



FUEL HEDGING 101

HOW TO CONTROL YOUR FUEL COSTS

What is Fuel Hedging?

Fuel Hedging or Fuel Risk Management is a strategy some companies use to reduce or eliminate their exposure to volatile and potentially rising fuel costs. It is a contractual tool that allows a company to fix or cap a fuel price at a certain level and for a specific period of time. Hedging can be utilized for a variety of fuel types – diesel, gasoline, jet fuel or any other refined product.



Reasons for Fuel Hedging

For companies whose fuel expenses represent a large fraction of their operational costs, fuel hedging can provide protection from unexpected changes in the price of fuel that could have a serious impact on your budget and your profit margins. By fixing your fuel costs, you can offset the risk of unstable fuel prices and eliminate budget overruns caused by an unpredictable and volatile oil market.

Mitigating exposure to market volatility offers a competitive advantage by providing budget protection, improving cash flow, and increasing price stability.

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How Fuel Hedging Works

A fuel buyer establishes a market position by purchasing a futures contract - a standardized contract between two parties to buy or sell a specific commodity for a quantity and price agreed upon at the time of the transaction, with delivery and payment occurring at a specified date in the future. The consumer is obligated to buy the commodity at the contracted price for that time period. Similarly, the provider is obligated to sell the commodity at that price.

Utilizing Hedging to Minimize Your Exposure to Rising Fuel Prices

Let's assume that you own a trucking company, with a variety of rig sizes, eighteen-wheelers, wreckers, and other heavy equipment, all with diesel engines. To ensure that your fuel costs do not exceed your budgeted fuel price, you have been asked to "fix" or "lock in" the price of your anticipated fuel consumption. Here is an example of how hedging on diesel fuel might work for your company.



Example:

Diesel fuel is currently priced at an average of \$1.50 per gallon. In order to complete a customer contract and fuel all the required equipment for the job on time and within budget, you cannot afford to pay any more than the average price of \$1.50 per gallon within the current month.

You enter into a fixed price agreement with a counter party, such as a hedging firm, for diesel fuel for that month, locking in your rate at the current \$1.50 per gallon. You continue to buy fuel as needed, at whatever price it's currently being sold, for the length of the agreement.

By the end of the month, the price of fuel has spiked once again and has risen to \$1.85 per gallon. Your company bought a total of 10,000 gallons of fuel at that price. The counter party now owes you the \$0.35 per gallon difference for those 10,000 gallons, or \$3,500, meaning that your cost for diesel for the month remains locked at \$1.50.

On the other hand, if the price of diesel had gone down, and the \$1.50 per gallon price dropped to \$1.15 by the end of the month, you paid the counter party that same \$3,500 to maintain the locked in price of \$1.50 per gallon. However, you have maintained your budgeted cost for the month, which was your ultimate goal.



Benefits of Having a Fixed Priced Program in Place

You have to weigh risk against reward. You may save money, but it can also cost you. You may miss the lowest fuel prices, but in the same regard, you may avoid any upward swing that fuel prices may take. That is the risk you take with fuel hedging. But, to have no contract in place has its own risks, since fuel prices are subject to, and often do, change overnight.

In the previous scenario, in order to stay within your budget, your company is unable to afford more than the current \$1.50 per gallon for diesel fuel. Without that \$3,500 reimbursement, your budget is overdrawn, leaving your company and shareholders “in the red.” These consequences could have been avoided by having a fixed price contract in place.

You may be disappointed if prices fluctuate downward rather than upward; however, you have not lost. Instead, the budgeted \$1.50 per gallon of fuel for the month was met. Your overhead cost remains within budget limits, and your company remains in the black. In this case, the stability is worth missing out on the extra savings.

With the unpredictability of fuel prices, a company or fleet manager is able to remain comfortable, because of the guarantee that comes with utilizing hedging as a risk management tool. And, once the hedging contract period has ended, you are free to take advantage of the lower prices.

When making hedging decisions, it is important to remember that hedging should not be viewed as a tool to make money but, rather, a tool to help reduce risks and alleviate the stress that comes with trying to gauge fuel prices. In addition, fuel hedging allows a fleet manager to do his job – that is, manage his fleet.

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Who Is Fuel Hedging Best Suited For?

When fuel prices were at their highest, companies found themselves having to implement fuel cost reduction programs to combat price instability, including downsizing to four-cylinder vehicles, restricting personal use of company vehicles and holding online meetings instead of traveling off-site. These are all helpful solutions, but the price volatility of fuel cannot be ignored. The efficiency of your company should not rely on world events, natural disasters or other factors that affect the price of oil.

For companies that prefer to prepare for the unknown and budget accordingly, fuel hedging is a good option. Having a set fuel price, immune to market fluctuations, can have a positive effect on things such as keeping equipment in service, reducing layoffs, and the realization of profit for owners and shareholders.

Even if you have a small fleet, there are an array of hedging options available to you. You don't have to be using a vast amount of fuel on a monthly basis to take advantage of a hedging strategy.

In the end, you need to weigh all major factors – fleet size, tolerance to fluctuating oil prices, your organization's current and future financial goals – when deciding if fuel hedging is the right fit for your fleet. And, don't try to do it alone. Let the experts help you take control of your energy expenses for months or years to come.

Why Have a Fuel Risk Manager?

Proper development and implementation is vital to the creation of a successful and ongoing energy management solution to help lower overall energy costs over time and offer greater control over your operating budgets.

A Fuel Risk Manager can help you prepare a plan, outlining strategies for managing your fuel needs more effectively. Look for a risk management company with proven market experience and one with knowledge of the physical energy markets, as well as an awareness of products offered by financial institutions or energy commodity exchanges.

An experienced Fuel Risk Manager will conduct a comprehensive analysis of your current energy needs, and develop a proactive strategy for budget protection that offers flexible and customized risk management strategies and solutions. In addition, they will continuously evaluate your situation, especially as new hedging opportunities emerge, and anticipate your company's changing needs.

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About PS Energy

We are a wholesale marketer of bulk transportation fuels for utility, retail, and government. We offer a comprehensive and reliable fuel-management program to control costs, improve efficiencies, and keep fleets running.

