

Electricity Hedging



A COST EFFECTIVE APPROACH TO MANAGING YOUR ELECTRICITY

HEDGING YOUR ELECTRICITY PRICE RISK

Electricity hedge products allow you to manage the risk associated with purchasing electricity off the spot (wholesale) market.

Hedge contracts can shield your expected electricity costs from unpredictable shifts in the spot market.

BENEFITS

- Cash flow and budget are protected from market volatility through either a fixed price or shared exposure to price risk.
- Typically lower unit pricing compared to standard electricity supply contracts.
- Protection against spot-price volatility.
- Optimise your electricity purchasing by tailoring your hedge to your electricity usage profile.
- Reduce exposure to potentially unfavourable renewal prices by staggering your contract renewal dates.
- Maximise gains if you can reduce your electricity consumption at times of high spot pricing.
- The opportunity to purchase additional Swap contracts to better manage your electricity price risk.
- Service support with a dedicated Account Manager.
- Online spot prices at your fingertips at www.mercury.co.nz.
- Email and SMS text message price alerts when prices exceed your predetermined levels.
- Transparent charging.

SWAP CONTRACTS

A Swap contract is a type of hedge that allows you to effectively manage your electricity price risk.

Hedge arrangements, such as Swaps (also known as a Contract for Differences) provide price certainty and introduce real product flexibility to better control what you will pay for your electricity.

The Mercury Energy Swap is a purely financial agreement, settled on a monthly basis. This is distinct from your physical procurement of electricity that, while under a Swap agreement, is purchased at the spot rate as set by the market.

HOW SWAPS WORK

The Swap essentially delivers a fixed price (the 'strike price') against a predetermined quantity or load. This arrangement differs from traditional contracts in that both the price and quantity are fixed.

The Mercury Energy Swap is based on a pre-determined strike price for a fixed quantity of energy.

If the average spot price for the month exceeds the agreed upon strike price then Mercury Energy will pay you for the difference. Likewise, if the average spot price is lower than your strike price, then you are required to pay Mercury Energy for the difference.

Hence, even though you purchase the physical electricity at volatile spot prices, your electricity costs for your agreed load ultimately remain fixed.

COMPETITIVE PRICING

The Swap prices ('strike prices') that we offer will be based on Mercury Energy's current expectation of electricity prices in the future.

As an electricity retailer we are exposed to the volatility of the wholesale electricity market. When you enter a Swap arrangement with us you are agreeing to share price risk exposure.

If we can accurately predict how much electricity you will buy (such as specified in a Swap) we can reduce our exposure to market price volatility, and so offer competitive pricing for this type of hedge contract.

For an explanation of how the wholesale electricity market works and price volatility, see our NZ Electricity Market brochure or visit the large business section of our website www.mercury.co.nz

SELECTING YOUR SWAP VOLUME

The Swap volume you agree with us determines your level of exposure to the price volatility of the spot market.

Electricity Swap volumes can be purchased in two ways: as either base load or customised (customer specific) Swaps.

Base load is a measure of constant usage over time. Swaps of this nature are priced lower than sculpted Swaps due to our ability to manage the price risk associated with that agreement.

A customised hedge ('sculpted hedge') volume is a reflection of how a business actually expects to use its electricity over a given period of time – your load profile.

Your expected electricity usage can be calculated based on your historical usage patterns as well as your own business knowledge. Our Account Managers can help you calculate your Swap volume, or you can seek advice from an independent consultant.

COLLECTING YOUR TOTAL CHARGE

From the date your Electricity Swap agreement commences you will purchase all the electricity you need on the spot market at spot market prices. Purchase of your electricity on the spot market can be through Mercury Energy or any other electricity retailer.

For each month of your Swap agreement we calculate your 'hedge charge'. This is your Swap volume, charged at the difference between your strike price and the spot price. That is why it's sometimes called a "Contract for Differences".

If we supply both your physical supply and Swap contract and the spot price is lower than the strike price, we'll simply add the hedge charge to the spot charge to get your total energy

charge. If the spot price is higher than the strike price, we'll deduct the hedge charge from the spot charge.

The table below shows four basic Swap scenarios where actual usage is over or under the Swap volume, along with the effect of a fluctuating spot price. The Electricity Swap contract in this example is for 1,000 kWh at 5 cents per kWh.

ELIGIBILITY

To be eligible for the benefits of a Swap contract you must have your electricity consumption measured using half hourly meters with an overall consumption of over 10GWh per year.

WHAT TO DO NEXT

If you think that a Swap contract may be suitable for your business, then contact us on 0800 490 010. Our Account Managers can discuss with you how hedge arrangements such as Swaps can work best for you and organise a quote based on your business requirements.

Swap Volume	Spot Price	Example	Settlement
More than consumed	Above strike price	Spot price = 10 cents Volume consumed = 900 kWh Spot 900 x 10 cents = 90 Hedge 1,000 x (5 cents - 10 cents) = (50) Total Electricity charge \$40 Average price \$0.0444 cents/kWh	Strike price = 5 cents Swap volume = 1,000kWh <u>Mercury Energy pays</u> the customer on the Swap settlement
	Below strike price	Spot price = 3 cents Volume consumed = 900 kWh Spot 900 x 3 cents = 27 Hedge 1,000 x (5 cents - 3 cents) = (20) Total Electricity charge \$47 Average price \$0.0522 cents/kWh	Strike price = 5 cents Swap volume = 1,000kWh <u>The customer pays</u> Mercury Energy on the Swap settlement
Less than consumed	Above strike price	Spot price = 10 cents Volume consumed = 1,100 kWh Spot 1,100 x 10 cents = 110 Hedge 1,000 x (5 cents - 10 cents) = (50) Total Electricity charge \$60 Average price \$0.0545 cents/kWh	Strike price = 5 cents Swap volume = 1,000kWh <u>Mercury Energy pays</u> the customer on the Swap settlement
	Below strike price	Spot price = 3 cents Volume consumed = 1,100 kWh Spot 1,100 x 3 cents = 33 Hedge 1,000 x (5 cents - 3 cents) = (20) Total Electricity charge \$53 Average price \$0.0482 cents/kWh	Strike price = 5 cents Swap volume = 1,000kWh <u>The customer pays</u> Mercury Energy on the Swap settlement

Table 1 Swap scenarios

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Mercury Energy