Flexible Energy Procurement

A quick guide to the flexible procurement of gas and electricity and what it could mean for your energy spend.

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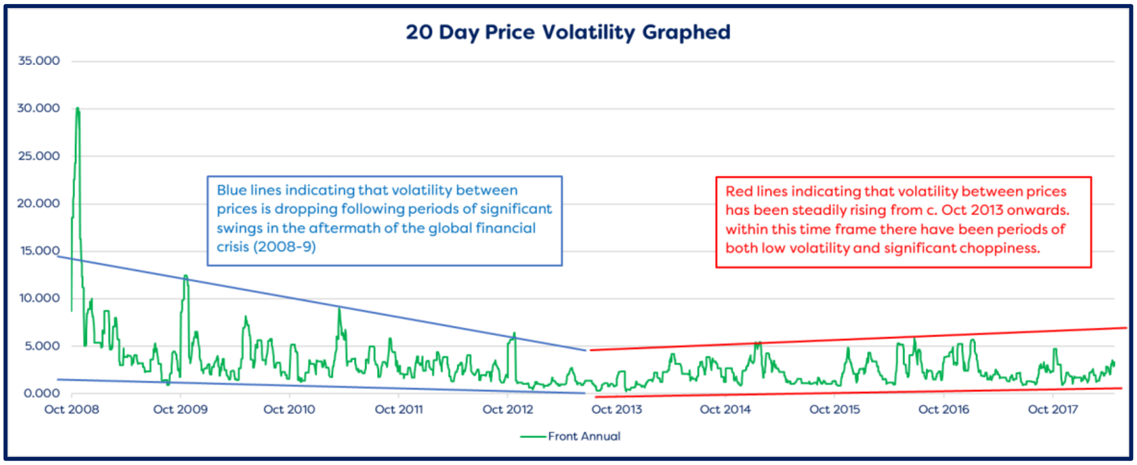
What is Flexible Purchasing?

An Introduction

As the below graph shows, fundamental changes to the way the UK sources its electricity, as well as increased market entrants and more unpredictable macro-economic indication, have seen volatility in energy markets progressively increase over the last five to six years or so.



While this provides greater levels of risk and budget uncertainty for business energy consumers who take consecutive short term fixed contracts, a greater product offering from energy suppliers and consultants alike, has ensured a far greater level of opportunity available to businesses in the market.

Opportunity in markets

In an increasingly competitive and maturing market, suppliers and consultants alike are increasing their product offerings, aiming to differentiate themselves from competitors. Initially flexible contracts were introduced, allowing clients to buy and sell gas and electricity. These contracts aim to spread the risk of your energy purchasing as well as aiming to better your billed energy rate. Over time this form of contract has opened itself up to a greater number of business energy consumers as suppliers begin to accept customers with smaller volumes on this type of contract in an increasingly flexible market place.

Trading Energy

In essence, the energy component of your bill can be traded as a commodity in short, mid or long-term periods. This enables businesses to adopt long-term purchasing strategies and time horizons when looking at their energy spend.

Indeed, while the work surrounding a fixed contract is generally complete following the completion of the tendering process, for a flexible purchasing contract the job has only just begun. With this in mind, a number of variables and details need to be considered when entering such a contract.

Parameters such as **budgets, hedged positions, frequency of purchasing, volumes to be locked and overall risk management strategies** (in line with the risk appetite of your business) all need to be considered. Hence, with so many variables to consider, choosing the right supplier, information sources and consultant are essential to ensure that your business pursues the most appropriate procurement strategy.

This quick guide will give you a taste of the procedures and models we put in place to ensure that all of these requirements are met, from agreed risk management stipulations to our sophisticated trading models.

At Brownlow Utilities we have been consistently expanding and refining the flexible purchasing arm of the business from our inception in 2013, aiming to provide a market-leading product offering to businesses in both the UK and Ireland. We hope this document is of interest to both yourself and your business and should you require any further information then please don't hesitate to get in touch with our flexible purchasing team at: flexibles@brownlowutilities.co.uk (Tel: (+44) 1695 663 997)

The Difference between Fixed and Flex

Fixed Energy Procurement

A fixed price contract allows your business to agree a set price or all-inclusive rate for its gas and electricity on the day the contract is signed. This agreed fixed price lasts for duration of the contract which typically runs for roughly 12 to 24-month periods and occasionally up to 36 months.

> One of the huge selling points of a fixed price energy contract is that businesses have relatively secure **budget certainty** and very high levels of **predictability** for their forecasted energy spend for the contract duration. However, this is only providing that their actual energy consumption remains within the predefined contract tolerance levels.

While the notion of budget certainty has its benefits for your business and its energy spend, it certainly has inherent limitations. Perhaps one of the most obvious benefits of fixed energy contracts is the protection you receive from potential future price increases. In this instance, should you expect energy prices to rise in the future, and you fix your contract at a market low point, you will protect your business from the risk of rising tariffs.

Conversely, however, a fixed contract leaves you with the inability to take advantage of potentially beneficial, falling market movements. Should you fix your energy spend at £50/MWh and prices later fall to £35/MWh, you will not be able to track this price movement downwards and reap the benefits of a considerable price drop.

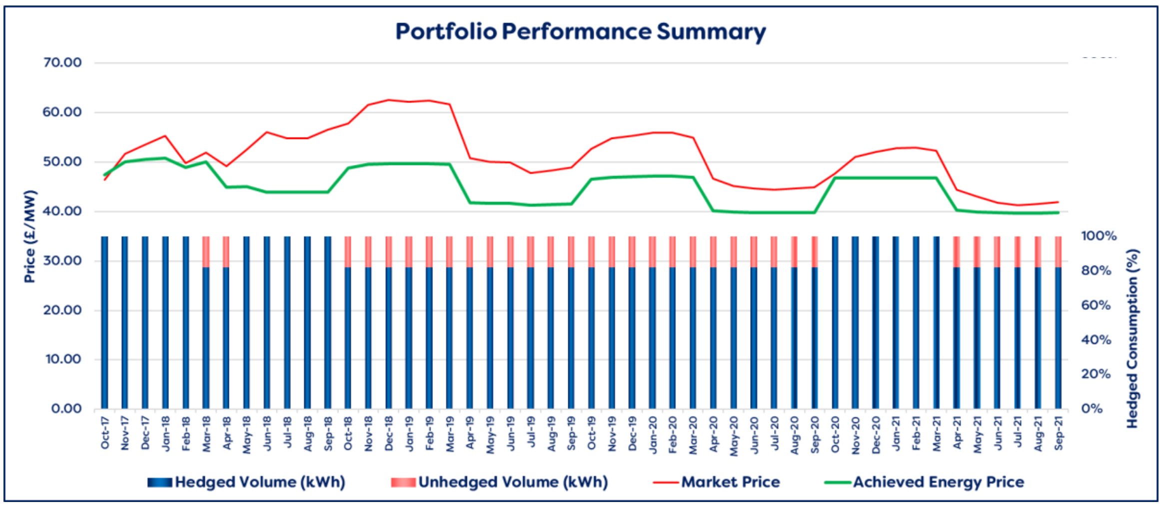
Ultimately, if your business is **risk averse** with **predictable energy consumption** patterns and **budget certainty requirements** over a contracted period, then **a fixed energy contract is right for you**.

Please note, however, that in order to assure this budget certainty, energy suppliers are estimating against unforeseen price fluctuations and estimating unpublished non-commodity costs for your contract period. Hence, you must pay an inescapable price premium when agreeing a long-term fixed contract.

Flexible Energy Procurement

Should your business wish to optimize their energy spend and consumption, then a flexible purchasing arrangement is the type of contract for you!

In volatile energy markets, prices can rise and fall unpredictability. Hence, if managed correctly, a flexible procurement contract or arrangement offers you a great level of freedom and control, where fixed procurement does not, and allows you to optimize your energy spend in a dynamic fashion. Taking a longer-term outlook on your energy spend, as the graph below evidences, can help you **curb the impact of unforeseen year-on-year increases** and help you achieve long term **competitive energy rates** by fixing and unfixing *tranches* of energy progressively.



In this sense, flexible energy procurement is suitable (though not limited to) businesses with larger energy consumption requirements or businesses who are placing an increasing level of attention or importance on their energy spend and volume requirements.

In an increasingly competitive market for suppliers, the product offering for flexible procurement contracts between suppliers is increasingly diverse and ever changing. Suppliers' flexible procurement offerings differ drastically in competitivity in terms of cost-effectiveness and qualitative parameters to allow you greater volume or trading flexibility. Hence a thorough and prudent tendering process is essential to find the right supplier for you.

Why is a purchasing or risk management strategy so necessary?

By entering a flexible energy contract, you will have the ability to have full **transparency** over all commodity and non-commodity components that make up your total energy spend. The separation of the commodity and non-commodity costs in a flexible contract gives you the potential to continually trade the commodity itself dynamically throughout the course of your contract, **allowing you to optimize your 'energy-only' rate**. Having the non-commodity costs separated and 'passed-through' ensures that you **minimize the amount of risk margin** placed on them by energy suppliers who would otherwise include this premium in a fully fixed arrangement.

Naturally, there is a higher associated risk inherent in this type of procurement. Hence, it is chiefly used by business energy consumers who either employ dedicated purchasing personnel or a purchasing consultant, responsible for analysing market movements and optimising your purchasing/risk management strategy and the timing of any transactions.

Hence, with such risk in place, it is entirely necessary that businesses wishing to pursue a flexible contract have strong energy purchasing and risk management policies in place that align with the overall risk strategy and direction of your business. It's also fundamental that the right personnel are employed to implement and manage the ongoing processes of any risk management strategy put in place. Without these tools in place, the results of your flexible purchasing arrangement will not meet your requirements.

Before we move onto our suggestions for risk managing your energy spend, and the services we can provide in order to implement such a strategy, consider the advantages and disadvantages of flexibly purchasing energy.

Pros and Cons of Flexible Purchasing

The Pros

- **Complete price transparency...**
  Complete transparency over the components that make up your energy bill allows you to clearly separate your commodity and non-commodity cost elements and, through a rigorous supplier tendering process, allows you to minimize the energy suppliers risk margin.

- **Focuses purchasing on underlying energy component...**
  Purchasing is focused on the only cost element you can feasibly alter: the commodity. This rate is a direct calculation of your purchasing performance throughout the course of your contract.

- **No volume limitations...**
  The ability to continually reforecast your forward consumption both upwards and downwards throughout your contract gives you flexibility to purchase acutely in line with the plans of your business.

- **Reduces risk of contracting at market peak...**
  Upon lock-in of your contract no prices have been secured. Throughout the course of your contract, the purchasing and selling of energy provides the basis of your energy-only unit rate.

- **Spreads the purchasing risk...**
  Removes the 1 in 365 days gamble to fix all of your energy costs. The risk is spread across a number of purchasing decisions made throughout the duration of your contract.

- **Access to real-time market opportunities...**
  Gives you the ability to purchase energy in a more sophisticated fashion, buying or selling in line with market movements for your own benefit. This access, in line with a pre-set purchasing strategy lets you take advantage of market falls while also providing you with substantial protection should prices rise.

The Cons

- **Knowledge and expertise are required...**
  The process of purchasing energy and managing your positions to a pre-set risk management structure is complex and such decisions need to be managed correctly and carefully. Receiving the correct information and ensuring the right people are managing your purchasing is a necessity.

- **100% budget security cannot be guaranteed...**
  With no rates secured upon the lock-in of your contract, you are initially fully exposed to market movements. Unless you set parameters for risk managing your portfolio this exposure will persist.

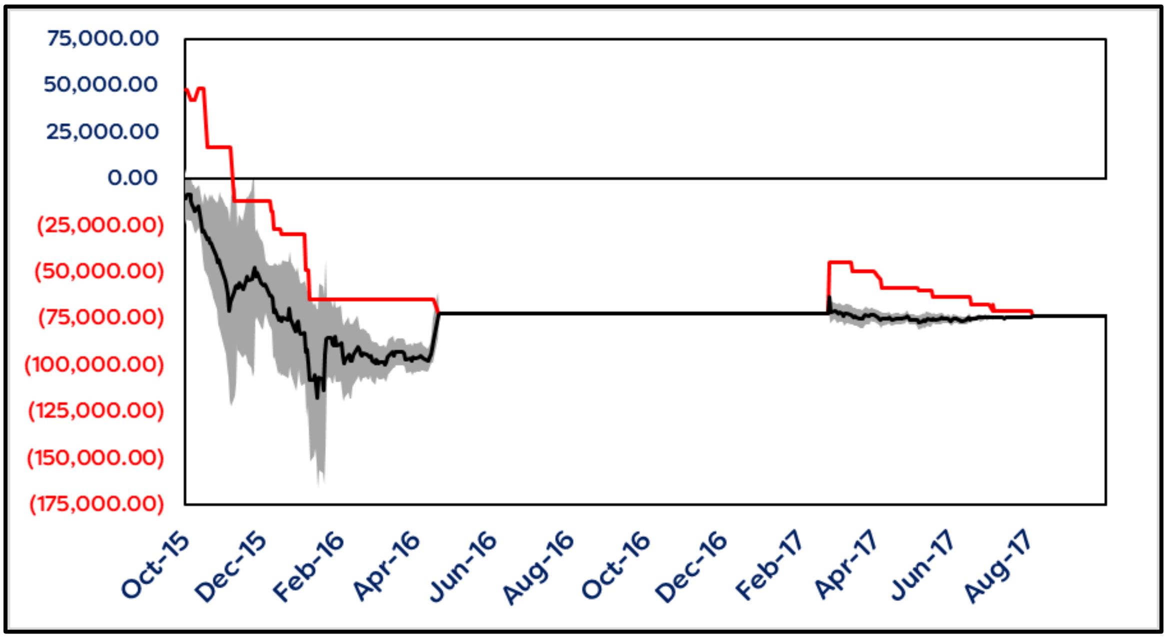
- **Ridged policy required in a rising market**
  Should prices continually increase from the inception of your contract, only a ridged purchasing policy, with a very low risk appetite protects your portfolio from increases.

- **Increased maintenance...**
  Contracting in such a way does require regular maintenance in terms of analysing and managing your purchasing and your actual consumption. Ensuring the right personnel are managing your flexible procurement arrangement is an essential if you wish to negate the amount of maintenance required.

Our Model

‘Value at Risk’

Our Value at Risk model works alongside your flexible purchasing contract, ensuring the security and protection of your portfolio spend. We track your position’s movement and place a “Capital at Risk” line above it. This Capital at Risk line represents the amount of risk that you are prepared to authorise to give your company the opportunity to benefit from falling prices.



A tight Capital at Risk line means that we’ll be more responsive to upward price movements and will lock out positions should your positions move up towards this line.

However, in doing so, we may be overly responsive and miss the opportunity to take advantage of downward price movements that may have immediately followed. A higher Capital at Risk line would allow us to track upward movements but to not be overly responsive to them, allowing us to take advantage of future downward movements.

How we would implement 'VaR'

The sophisticated systems that we have in place to support our 'Value at Risk' model provide us with the tools to help our decision-making processes.

Our live Market Feeds allow us to tap into fundamental news and market movements to ensure that your position is always up to date to the second. We also build our technical analysis models and triggers around these prices. This provides us with a sophisticated triggers system, using technical analysis indicators to ascertain changing trends in markets and alerting us to the onset of a potential opportunity. We also capture elements of Brownian Motion and Monte Carlo simulation to aid our calculation of the volatility present in each market.

Ultimately, we recognize that it is of vital importance that the businesses' whose purchasing we manage, understand the risks of entering a flexible contract. Hence, we bespoke each flexible arrangement to each businesses' risk management requirements, volume requirements and purchasing requirements, managing their positions accordingly. Typically, implementing such a contract allows you to take a 3-4 year time horizon on your energy spend and we would recommend contracting for such a period to ensure that your long-term positions are managed effectively.

Market conditions alter on a daily basis and as such we would be in touch with yourselves to update you on any drastic changes. We would report to you on a daily basis with a client specific position report and daily market commentary. We would also hold monthly risk management conference calls with yourself to ensure that you're fully updated on the progression of energy portfolio spend, of any potential opportunities and to update ourselves on any updates to your risk management parameters.

Introducing Brownlow Utilities...

An awarding winning business...

Brownlow Utilities Ltd. are an award-winning energy consultancy, specializing in all manner of energy services, from procurement and purchasing to site services and carbon compliance. We're built on values of honesty, transparency and fairness, ensuring that our own services go the extra mile for customers. We were formed in 2013 and from humble beginnings we've since grown into a nationally recognized business, still managing to maintain our local feel and the levels of service, care and attention that we feel our clients deserve.

A one-stop shop...

For prospective and existing customers, our aim is to make you competitive, compliant and efficient as far as your energy and utilities are concerned. Our approach is to do this with clarity, honesty and experience.

Our team has centuries of combined experience in energy contract negotiation and utility management and we aim to be a one-stop-shop for all of your business energy needs. To find out more about the plethora of services that we as a consultancy provide, visit www.brownlowutilities.co.uk

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We hope you've enjoyed this document and have found it useful. Should you wish to do so, please feel free to share this guide with friends, co-workers and anyone who may find it of interest. We hope to hear from you soon!