Diesel Fuel Procurement Strategy

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What is GO?

GO Transit is the 3rd largest commuter service operator in North America, offering an extensive network of Bus and Rail Commuter Services within the Greater Toronto and Hamilton Area (GTHA):

- Annual ridership of 65M passengers in 2012
- Bus fleet of 436 motor coach / double decker buses
- Rail fleet of 560 bi-level rail commuter coaches, hauled by 65 locomotives

Background

- 19%, or $60 Million, of the GO Operating Budget is Fuel
- Three procurement strategies to reduce risk of commodity price fluctuations, and provide an element of cost certainty
- Operating Budgets are for a one year term, and there is no mechanism to create a "Fuel Reserve Fund"
- 80% of operating costs recovered from the fare box; balance subsidized by the Province of Ontario

Procurement Approaches

1. Spot Purchases in Market
2. Hedge through "Fixed Forward Pricing Contract" with existing fuel supplier
3. Financial Hedging using "Commodity Swap" tool

Subject Matter Expertise

- Use expertise of external financial consultant
- Market expertise critical in determining timing and cost exposure
- Consultant monitors the market, NYMEX, the exchange rate, risks, and premium charged for that risk

1. Spot Purchases in Market

- Spot purchases is the “Default” until market conditions become more favorable for other types of hedging tools
- Generally the cost of market fixed forward pricing contracts (hedging) is much higher than the spot rate
- Risk is that we may pay more overall, if prices rise significantly

2. Fixed Forward Pricing Contracts

- Fuel is hedged exclusively through our existing supplier
- Maximum 12 month term
- Premium for hedging with existing fuel supplier is between 5 to 8 cents/litre above spot

3. Financial Hedging Tool - Commodity Swap

- New tool, no experience yet
- An agreement whereby a floating price on a commodity is exchanged for a fixed price over a specified period
- User of the commodity agrees to pay the financial institution a **fixed** price for the commodity in exchange for the institution paying the user the **spot price** for the same commodity
- Only cash is exchanged, representing the difference between the fixed and spot price

Example of Commodity Swap

- We purchase a ‘swap’ for 1 million litres at $0.80 per litre for July
- In July the average spot price is $0.85, so the bank has to pay us the difference in the two prices ($0.85 - $0.80) or $50,000 (1 million litres @ $0.05)
- We then pay our existing supplier for 1 million litres at the spot price of $0.85 or $850,000
- The two transactions together (bank and supplier) equate to the desired $0.80 outcome
- Conversely, if the spot price had fallen to $0.75, we would pay the bank $50,000

Next Steps

- Currently seeking to set-up with major banks, a "commodity swap" option
- Obtain quotations from various banks, and select lowest cost option
- Enter into International Swap Dealers Association Inc. (ISDA) master agreement with selected bank(s)

Conclusions

- It is critical to our business to maintain an element of fuel cost certainty to meet budget constraints and service delivery
- Diversification of diesel fuel procurement strategy is necessary to proactively address changing market conditions

Thank you