



## Capital Ideas

### Increasing Liquidity to Fund Your Supply

**THE TIGHTENING CREDIT MARKET, SHRINKING** world economy and wild oil price gyrations in the last year have forced home heating oil dealers to rethink every aspect of their business, and financing their supply each year is no exception.

For years, maybe even decades, businesses were able to simply go to the terminal and pick up their supply, add their margin and sell the fuel. With the advent of different price programs and increased competition from other heating oil companies and fuels, many dealers had to change how they looked at financing supply and their relationship with their supplier, bank and customers.

The recent economic climate has only hastened that necessity, according to a presentation by Matthew Ide of RenRe Energy Advisors and Mark Bloom of Angus Energy titled "Fuel Dealers: The New Circle of Life" that they gave at this year's Atlantic Region Energy Expo (AREE).

You need to create a system where you are ambivalent to whether the price of oil goes up or down.

— Matthew Ide, RenRe Energy Advisors

The pair began by mentioning that an old "circle of life" didn't even exist in the heating oil world, as dealers spoke separately with banks, customers, their hedging counsel and supplier.

"The costs associated with funding your supply is so large, you can't be having these one-on-one conversations anymore," Ide said. "It's imperative that you change your model and become more connected."

Instead of running price plans without protection or charging the customer adequately for the service, Ide suggested several reasons

to keep everyone related to the business involved, because improving personal relationships can help maintain professional ties.

Local banks, for example, are often in a greater position to lend right now because many of the larger institutions have been hit so hard by the credit crisis. However, the banks require more than a cursory credit application; dealers must be willing to present all the proper documents and account for why they need money and how it will be spent.

It's also important to treat suppliers as your business partner, Ide said, because they understand the economic climate, but cannot help if there is not an open line of communication.

By giving the bank a proper understanding of how you will fund your supply and making your supplier aware of what type of programs you are running, the next most vital step is making sure that customers are aware of what services are available—and willing to pay for those services.

#### PLANNING FOR SUCCESS

While fluctuating oil prices from April to December 2008 caused countless headaches for dealers and customers locked into high prices, for some who hedged their purchases it was actually a profitable period, but still a rollercoaster ride.

"You need to create a system where you are ambivalent to whether the price of oil goes up or down," Ide said.

For that reason, Bloom and Ide said that a fixed-price program is one of the riskiest methods for a dealer going into the season. With the present volatility in the market, there are just too many risks for the dealer to take on in order to offer such a program and feel confident.

Though customers can enjoy the stability of such a program, they can also become quickly dissatisfied if the price of oil drops after they've locked in. This opens up a host of risks for the dealer, including customers leaving the program or taking delivery from other dealers, in addition to losing profits due to improper hedging or locking in the price at the wrong time.

One of the best ways to mitigate risks, according to the pair, is to set up a capped-price program for customers. This type of program sets a "cap" on how high the customer's price per gallon will be for the season, which gives a much greater sense of stability. It also removes the need for customers or dealers to try and time the market.

"The capped-price program provides similar risks for dealers and customers," Bloom said. "It's a nice balance of risks for the dealer."

What separates the fixed- and capped-price plans is that a fee must be paid in order to receive the benefit of a cap, as a type of insurance. While this adds to the cost of the plan, the greater ability to maintain a margin since customers will not be walking away or taking other delivery makes it more appealing, Bloom said.

In this era of interaction, the capped-price plan also strengthens the relationship between members of the "circle." By communicating the advantages of a capped price and giving customers an incentive to stay with you as a dealer, customers become more integrated into the experience. Similarly, the capped-price plan opens up a dialogue with the supplier and gives your bank a greater sense of security because of the fewer risks associated with it.

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**MANAGING RISK**

Picking the proper way to sell supply during the season by inviting all stakeholders into your "new circle" is critical for funding your supply, and business as a whole, according to Bloom and Ide.

As companies were slow to react to the changing realities and challenges of running a heating oil dealer, many hurt their balance sheet as they relied on credit or anticipated accounts receivable to stay afloat. Consumer credit problems and oil volatility compounded these problems and turned what could have been short-term working capital problems into fundamental under-capitalization issues.

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— Mark Bloom, Angus Energy

The average heating oil dealer in the Northeast, with annual sales up to \$25 million, faced decreased liquidity from 2004 to 2007, according to the Risk Management Association. Small dealers with annual sales of \$1 million to \$3 million faced the steepest decline according to the report, and this did not include data since the economic downturn.

"That's why many companies go out with a pre-buy program, because they need the cash to fund their season and it feeds a negative cycle," Ide said.

Instead of using a pre-buy program to fund supply, Ide suggests getting more customers on a budget plan each year. This method again establishes a longer-lasting relationship with a customer, provides them with stability and gives your bank more incentive to lend.

Regardless of the plan, Ide advises dealers to make sure they have an adequate "make whole" clause in all contracts in order to protect themselves from customers leaving during the season. If customers realize the penalty for leaving is minimal, dealers can experience a sharp decrease in projected revenue and could be stuck with additional fuel from their supplier.

Dealers need to balance their program offerings, according to Ide, instead of relying on the old "one size fits all" model. By getting more customers on budget and capped-price plans, companies are able to increase their working capital. Increasing their liquidity means that dealers can rely less on their bank as they prepare for the heating season.

"Aggressive marketing of budget plans and keeping a positive working capital can severely diminish the need for a large credit line," Ide said. ☐

## Mass. Mandate Calls for Only Waste Feedstocks State Also Waives First-year Volume Mandate

**WHEN MASSACHUSETTS GOV. DEVAL PATRICK SIGNED INTO LAW THE CLEAN ENERGY Biofuels Act in July 2008, he gave the state two years to come up with the regulatory framework to implement a biofuel mandate.**

The law called for all heating oil and diesel fuel sold in the state to contain a 2 percent biofuel component in the first year, increasing by at least 1 percent per year up to a 5 percent blend.

With less than a year before the mandate is expected to begin, the state recently released some key information about what feedstocks can be used and how they will be counted, while also confirming the mandate will begin July 1, 2010.

In the first year, through June 30, 2011, mandated volume requirements will be waived, but "Early Action Credit" will be provided for all gallons of qualified advanced biofuels, which will be applied to second-year mandate obligations.

In another important rulemaking, the state said that until further notice, only applications for waste biofuels will be accepted. The state is basing its reasoning off of analysis provided by the California Air Resources Board (CARB) and U.S. Environmental Protection Agency (EPA), which calls for feedstocks that yield a 50 percent greenhouse gas reduction.

With the science behind the CARB and EPA numbers being debated, the biodiesel industry was hoping that the state would accept biofuel from a variety of feedstocks, including soy and palm oil.

Massachusetts-based companies such as Baystate Biofuels, profiled in August's *Oil & Energy*, and Dennis K. Burke have said they will offer waste feedstocks that comply with the regulations.

The state will decide by Dec. 31, 2010, whether the second-year mandate will be at the 2 or 3 percent level. The mandate will be implemented in subsequent years on an "averaging basis" such that petroleum terminal operators must show that sufficient volume of qualified advanced biofuels was supplied to meet the required percentage on average, over the course of the full compliance year.

Terminal operators that supply heating oil and diesel fuel consumed in Massachusetts will be subject to mandatory reporting of heating oil sales, diesel sales, non-qualified biodiesel content in all shipments received up to 5 percent and qualified advanced biodiesel volume sold by each supply source for early action credit.

Prior to the mandate beginning, the state has said that:

- Final draft regulations will be prepared by Dec. 31 and a public hearing process will commence, with regulations by May 2010;
- Application forms will be prepared, and the state will begin accepting applications for qualifying advanced biofuels by October 2009;
- The state will continue to track and engage with federal and California efforts to establish analytical methodologies and protocols for evaluating non-waste feedstock biofuels, and will expeditiously seek to adopt such protocols, as they become available, for the purpose of the mandate.
- Biofuels that are produced from a mix of waste and non-waste feedstocks can seek qualification from the state for the portion of the finished biofuel that is attributable to the waste feedstock.
- The state will prepare an Advanced Biofuels Mandate Schedule for possible inclusion with tax filings by November 2009.
- The state will assess needs and options for enforcement, tracking of credits, and trading platform, by November 2009.

The Massachusetts Oilheat Council (MOC) has been working closely with the state in all aspects of the bill's progression: helping to guide its drafting; fine-tuning language; sitting on state task forces and panels; testifying at numerous hearings; forming alliances with like-minded partners; working it into the National Oilheat Research Alliance (NORA) framework; and touting its merits at the state, regional and federal level.

MOC has further meetings scheduled with the state in order to continue to represent the industry and help ensure the mandate takes heating oil dealers into consideration as they complete the regulatory process. ☐