

## “Time for a reality check”



by Philip J. Baratz, C.T.A.\*

In the February issue of this fine publication, there was a Special Study presented by the Editor Emeritus (and all-around good guy) Paul Geiger. Paul was reporting on results of a survey of heating oil dealers on their price-protection programs, in light of the extreme volatility of oil prices.

As these topics (oil prices and market volatility) have, and likely will, dominate the marketplace for the foreseeable future, I would like to use this space to throw in my two-cents on some of the comments that Paul received.

*The first comment from the Middle Atlantic read:*

“These price protection programs work great when you do the following: plan, execute, hedge (and no speculation).” I can only hope that the comment was contributed by one of our clients at Angus Energy, but even if not, I couldn’t have said it better myself (although I do often try to). If the comments had ended there, I could have been left with the impression that “everyone gets it”. How nice it would be to have ALL the market participants recognize that no one can consistently predict where prices will go. With that recognition, and the desire to keep prices from getting (even further) out of control, the aforementioned plan of “plan, execute, hedge” would work out just fine.

*The second Middle Atlantic comment was one that should be of concern:*

“The cap price or guaranteed price is probably the worst thing the fueloil industry did, not only for companies, but also for the customer”. This one is a tough one to swallow. My father is paying (I believe) \$1.49 for heating oil for this winter, with racks in the \$1.50’s, and retail prices above \$2.00/gallon. How exactly is this the “worst thing” for the customer? Maybe it’s me, but if a consumer has the opportunity to lock in or cap oil that turns out to be 50 or 75 cents less than he or she would have otherwise paid, it would seem to be a good thing. I wonder what this “commenter” would consider a good thing for the customer.

Over the years, heating oil dealers (often with good reason) have had various gripes relating to their business struggles. For a while it was OPEC price manipulation. Then, when oil prices had spiked, the culprit was the natural gas utilities. Then, when prices fell, it was the C.O.D. discounters. Then, when retail margins weren’t as wide as many would like for them to be, it was the buying groups (the co-ops). You can always find a reason why things don’t go so smoothly, but with affordability becoming an issue for many consumers, it seems that peace of mind would be a good thing. As far as the “industry” goes, the companies that offer these programs—and consistently hedge the offerings—are making some of the best margins around. Where companies suffer is when they try to outguess, or time, the market—and let their opinions get in the way. No matter how strongly you think something should happen (as far as oil prices go), that thinking is not going to influence where prices go.

Lastly, if the reference was meant to imply that hedging by heating oil dealers has CAUSED high prices or volatility, there is ab-

olutely no evidence of that whatsoever. Futures trading is a “zero sum game”. For every “long” there is a “short”. For every dollar made, there is a dollar lost.

A few of the other comments fell into a bucket—“I gambled too heavily this year by not buying anythin...” This guy just answered his own question, but at least recognized that he GAMBLED by not hedging. Another said that premiums are so expensive that they might discontinue offering caps. This one is real interesting. Option premiums are, indeed, very, very expensive. The wider the market swings, and the higher prices are, the more costly it will be to buy options. However, if the premiums have allowed you to control costs to your customers, AND (provided that) the customers are aware of this benefit, the higher premium must be borne by the customer. If a customer wants to “opt out” of having price protection, that is one thing. But, to cease an offering—that works!!—because it’s too expensive, is not a decision to be made without a lot of thinking, and consideration of what your customers will think.

Finally, the last printed comment pointed to customers who will threaten to quit if prices go way down. Firstly, this writer grouped together those who would threaten to quit, as both cap and pre-buy customers. That says to me that there isn’t a REAL cap going on. If you promise a customer that prices won’t exceed, say, \$2.00/gallon for next year, and then, let’s say that racks fall by 75 cents per gallon, and you lower your price to \$1.50/gallon.... Customers are going to QUIT because you lowered your price by 50 cents?!? The argument of falling prices potentially affecting the nerves of fixed-price customers is, I believe, a legitimate concern. If you offer fixed and capped prices, you NEED to establish guidelines with your customers, which will clearly explain that a fixed-price is a fixed-price. If they (the customer) want to benefit from paying less for oil, in the event that prices do drop, a fixed-price program is not for them. Those are the customers who should have a cap. Often the best way to get customers onto a cap program (even when the cap is at a higher level than the fixed, and even if belonging to the cap program required the payment of a “cap fee”) is to give them a simple “what if” table—to show what they can expect to pay in a few different scenarios. We have some samples. If you are interested, please contact us.

The last line, “We are oilmen, not stock or commodity brokers”, should be repeated in every heating oil company’s offices every day from March through September, as “oilmen” try to become oil traders. If you can figure out where prices are going, why do you want to work so hard, and so many hours? The NYMEX is only open for heating oil trading for less than 4 ½ hours a day. Think of all the free time!! The bottom line is that making money as a speculator is quite difficult. Making money selling heating oil certainly has its own sets of challenges, but price speculation need not be one of them.

I do not seek to make light of struggles and tension, nor do I look to poke fun at those who have contributed their opinions, and who are, indeed, quite frustrated by market circumstances. We’d all like a winter that was consistently 5% colder than normal, with rack prices at \$.50/gallon. Maybe we will have a year like that—in the future. For now, that is not the reality, but you still have to deliver oil, and price it competitively. Properly “plan(ned), execute(d), and hedge(d)” cap programs can do that for you. You just need to understand how they work, and how they can benefit you. Some do look at caps as nothing more than a necessary evil, in order to keep from losing customers. Others offer programs to loyal customers, year in and year out, and are amongst the happiest (and most relaxed) oil dealers that I know.

See you in Atlantic City and the A.R.E.E.

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