MAVERICK ENERGY CONSULTING:

NATURAL GAS, DIESEL, UNLEADED GASOLINE & ELECTRICITY

MAVERICK ENERGY

PRINCIPLES OF **PRICE RISK MANAGEMENT:**

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PRINCIPLES OF PRICE RISK MANAGEMENT:

Once a customer determines their purchasing objective and establishes their risk tolerance parameters, it is time to consider how to execute the plan. Below is a brief description of five strategies for making your procurement plan a success.

CAN YOU RISK BEING COMPLETELY MARKET SENSITI VE?

Customers' energy budgets can get lost in a tangle of missed price opportunities and excess time spent managing a month-by-month purchasing program. At risk is the customer's bottom line and ability to predict costs and project profits.

If you are an industrial or commercial end-user, your business is not speculating on energy prices. Rather, your business is buying energy at an efficient cost and operating your facility at a profit that gives you an acceptable return for your company. As an outspoken advocate of hedging energy purchases, I often ask myself if it makes sense for a company to hedge. For example, I like to use the analogy of buying fire insurance to a company's decision to hedge. Clearly, a company would want to buy fire insurance because the risk of losing one or all of its assets to fire is a risk that is too high to take. Similarly, a company's risk of loss from volatile price changes is just as great and therefore, one should view hedging as a means of buying price insurance.

CAN YOU RISK BEING COMPLETELY MARKET SENSITIVE?

I believe if you are not hedging you are speculating on the price of energy. A company's ability to speculate depends not only on how diversified its risk is, but how much it has to lose. Can you risk being completely market sensitive? How exposed can you be when you have a budget to meet?

NOT HEDGING CAN BE A MANAGEMENT DISTRACTION.

Finally, a company's decision not to hedge can actually be a management distraction. Locking in prices allows management to focus on things they can do something about --like selling their product versus focusing on something they have no control—like energy prices. The energy industry offers customers sufficient tools, knowledge and information to assist customers in developing a variety of price risk management plans to help them save their budget from volatility and avoid the hazards of confusing price swings.

WHAT DRIVES YOUR BUYING STRATEGY?

Although market opinions and price projections are valuable tools, having that knowledge does not negate the risk of price volatility. Depending on your objectives and tolerance for risk I encourage customers to prepare themselves by developing a purchasing plan that makes sense for their business.

Speculator	*Speculator*
• **Float with index** • Variation in cost from month to month is not relevant to business/budget • No need for an energy plan	• **Short-term perspective** • **Try to anticipate price directions in order to "beat the market"** • Base decisions on technical/fundamental analysis. • Continually monitor the market • Mixed portfolio
Hedger	*Hedger*
• **Long-term fixed price** • Plan based on ability to manage budget without exposure to risk	• **Insure against volatility in order to meet/beat budget** • **Long & short-term hedges** • Base decisions on technical/fundamental analysis • Continually monitor the market • Mixed portfolio

X – Axis = Proactivity (How involved in making purchase decisions)
Y – Axis = Risk Tolerance

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