Customized Financing:
The Path to Expansion and Growth in the Energy Industry

Natural Gas and Power Choice programs around the country have been picking up speed in recent years, offering a larger group of energy consumers access to a wider array of choices. Public Service Commissions ("PSCs") in energy-deregulated states are increasing their efforts to promote competitive markets by encouraging the growth of Retail Energy Providers (otherwise known as "REPs", "Energy Service Companies", or "ESCOs" or, that re-market natural gas and electricity. Most notably in fully deregulated states like New York, New Jersey and Pennsylvania, PSCs have been reaching out to REPs in order to coordinate efforts to promote growth.

Despite all this, however, growth of deregulation has been sluggish. In New York, for example, over 75% of residential consumers and 60% of commercial consumers still purchase natural gas from their local utility companies. In Pennsylvania, 93% of consumers still purchase from the utilities, and in New Jersey that figure stands at over 97%[i].

While this signals that something is lacking in terms of current REP growth, it also indicates the massive potential for future growth in the industry. In fact, some companies are starting to show signs of this growth: Ignite Energy grew from $70mm of sales in 2005 to $900mm in 2010. Ambit Energy grew from zero sales in 2006 to $415mm in sales in 2010. Viridian Energy grew sales from $2mm in 2009 to $50mm in 2010.

So what is keeping other REPs from experiencing similar growth? Why have only a handful of REPs capitalized on the bulk of the growth to date?

Like many small businesses, REPs are inhibited by their needs for- and lack of- credit. REPs are typically small companies, trying to keep overhead down so they can pass on savings to their customers. This usually means they neither carry large cash balances with which to buy power or gas, nor have large balance sheets against which they can borrow. Without borrowing power of their own, REPs must look elsewhere for credit- either to commodity suppliers or high-interest opportunistic lenders.

For small REPs, supplier credit poses a few major problems. It is expensive, shaving 3-6% off of gross sales. In addition, REPs pay suppliers a flat fee per dekatherm, even during low season when they can pay on time. Thus, REPs can lose as much as 20-40% of their gross margin by relying strictly on supplier finance. To make matters worse, suppliers tend to grow impatient with delayed cash payments during peak season, which endangers REP-supplier relationships and often results in insufficient credit especially during these peak periods when REPs need it most.

Supplier credit may not be as flexible as REPs need it to be. This poses three problems for small REPs:

- First, they are restricted in terms of growth: a small REP that wants to grow sales is limited by the amount of credit the supplier is willing to extend.

- Second, they are vulnerable to price fluctuations: As an example, in 2010, the average price per dekathem in New York was approximately $6. In 2008, however, the price was closer to $17. If natural gas prices increase again, the hardest hit will be REPs who may need a lot more credit to buy the same amount of natural gas.
- Third, for heat-load customers (such as residential customers on the east coast), approximately 90% of heating usage occurs between the months of November and March, and volume is heavily influenced by severe weather. An REP's credit with a supplier may be insufficient to cover periods of heavy usage.

The concurrence of high cost and low flexibility results in a typical case of the big getting bigger, where the biggest REPs with the most credit can buy more energy or natural gas at better prices and therefore sell at lower prices, while the small REPs are limited by smaller buying capacities and higher costs of capital, and are consistently threatened by lack of credit.

The obvious solution for smaller REPs is flexible, customized third-party financing and credit enhancement. A revolving line of credit can give an REP access to short-term cash to bridge the gap between collections and payments during peak season, as well as to cover operating costs and finance expansions and sales growth. With a revolving LOC, an REP need only pay for the capital they use when they use it. A structured and customized credit facility can lower an REP's borrowing costs and dramatically reduce their deposits (and frequency of payments) at the ISO so they can use the excess capital and cash flow to fund the marketing and growth.

About Advanced Energy Capital ("AEC"):
AEC is a finance company that specializes in cash lines of credit and credit support in the energy industry. Specifically, AEC provides working capital and supply lines of credit for Retail Energy Providers in strategic cooperation with ***BP Energy Company.*** *AEC lends against REPs' receivables, billed and unbilled, which means an REP does not need a massive balance sheet to qualify for funding. AEC's customized, flexible REP credit programs dramatically increase an REP's cash flow and reduce an REP's cost of capital.*

AEC can be reached by email at info@advancedenergycap.com, by phone at (347) 799-1685, or online at www.advancedenergycap.com

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[i] All figures according to the U.S. Energy Information Administration <www.eia.gov>