Outline

- Purchasing Structures
- Timing
- Changes in the Market
- Questions
Structures

Purchasing goals

- Want the best Price
  - To move down w/the market
  - Be capped when the market moves up
- Budget certainty or at least manageable risk
- Spectrum of Choices
  - Low control to very high
  - Start with the extremes
Structures

- **Fixed Price**
  - Easy to compare
  - Budget certainty
  - Needs to be timed right – no market movement

- **Index Price**
  - Cash Market Hub Pricing
  - Avg. of actual deals reported
  - Subject to some criminal prosecutions lately
  - No direct locking mechanism prior to delivery month
  - Big lack of budget certainty
Structures

- Caps
  - Index price with a max limit
  - Usually costs customer
  - Cap level determines cost
    - Higher the cap, lower the cost
  - Purchasing insurance
    - Supplier is purchasing call options
Structures

- Collars
  - Index price with Max and Min limits
  - Sometimes costless – value in the min.
  - Max and Min dictate the cost
  - Good if you think cash is going down
  - Other flavors available
    - Collar with a re-opener if certain high or low levels are met.
Structures

- **Basis Differentials**
  - Differential between NYMEX & delivery point.
  - Dependent on term and volumes per month
    - Different basis for different months
  - Changes day to day
    - not typically minute to minute
  - Can be positive or negative
  - Prices high = Basis Bigger
  - Prices low = Basis tighter

<table>
<thead>
<tr>
<th>Location</th>
<th>Basis on 2/20</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNG (south)</td>
<td>$(0.031)</td>
</tr>
<tr>
<td>Columbia Gas</td>
<td>$(0.064)</td>
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<tr>
<td>Iroquois - Waddington</td>
<td>$0.249</td>
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<tr>
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<td>$0.621</td>
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Structures

- Basis locked with supplier for volume and time period
- Prices not locked until locked by customer
- Price locks are directly off NYMEX pricing
- Typically locked by contacting supplier
- Things to watch out for:
  - How you lock in price with supplier
  - Volume increments you have to lock
Timing Issues

Good Timing
Timing Issues

- There is more to it than just “What Day”
  - When during the day?
  - Supplier responsiveness
Timing Issues

- Time Period Hedged
  - Managing risk how far out?
  - Within the current budget cycle or beyond?
- Need to be able to access the next budget cycle
  - Start locking at least 6 months before you get there if possible
- When was the basis locked?
Timing Issues

- Basis changes with time and time period:

### Basis Differentials - Spot Points vs. NYMEX Futures

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Timing Issues

- Henry Hub to Houston Ship Channel Basis:

![Graph showing the Henry Hub to Houston Ship Channel Basis spread over time from October 8, 2005, to February 8, 2007. The graph indicates fluctuations in the basis spread, with periods of higher and lower values.](image-url)
### Timing Issues

- Good Basis hedge can make up for missing low prices.
- Basis typically more advantageous when prices are higher on NYMEX

#### Basis Differentials - Spot Points vs. NYMEX Futures

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Timing Issues

- Locking months in advance determines risk management effectiveness.
- Locking in increments over time allows you to balance budget certainty or pursuit.
  - Supplier flexibility should be accounted for in awarding contracts.
- Risk Management is the key!!! Not getting the lowest price.
- Not just about physical supply – get technical information.
Other items:

- NYMEX not trading 24 hr/day
  - Electronic Trading
  - Sunday Evening through Friday afternoon
- NYMEX pit trading now starts at 9:00 a.m. Eastern time (was 10:00 a.m.)
- Other trading platforms offering NYMEX equivalent
  - Intercontinental Exchange (Ice)
- Who does your supplier use?
  - When making a lock, which screen should you be watching?
QUESTIONS???