

# How will you buy this autumn?

Gary Worby at EnergyQuote looks at the many influences on energy buyers as the traditional buying season fast approaches and suggests some alternatives to the traditional purchasing techniques and methods

Anyone renewing their gas and electricity contracts probably has a whole list of questions that need answering following the rising volatility seen in the commodity markets over the past couple of years.

Commodity prices are characterised by the fundamental supply and demand shifts on a daily and seasonal basis that are driven by random weather and climatic variations such as climate change that is leading to scorching summers and milder winters thus shifting the long-established demand patterns.

Of late, carbon is becoming an increasingly important driver of electricity prices and is attracting large volume of trading in the past few seasons. Coal is about to get an international commodity status that may potentially mean a more volatile price regime for coal as well, which has been hitherto the least volatile of all commodities. While price changes of the input commodities oil, coal and carbon have a knock-on impact on gas and electricity prices, the impact of inherent supply and demand fundamentals like Langede, LNG, LCPD Directive etc also have a bearing on the volatility and direction of prices.

## Volatile price environment

So what should you be your buying strategy in a volatile price environment and how should you be handling the volatility and price risk in an optimal way?

The buying strategy employed will largely depend on the risk culture of the organisation. A risk averse company will usually find comfort with a fixed price approach, while companies with a greater appetite for risk, and the larger rewards that can be accrued, may take a more flexible approach to buying. The success of this flexible approach will be based on



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the ability to forecast price movements and buy (and sell) accordingly to maximise value.

Around 85 per cent of the industrial and commercial market renew annual electricity contracts for either an October or a November start date. As such there is greatest buying demand in this two-month time window, which can lead to appreciable market upside as October and November contract renewals approach. So come October, the prices being quoted will not necessarily represent a fair valuation of the underlying costs and fundamentals. If this is the case, why do so many customers find themselves trying to renew annual contracts during the months of July, August and September?

There are alternative times to buy annual contracts. Companies can lock in contracts now before prices start to rise or can even negotiate an extension of the existing contract. The contract decisions taken will be guided by the risk-reward approach of the company. For example, a company may decide to lock in a supply deal for two or three years, rather than review on an annual basis, but the risk here is that the company will

miss an opportunity if contract prices fall over the maturity of the two/three year contract.

## Risk brings reward?

The conventional rule within risk management is that taking on market risk brings with it the possibility of reward. Taking on specific risk will not be rewarded as specific risk can be diversified away, and the market does not reward unnecessary risks. In the energy markets over the last few years there has been little ability to manage away the market risk, due to its volatile and unpredictable nature, but we have developed alternatives to the traditional fixed and flexible approaches to energy procurement.

The Guaranteed Fund was launched in 2006 and can be regarded as a sort of hybrid between a fixed and a flexible contract: It is a product which allows you to eliminate the risk of securing your entire power requirement at the height of the market, whilst ensuring that complete budgetary certainty operates from contract start to contract end.

The Guarantee Fund spreads the risk of making a poor purchasing

decision from a timing perspective. (In the financial markets few fund managers try and gamble on the timing of a purchase - this is too risky; rather they will buy multiple products, instruments and investments to ensure that specific risk is avoided and the position is hedged.) The guaranteed fund is based upon two key objectives; firstly to ensure budgetary certainty, prior to the start of an annual contract, and secondly to hedge against the specific risk of buying against the height of the market. In effect it guarantees the buyer that they will get average or better than average pricing. EnergyQuote's Guaranteed Fund customers have been delighted with the results that our Trading desk has achieved.

Changing the way your business purchases its energy is not a decision that should be taken lightly. However, it is sometimes necessary to move away from the traditional approach for a myriad of factors; whether it is to gain a competitive edge or to purchase in line with a new corporate policy.

We understand that every business has its own attitude and appetite for risk when procuring energy, which is why our 'Funds' offer varying degrees of flexibility and can be tailored to your own individual requirements. 'Fund' members immediately benefit from increased economies of scale as physical volume constraints are removed which allows smaller energy users to access buying methods normally reserved for organisations typically spending in excess of £5m on energy per annum. The benefit of these more efficient and flexible methods is access to better pricing and improved risk management. ■

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