Overview

Ofgem produces a rolling average net margin on supplying a typical, standard tariff, dual fuel customer[1]. This is an average of the net margin data for the previous six months, the current month, and the next six months[2]. 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 £70. As the estimate is calculated from the current, past and future snapshot margins, the rolling average net margin includes the impact of all the announced price changes (SSE, British Gas, Npower Scottish Power, EDF and EON).

Our estimates also show that for the forward looking 12 month period from December 2012, up to and including November 2013, the total indicative net margin will be approximately £100 per customer based on a current average annual bill of £1,400 per year. This snapshot margin is £10 higher than last week's estimate due to the impact of EDF's price increase effective at the end of last week.

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 be £5 lower and the indicative margin would be £105 (compared to the December snapshot of £100). Using a 24 month hedging strategy, wholesale costs would be £10 higher and the indicative margin would be £90.

Based on the price increases announced by suppliers, our calculations show that this snapshot margin will peak at £120 over the next three months (once the EON price rise is in effect). There are many uncertainties, not least continued changes in wholesale and retail prices, which could affect this figure. Our analysis currently shows that wholesale costs are set to rise towards the end of the winter which will reduce this margin.

Our approach is to update cost estimates where appropriate and previous updated assumptions are listed at the end of the report.[3]

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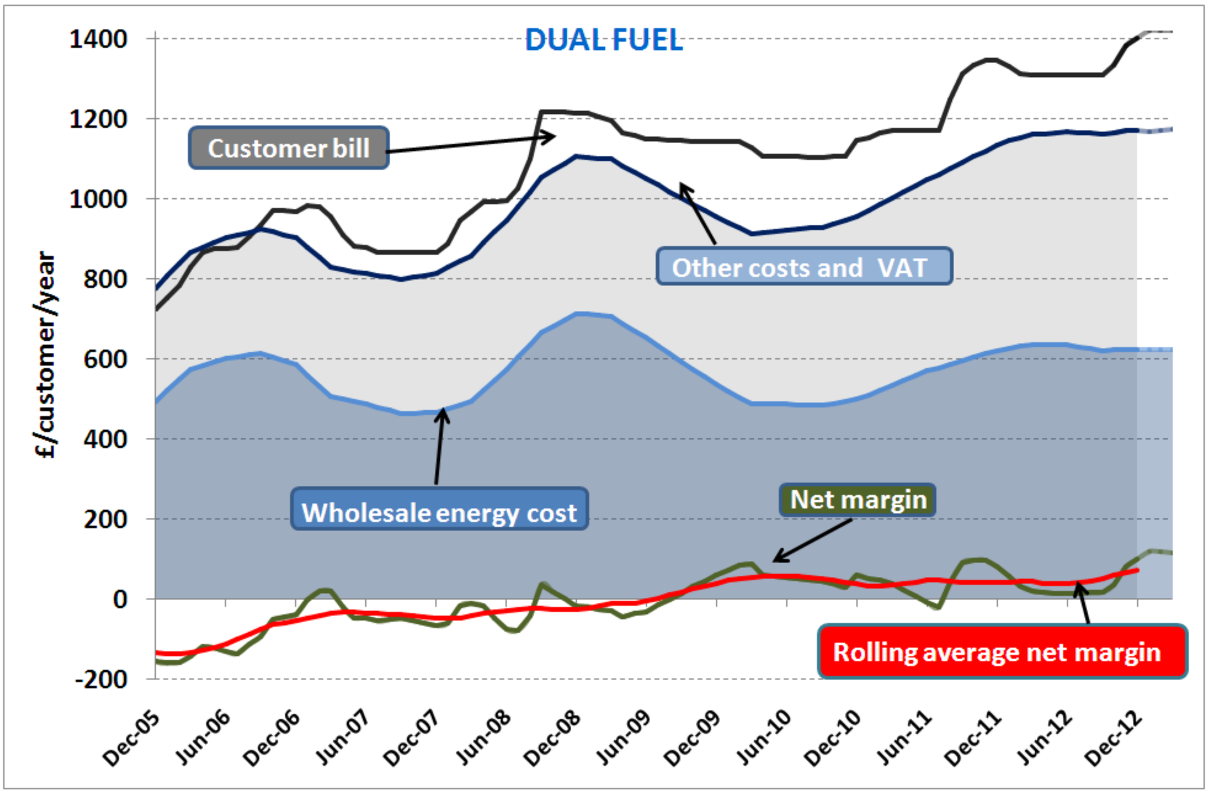
[1] This estimate is one indicator of supplier margin, however there are others. For example, Ofgem requires the large, vertically integrated suppliers to publicly report a Consolidated Segmental Statement (CSS). The CSSs provide separate revenues, costs and profits for generation and for domestic/non-domestic electricity and gas supply. The CSSs are published on each supplier's website. Links to the 2011 statements can also be found on the Ofgem website at http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=317&refer=Markets/RetMkts/rmr

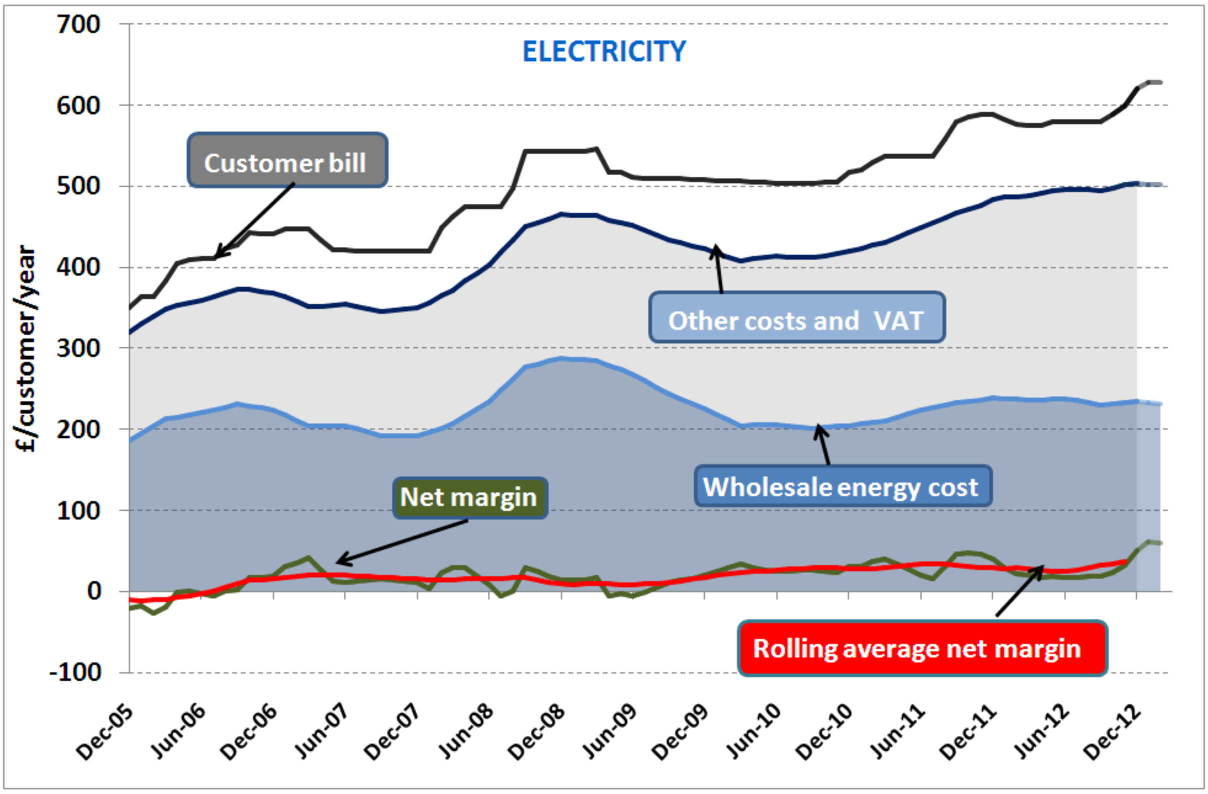
[2] A detailed description of the rolling average net margin indicator can be found in our methodology statement, available at: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Documents1/SMR_METHODOLOGY.pdf

[3] 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.

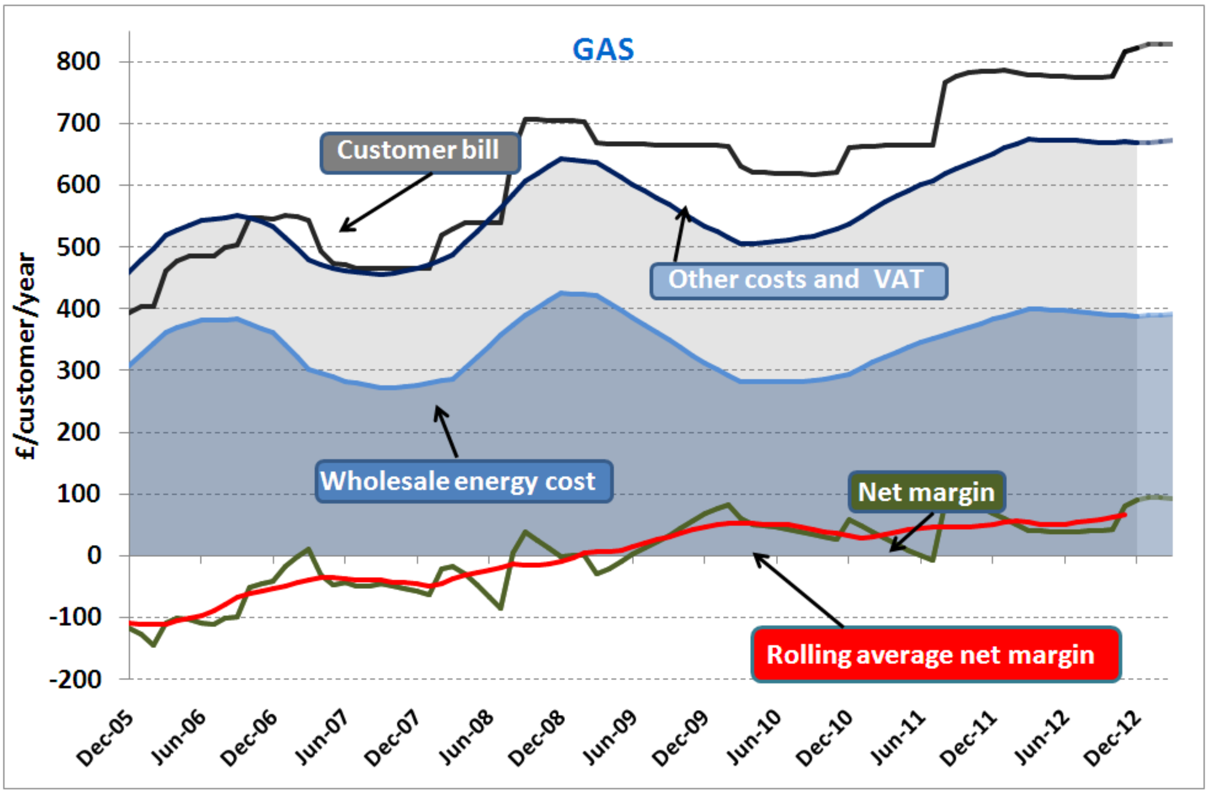
Typical dual fuel customer bill, costs and total indicative net margin for the next 12 months



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 –December 2012[4]

Dual Fuel	**Year**				
	Dec-08	**Dec-09**	**Dec-10**	**Dec-11**	**Dec-12**
Customer bill	£1,215	£1,145	£1,145	£1,345	£1,400
Wholesale costs	£715	£535	£500	£620	£620
VAT and other costs	£390	£415	£455	£510	£550
Gross margin	£110	£190	£190	£210	£230
Operating costs	£125	£130	£130	£130	£130
Total indicative net margin for the next 12 months	-£20	£60	£60	£80	£100
Rolling net margin	**-£25**	**£40**	**£35**	**£40**	**£70**

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.

[4] This information was updated on 21/11/12 to reflect retail bill data provided by suppliers

Electricity	Year				
	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12
Customer bill	£545	£505	£515	£590	£620
Wholesale costs	£290	£225	£205	£240	£235
VAT and other costs	£175	£195	£215	£245	£270
Gross margin	£80	£85	£95	£105	£115
Operating costs	£65	£65	£65	£65	£65
Total indicative net margin for the next 12 months	£15	£20	£30	£40	£50
Rolling net margin	**£10**	**£20**	**£30**	**£30**	**£40**
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.					

Gas	Year				
	Dec - 08	Dec - 09	Dec - 10	Dec - 11	Dec - 12
Customer bill	£705	£665	£660	£785	£825
Wholesale costs	£425	£310	£295	£385	£390
VAT and other costs	£215	£220	£245	£270	£280
Gross margin	£60	£130	£125	£135	£155
Operating costs	£65	£65	£65	£65	£65
Total indicative net margin for the next 12 months	£0	£75	£60	£70	£90
Rolling net margin	**-£10**	**£45**	**£30**	**£50**	**£70**
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.					

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[5].

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

[5] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Documents1/SMR_METHODOLOGY.pdf

becomes available. It also does not capture all the discounted deals that may be available to consumers, including those available online.

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. 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

12 December 2012 – updated retail bill reflecting a price change announcement

05 December 2012 – updated retail bill reflecting a price change announcement

28 November 2012 – updated retail bill reflecting a price change announcement

21 November 2012

- updated retail bill reflecting a price change announcement
- update to our retail bill data based on information provided by suppliers

31 October 2012 – updated retail bill reflecting a price change announcement

24 October 2012:

- 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 2012 – 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.