

## Overview

Ofgem produces a rolling average net margin on supplying a typical, standard tariff, dual fuel customer<sup>1</sup>. This is an average of the net margin data for the previous six months, the current month, and the next six months<sup>2</sup>. We also produce a snapshot estimate of the net margin on supplying a typical, standard tariff customer for the next 12 months.

Our latest calculations show that the rolling average net margin for a typical, standard tariff, dual fuel customer is approximately £50. This is £5 higher than last week's estimate. As the estimate is calculated from the current, past and future snapshot margins, the rolling average net margin includes the impact of the SSE price increase, as well as future rises in bills announced by British Gas, Npower, Scottish Power and the most recent announcement from EDF.

Our estimates also show that for the forward looking 12 month period from October 2012, up to and including September 2013, the total indicative net margin for a typical, standard tariff, dual fuel customer will be approximately £35 per customer.

We expect this snapshot margin to rise to around £95 over the next three months. This is largely a result of a change to the future retail bill, reflecting the effect of the price rises highlighted above. However, there are many uncertainties, not least continued changes in wholesale and retail prices, which could affect this figure.

The SMI uses an 18 month hedging strategy to estimate supplier wholesale costs. However, we recognise that suppliers may hedge over different periods of time. These hedging periods will have an effect on the costs that suppliers incur. For example, we estimate that using a 12 month hedging strategy, wholesale costs would fall by £15 and the indicative margin would be £50 (compared to the October snapshot of £35). Using a 24 month hedging strategy, wholesale costs would rise by £5 and the indicative margin would be £30. This is unchanged from last week's estimates.

We have also assumed that the current average annual bill of a 'Big Six' standard tariff, dual fuel customer has remained the same as our previous estimate of £1,335 per year.

Our approach is to update cost estimates where appropriate and previous update assumptions are listed at the end of the report.<sup>3</sup>

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<sup>1</sup> This estimate is one indicator of supplier margin, however there are others. For example, Ofgem requires the large, vertically integrated suppliers to publicly report a Consolidated Segmental Statement (CSS). The CSSs provide separate revenues, costs and profits for generation and for domestic/non-domestic electricity and gas supply. The CSSs are published on each supplier's website. Links to the 2010 statements can also be found on the Ofgem website at

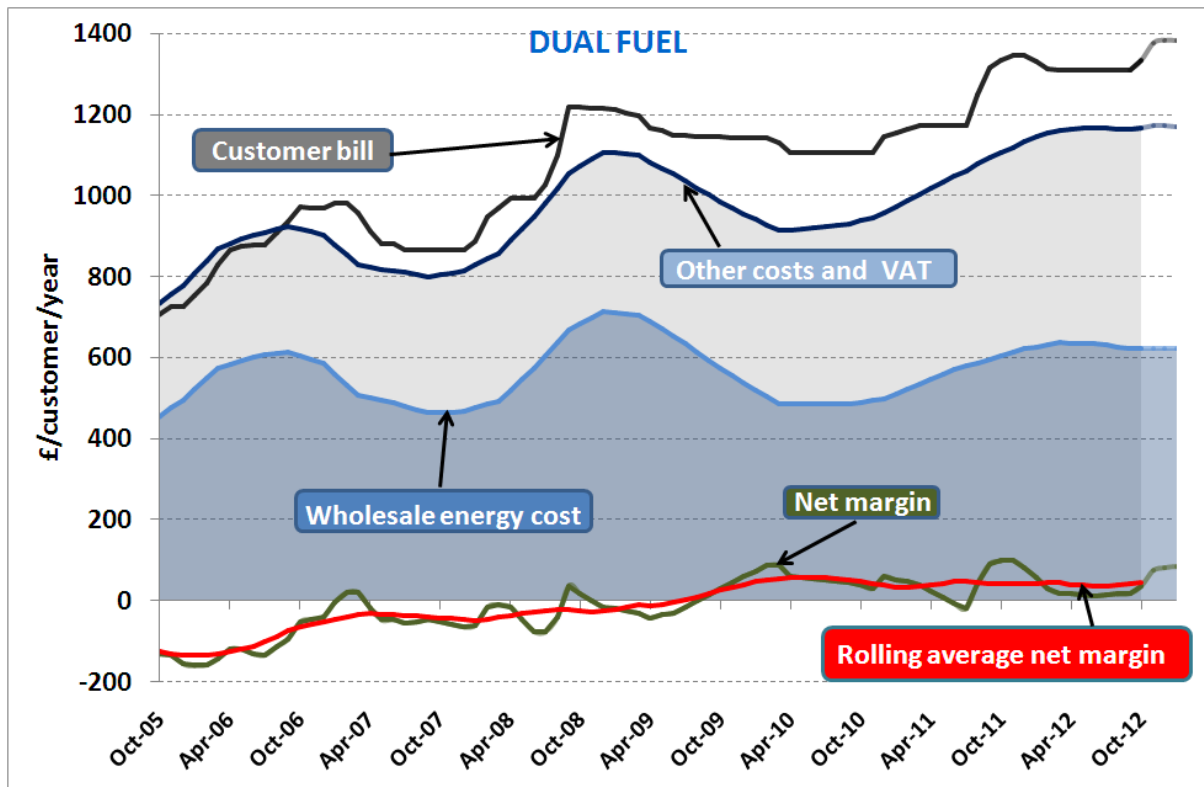
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=283&refer=Markets/RetMkts/ensuppro>

<sup>2</sup> A detailed description of the rolling average net margin indicator can be found in our methodology statement, available at:

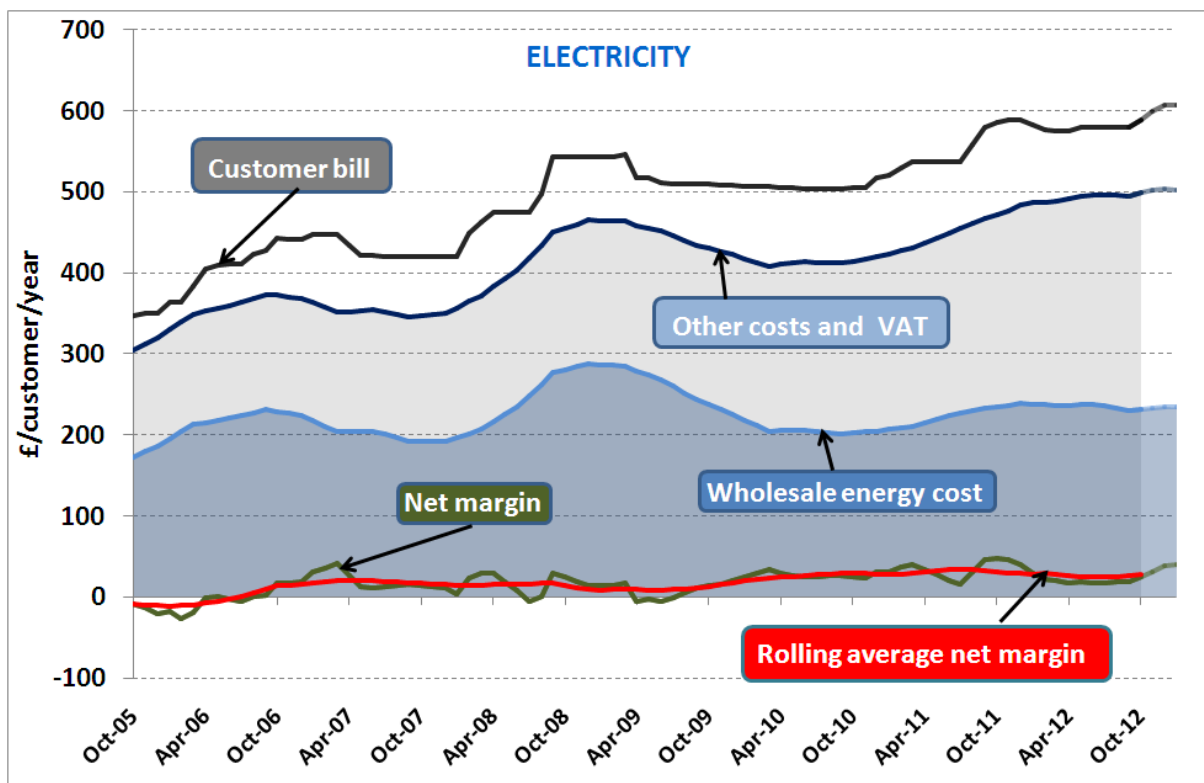
[http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Documents1/SMR\\_METHODOLOGY.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Documents1/SMR_METHODOLOGY.pdf)

<sup>3</sup> Note our estimate of costs for the CERT/CESP environmental programmes is based on the Government's Impact Assessment and assumes costs are incurred evenly over the period of the obligation. There is anecdotal evidence that recent costs of delivering these obligations have increased, which may at least in part be due to suppliers needing to deliver a disproportionate share of measures in later years. If this is the case, this is not reflected in our estimates.

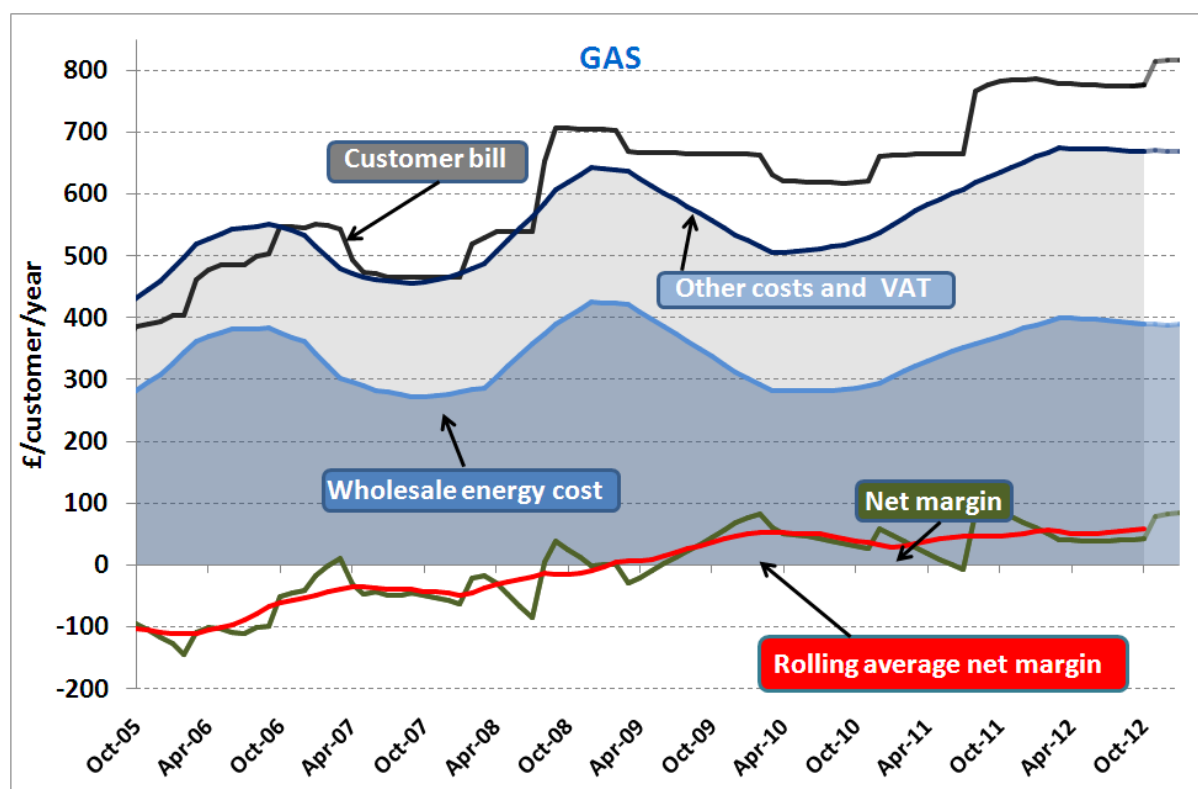
**Typical dual fuel customer bill, costs and total indicative net margin for the next 12 months**



**Typical electricity customer bill, costs and total indicative net margin for the next 12 months**



## Typical gas customer bill, costs and total indicative net margin for the next 12 months



## Changes in retail bills, costs and total indicative net margin for the next 12 months – October 2012

Dual Fuel	Year				
	Oct-08	Oct-09	Oct-10	Oct-11	Oct-12
Customer bill	£1,215	£1,145	£1,105	£1,335	£1,335
Wholesale costs	£680	£575	£490	£605	£620
VAT and other costs	£390	£410	£450	£500	£545
Gross margin	£145	£160	£170	£230	£165
Operating costs	£125	£130	£130	£130	£130
Total indicative net margin	£20	£30	£40	£100	£35
<b>Rolling net margin</b>	<b>-£25</b>	<b>£25</b>	<b>£45</b>	<b>£40</b>	<b>£50</b>

Notes: 1) Customer bill is for standard tariffs, weighted by payment method and market share. Average figures assume electricity consumption of 4MWh/yr, gas consumption of 16.9MWh/yr. Figures rounded to nearest £5 and may not sum due to rounding. Gas and electricity bill values may not equal the dual fuel bill partly reflecting different market shares for dual fuel and single fuel customers.

2) The indicative net margin for a dual fuel customer may not equal the sum of the gas and electricity indicative net margins, partly reflecting different market shares for dual fuel and single fuel customers.

Electricity	Year				
	Oct-08	Oct-09	Oct-10	Oct-11	Oct-12
Customer bill	£545	£510	£505	£585	£590
Wholesale costs	£280	£235	£200	£235	£230
VAT and other costs	£175	£195	£210	£240	£265
Gross margin	£90	£80	£90	£115	£90
Operating costs	£65	£65	£65	£65	£65
Total indicative net margin for the	£25	£15	£25	£45	£25
<b>Rolling net margin</b>	<b>£15</b>	<b>£15</b>	<b>£30</b>	<b>£30</b>	<b>£30</b>
<i>Notes: Customer bill is for standard tariffs, weighted by payment method and market share. Average figures assume electricity consumption of 4MWh/yr. Figures rounded to nearest £5 and may not sum due to rounding.</i>					

Gas	Year				
	Oct-08	Oct-09	Oct-10	Oct-11	Oct-12
Customer bill	£705	£665	£620	£780	£775
Wholesale costs	£400	£335	£285	£370	£390
VAT and other costs	£215	£220	£235	£265	£280
Gross margin	£85	£110	£95	£145	£105
Operating costs	£60	£65	£65	£65	£65
Total indicative net margin for the	£25	£45	£30	£85	£40
<b>Rolling net margin</b>	<b>-£15</b>	<b>£35</b>	<b>£40</b>	<b>£45</b>	<b>£60</b>
<i>Notes: Customer bill is for standard tariffs, weighted by payment method and market share. Average figures assume gas consumption of 16.9MWh/yr. Figures rounded to nearest £5 and may not sum due to rounding.</i>					

## Methodology

Our methodology is unchanged from the publication of the quarterly reports. The only addition is a rolling average net margin figure. We have introduced this indicator to increase transparency about net margin levels. As the net margin figure can vary significantly in a year, in reaction to falling or rising costs, a balanced alternative measure is to consider the average margin over an extended period of time. This then smoothes out fluctuations and volatile net margin figures. You can find a link to our methodology [here](#)<sup>4</sup>.

Notwithstanding the introduction of a rolling average net margin indicator to the supply market indicators, it is important to remember that it is a forward-looking estimate of the net margin on supplying a typical, standard tariff, dual fuel customer. It is therefore likely to change over time as more information on costs and prices becomes available. It also does not capture all the discounted deals that may be available to consumers, including those available online.

<sup>4</sup> [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Documents1/SMR\\_METHODOLOGY.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Documents1/SMR_METHODOLOGY.pdf)

More comprehensive information on individual energy companies' revenues, costs and profits in both their generation and supply arms is available on a backward-looking basis through their Consolidated Segmental Statements. These are produced annually by energy companies and are available on the Ofgem website. The requirement to produce these accounts was introduced by Ofgem following its Energy Supply Probe.

### **Updating our assumptions**

Our estimate of net margin is based on numerous assumptions. These include assumptions about typical household energy consumption and estimates of suppliers' costs. We will periodically review these components in due course and will look to update our assumptions as they change, including for example, updating our consumption information. We may also utilise requests for information where this is the most appropriate route to gather data. However we do not intend to use this approach for the foreseeable future. In the meantime, if suppliers wish to provide us with updated information we will be happy to consider utilising it in the report.

Where we update our data, we will keep a log of when a change takes effect and a short description, as below.

### **Updates to assumptions used**

31 October – updated retail bill reflecting a price change announcement

24 October:

- updated payment method shares (direct debit, standard credit and prepayment);
- updated retail bill reflecting price change announcements;
- updated assumption to forward network charges and balancing charges;
- update to cost of Feed in Tariffs;
- update to Renewable Obligation costs, accounting for higher obligation.

19 September – updated suppliers' market shares.

17 July 2012 - updated suppliers' market shares.

2 July 2012 – updated suppliers' market shares and updated payment method shares (Direct Debit, standard credit and prepayment).

20 June 2012 – update to other costs including the inclusion of ECO in the model.

21 May 2012 – updated suppliers' market shares.

25 April 2012 – updated electricity network charges in 'other costs'.

11 April 2012 – updated payment method shares (direct debit, standard credit and prepayment).

21 March 2012 – updated suppliers' market shares.