I'm going to propose them to you anyway.

Mike Disabato:

There were two winners of the National Football League Super Bowl last Sunday, the Los Angeles Rams and online gambling. Gambling is having a technological renaissance of sorts, due to online sports betting. Traditional casinos, like MGM Resorts, Wynn Resorts, and Penn National all have their own apps, as well as purely online companies like DraftKings and FanDuel. What's interesting about all this, is that professional sports have decided to embrace online gambling. And that's a marked turn from the past where gambling scandals and the possibility of fans losing confidence in the integrity of the game meant leagues would go out of their way to ensure their sports were not linked to gambling at all. But now announcers are talking about online gambling platforms as though they once did hot dogs and hamburgers. That uneasy marriage made me think about how investors are reacting to this growth in online gambling.

Mike Disabato:

You may not know this, but early ESG investing was hinged around value propositions. Unions would screen out companies from their pensions that didn't use union labor or religious organizations would screen out sin stocks of their endowments. Sin stocks, by the way, are shares and companies involved in activities that are considered unethical like tobacco, alcohol, porn, weapons, and of course gambling. I should note that sin stocks are just this evangelical almost term of art that's stuck in the market. We are not God fearing here at ESG Now. We just fear systemic risks.

Mike Disabato:

Anyway, I thought maybe online betting had changed the market idea of gambling as it has changed the sporting community idea of gambling. And we could call this segment, Has Technology Made and Act Safer or is it Still Suspect? Catchy title, I know. To answer that question, I called up my colleague SK Kim, who covers the casinos and gambling industry, and she said, as it pertains to the key ESG risks that these companies face, gambling is still very suspect

SK KIm:

I'm really hesitant to say there are leading online gambling companies because... Especially during the times when pandemic hit, right? And everybody was just had nothing to do, but mobile phones in their hands. The high penetration rate of mobile phones that exacerbating circumstances where gambling problems could become more of a social problems. So, even if the companies do have, say leading practices, meaning up to date technology where are the companies can actually detect the pattern of problem gamblers, and they apply money spending limits or cooling off limits, et cetera, but that doesn't really mean that those companies could be called leading versus others. Because casinos, or gambling in general, the majority of the revenue actually comes from a small portion of customers where they spend a lot of money. It's not like mass gamblers, like myself or you, who are just putting like $10 and you have sufficient control over yourself, but that there are really like less than 1% of the customers that are very problematic.

Mike Disabato:

So, even though there was a record setting number of bets placed on these apps over the weekend, the majority of these companies' revenue still comes from a small, extremely dedicated user base. A dedicated user base in the same way a smoker is a dedicated user of tobacco. The companies have tried to put a bandaid on this by ensuring their apps send out alerts to users that show the hours they have been online and the money they have won or lost in all their bets, but like with traditional casinos, this situation might mean online betting companies are going to face regulatory and reputational risks tied to addictive gambling. Yet there's one competitive benefit, and I guess increased risk that online gambling has, in that it's addictive customers can use the product from the seclusion of their homes. It's basically easier for these individuals to hide.

SK KIm:

Although those companies need to have, so-called, know your cost consumer mechanisms... So they have to identify who the customer is, but even with that, it's not perfect and it's not going to be as easy as what the physical casino's operators could actually do to stop proper and gamble because you don't have to be there in person. So, that's the biggest difference.

Mike Disabato:

Okay, so last thing. What about money laundering? Casinos are great places to launder money. You just take in your illicit cash and exchange it for chips, play a couple games and then cash out and claim the money is gambling winnings. To prevent this from happening casinos must comply with, especially in the US, with the Bank Secrecy Act and governments elsewhere are trying to crack down on the practice. They're doing things like preventing people from spending too much money in their casinos, like China did in 2014, but the act of laundering still regularly happens. What about online gambling? Is it more or less challenging to prevent money laundering from happening via online betting?

SK KIm:

Probably more challenging because the avenue for transaction could be credit cards, it could be cryptocurrency. So, those new ways of currency, for example, if I could put it that way, it's going to be a kind risk that online gamblers are facing.

Mike Disabato:

The growth in online gambling seems to have the makings of a reputational and regulatory firestorm, and we can see that firestorm already building in a region that has had online gambling for a lot longer than the US. Europe has had online gambling for some time. And one of its regional hubs is starting to show what can happen when vast sums of money are moved around without proper regulation. Malta has emerged as the undisputed capital of online gambling in Europe after the Archipelago offered a slue of agreeable tax rules and obliging regulators. You can think of what Ireland did for the tech industry after it gave it a lot of tax breaks. Malta houses a lot of the online gambling industry's headquarters as well. That's another similarity it has to Ireland. But now, Malta is the target of an international money laundering crackdown after the Financial Action Task Force said it can't be confident that basic financial safeguards are in place. Which means, regulators might step in to ensure the island's gambling industry doesn't fail.

Mike Disabato:

In the US, as the industry continues to grow and the novelty wears off, the real risk to watch out for is if online sports betting will have its tobacco moment. When consumer lawsuits and investigations show that there are more people hooked on gambling than ever before, and it's causing serious harm. As tobacco had a problem with proliferation, so too it seems, the online gambling industry might be dealing with a similar problem. Irrespective of all that though, and going back to the question that we posed at the beginning of this story, it seems that the industry remains where it has always been, a pleasure one is willing to sin for.

Mike Disabato:

And that's it for the week. I want to thank Elchin and SK for joining me to discuss the news with an ESG twist. I want to thank you so much for listening. I really appreciate it. If you like what you heard, don't forget to rate and review us. That always helps. And if you want to have a new episode in your podcast box every week, subscribe, and it'll be sent to you. Thanks as always and talk to you soon.

Speaker 4:

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