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FUEL OIL NEWS

www.fueloilnews.com MAY 2009

Tool & Service Equipment Roundup

Angus Energy & RenRe Investment Managers Financial Checklist

Questions to ask when preparing price programs

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HEDGING & PRICING PROGRAM CONSIDERATIONS

Are you offering pricing programs for the first time?
Make sure you have reviewed the Balance Sheet and Cash Flow Considerations and are positioned to develop profitable programs that won't cause financial issues mid-season.

If you plan to offer pre-buy, fixed price or capped price programs this year, have you reviewed the number of gallons and customers participating in each last year? What new variables could affect the level of participation in each this year?
While last year's participation levels and gallons will serve as a good starting point, keep in mind that differing commodity price levels and the current economic climate can significantly affect participation and nullify your assumptions. Remember, it's better to be conservative. You can always fill in your needs after your program offering. Furthermore, contact your hedging consultant immediately if you find you have over-purchased or under-purchased product for your programs so corrective action can be taken before larger price shifts occur.

Do you have a consistent annual date for announcing your program offering?
Stick to it! Nothing scares your customers more (and turns them into price shoppers faster) than a delayed offering. Remember, customers generally seek the benefits of the program in which they participate, not a specific price.

Have you thought about the "Design Risks" associated with your program offerings — not just the "Implementation Risk?"
In addition to properly hedging your program offerings, be aware that issues often overlooked by dealers in formulating pricing programs — pricing windows, volume assumptions, credit availability, banking and supplier relationships, cash flow impact and margin assumptions — all can have a detrimental effect on your company's financial standing if not fully understood before you begin to enroll customers.

Do your marketing materials limit your financial risk?
Remember to include a "Limited Gallons Available" clause to afford

you maximum flexibility as well as a Liquidated Damages Clause to protect against the financial impact of customer flight. Consult a knowledgeable contract attorney on these points as the specifics of what is acceptable in these clauses can differ by state. Also, tailor the material to the Pricing Window you are comfortable in extending — keep your Pricing Window as brief as possible.

When you buy your wet barrel contracts for next year's Capped Price program, are you buying puts (protecting the downside) simultaneously?
Remember, delaying is speculating! In the current challenging banking and credit environment, financial losses from speculation (whether knowingly or "unknowingly") reflect poorly on management and can severely impact your ability to obtain the necessary credit facilities to operate during the heating season.

Are all of your positions covered?
Don't leave yourself exposed! Constantly challenge your assumptions and review actual program participation to ensure you are not "long" or "short." Develop the reporting systems necessary to know your positions at all times. Contact your hedge consultant at the first sign of imbalance to take corrective action before larger market moves.

Does your Capped Price Program enrollment fee cover your full cost to hedge the associated gallons? If not, are you absolutely sure you are capturing the additional cost to hedge in your margin?
Dealers commonly feel pressure to reduce margins. Don't fall victim to this temptation! Always remember that hedging costs not covered in the enrollment fee must be added on top of your target margin or you will cannibalize your target margin and jeopardize your financial standing.

Ask yourself, "Am I designing my program offerings with the intent of reducing my borrowing/credit needs?"
Remember the importance of a "balance of programs." As the designer, you have the power to influence what your customers want.

BALANCE SHEET & CASH FLOW CONSIDERATIONS

Calculate your working capital position: Does your current ratio (Current Assets ÷ Current Liabilities) exceed 1.0x?
If not, be aware that you are operating with a working capital deficit.

Ask yourself: "What if I had to put my pre-buy and budget payments in an escrow account until I paid my supplier for the heating oil?" Could you operate?
If not, be aware that this is a sign of a working capital deficit and take steps to avoid the "Pre-buy Death Spiral."

On your most recent balance sheet, does your combined cash on hand and fuel inventory value meet or exceed your customer deposits (sometimes referred to as "deferred revenue")?
If not, this is another sign of a working capital deficit. Take steps to avoid the "Pre-buy Death Spiral."

If you have a working capital deficit, do you need to put more "capital" into the company or will other modifications to margins and program offerings alone solve the problem?
In the current banking climate and depending on the expected time to rebalance your working capital position, you may find that a capital contribution is a prerequisite to obtaining/maintaining bank financing.

Are you confident that your credit availability (supplier lines plus bank line(s) of credit) will comfortably cover your peak-season needs?
If not, changes to your program offering are likely required to reduce credit need. Many variables can affect your company's peak needs, including commodity cost, margin, receivable turns (i.e., length of time before you're paid) and budget payments. Even if you are comfortable with your credit availability, explore the ways programs could be modified to further reduce interest expense.

Have you determined what margin (per gallon) is required to hit your profitability targets for the upcoming heating season?
If not, prepare a 12-month projected budget and discuss with your advisor or accountant. Be honest with yourself about what average margin you really need in order to hit the targets and hold your ground.

Do you have the ability to regularly monitor actual margins achieved and make adjustments to your street price "on the fly" in the event of lost deliveries (e.g., from warmer than normal weather, lost customers or conservation) or in the event of compressed margins in certain segments of your customer base?
If not, improved financial reporting ability should be a top priority to stay out in front of "margin killers." At a bare minimum, develop a spreadsheet that captures the key variables. Remember to consider increased interest expense associated with carrying your slow-pay customers for a longer period. Waiting until season end to assess success or failure is still too common and is a recipe for disaster.

Have you thoroughly reviewed your program contract language to ensure that you have an adequate "make whole" (liquidated damages) clause in the case of customers who abandon you mid-season?
If not, an event of significant price volatility and the resulting flight of some program customers make your company susceptible to material financial deterioration. Consult an attorney who is versed with your state's contract law to develop your program contract language.

Can you increase the number of customers on a budget plan by 10 percent before the upcoming heating season?
Remember, each new customer on the budget plan reduces the reliance on credit from your suppliers and bank, thereby reducing interest expense. | FON