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# FUTURES \$ OPTIONS



Mike Schrengohst



by Philip J. Baratz,  
 C.T.A., Angus Energy

## Every day is a winding road

So, when do things get easier? With all the connectivity and information at our fingertips, on a non-stop basis, you might figure that there would be a sense of

balance in the world. After all, if everyone has access to just about the same information, and just about at the same time, the “haves” and “have nots” would be able to face each other on a fairly level playing field. If this all sounds quite reasonable, you have apparently not noticed what it is like to deal with oil prices in 2006.

Supplies are plentiful. The world economies are slowing down. Real estate prices seem to have—at least for the short-term—peaked, the Federal Reserve is continuing its policy of tightening via interest rate increases, we are coming off of a warmer-than-normal winter, and inventories are very high. Quick question: in what direction should prices be heading? If we laid out that set of fact to any of the “old time” oil guys 5, 10, 20 or 30 years ago, you can safely assume that they would have been quite comfortable placing a large bet that heating oil prices would be in a sharp downward spiral. If there’s plenty of it and people are struggling to pay for it, how could prices possibly be high—or move higher? That is the dilemma that we face in the spring of 2006.

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# Every day is a winding road

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The total disconnect between logic and prices is not without any reason. Before we buy into the farce of blaming “big oil” for all that ails us, the world in which we live (and are raising our children) is not the world that many of us grew up in. Whether it is Nigerian rebels kidnapping oil workers, Hugo Chavez threatening to sell U.S. aircraft to our enemies, Iraqi insurgents with no concept of the value of human life, or the Iranians threatening to block the Straights of Hormuz and to wipe Israel off the face of the map just because we are a little nervous about their plans to enrich uranium, there are a lot of political and military analysts who are having a hard time sleeping at night.

So, that’s where we are. The “fear factor” is the big bully, pushing around those who rely on fundamentals—such as basic supply and demand, and weather and economic forecasts. Traders are too scared to take prices too high—the inventories make that seem foolish, but they are also too scared to follow through when one of the selling signals kicks in (“what if Iran.....”).

## **COMMUNICATION**

This brings us to the real issue at heart—what do we tell the customer? We all know—as it has been beaten into us for the past decade—that customer communication is paramount. Great. So what are we supposed to say to the customers whom we are communicating with? Everyone has been taught to try to avoid answering the question “what is your price” by focusing on value, not price. While I buy into that theory 100%, you still have to—eventually—answer the question. With retail prices up in the high \$2.00s/gallon in most areas, and offerings for next winter, in many areas already (mid-May) above \$3.00/gallon, the “what’s your number” has become a critical question. We are in a market that gyrates by at least a nickel in most days and at times by as much as 10 cents per gallon—in a single day. How do you set a price, often for the next year, if you know that prices might fall 20 cents in the next week? Worse, yet, what if your competitor buys it next week, after prices fall by 20 cents? This is where having very little hair is a benefit—there is not much left to pull out!

As one of our clients put it: “If prices fall, the customers [not the word he used] want a cap of \$2.50 per gallon. If prices rise, the customers [again] want a cap of ..... \$2.50 per gallon.” In other words, the same rationale that we can’t figure out with regards to where prices are going—on a daily basis—has led customers to expect the best and lowest prices imaginable. Despite the fact that many gas stations in the Northeast are posting prices in the \$3.20s and \$3.30s, homeowners would love to see pricing for ’06-’07 at the same levels as they saw last year. The benefit of a cap offering is that IF (big “if”) prices do fall, those customers can pay lower prices. However, prices “are where they are,” and if they want (and you want) to have some certainty of cost for next winter,

all you can do is make an offer based upon conditions in the spring.

## **VOLUME VS. PROFITS**

Without question, the lower the price that you put out there, the greater the likelihood of you keeping a larger portion of your existing customers—and the possibility of picking up some new ones (although the new ones are most likely to be the ones who will leave you next year if someone else is cheaper). However, along with the ability to retain a large portion of your existing customer base, you are also assuring yourself that each of those customers will give you a profit margin that is, in all likelihood, less than your competition, and less than you want. Are you after maximizing your profits, or maximizing your customer count? We all want both, but given the inherent conflict in accomplishing both in unison, it would seem that profits should rule the day. It’s never okay to lose customers over “controllable” issues, but price has to be an exception. If you aren’t willing to lose some customers over price—arguably not the best ones to have in the first place—then you really should prepare yourself for small margins, and a lot of restless nights. You see, the problem isn’t only whether or not you are willing to work on a smaller than desired margin. You still need to do your buying, in hopes that you are smart enough, or lucky enough to “buy right”.

## **BUYING FOR NEXT WINTER**

That brings me to the last point: the buying. Unless you really, truly, believe that your crystal ball is in perfect focus, the buying process is not much more predictable than a roll of the dice. Waiting “for the right time” just doesn’t work. It is not a failing on your part—or on anyone’s part—to not know where prices will be next week, let alone next winter. Heating oil distributors that are making buying decisions based upon someone else’s analysis of where price should be, need to be aware of the consequences of what will happen if the given analyst or consultant is wrong. Many companies believe in ratable buying over a period of time. We, too, are advocates of this approach. It is not because we believe that it will help pick the lows, but it is because we fear picking the highs. The second part to the “belief” of the ratable buying is the planning and executing the purchases. It is one thing to believe that something needs to be done, but quite another to actually get it done. We commend those who set up a plan...but really respect those who act on that plan.

Running a heating oil business in today’s environment is tough enough. If you find that you are speculating on prices, and then giving away your margins, you really need to ask yourself if there is a future in the business for you and for your family. On the other hand, if you manage your time, and execute a plan to purchase and to price (appropriately) to your customers, maybe you can spend some time concentrating on growth and not on cutting down on attrition. □