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## Look in the Mirror: you might see your biggest competitor

As crude oil prices cruised their way towards \$100 per barrel in early November, up almost 40% in just a few short months, many were hitting the panic button—early and often. Phrases such as, “We’re going to get killed this year.”; “this is the end of a once thriving industry.”; “long-term customers are calling to see if the price on the bill is correct.”; “C.S.R.’s can’t explain why heating oil prices jumped so much, but natural gas prices have remained steady.”; etc., etc.; have become frequent. If you are shaking your head in agreement, you have either said or heard one or more of the above phrases.

The possible reasons for the unreasonable strength in the price of oil are all over the map. The dramatic decrease in the value of the U.S. dollar, relative to other currencies, is one of the favorites, as oil transacts in U.S. Dollars per barrel around the world, and while the U.S. Federal Reserve has been lowering interest rates to stave off inflation, it has had an impact of making a weaker dollar “demand” a higher price per barrel of oil. Another popular cause for the rally in oil has been the heavy investment by market speculators and hedge funds, who are hoping to ride the wave of higher prices to speculative profits.

Oh, yes, there is also that whole “supply/demand” thing. Despite a slowdown in the real estate market, and jitters in the U.S. equity markets, many sectors of our domestic economy are chugging along quite nicely, creating steady (and growing) demand for energy. World demand keeps growing, and OPEC—while pointing to ample reserves—refuses to really turn open the spigots. If you were getting paid twice as much as a year ago (and 10 times as much as 9 years ago), you might not want to increase supply, either. Why ruin a good thing?

Of the questions that have been asked, one is the easiest to answer: Is oil overpriced? The answer to that is an unqualified “YES”. Let’s bear in mind that according to many, the best way for oil prices to stop rallying is for interest rates to spike up, for the stock markets to falter and for the economy to start teetering. If that is what it takes to bring oil prices back to reality, is it worth it? You still have to face a simple reality. How does knowing the “cause” help with the situation? Even if you want to take the most basic and frightening (and illogical) theory that evil men and women in corner offices on Wall Street (and in Greenwich and Stamford, home of many Hedge Funds) are manipulating prices higher, how will that help? To be fair, there is little doubt that speculation has had a hand in the movement of oil prices, but as ALL trading is a “zero sum game”, for each dollar that is made, someone else is losing that dollar.

The reality is that heating oil prices have moved to record highs. Customers who are being forced to pay those prices are not happy. That’s reality. Companies who dissuaded their customers from pricing programs (or didn’t offer them at all) for this winter, because, in hind-sight, last winter’s programs “didn’t work out,” made a mistake. *That’s reality.*

Many companies complain about the disloyalty of their customers, but from what I see, most customers are quite loyal. You shouldn’t have to fight each year to keep your customers, but should just be concentrating on delivering and servicing the accounts. However, customers do have a breaking point, and although everyone likes to mention the accounts that they picked up because their competitors really dropped the ball with a service issue or a “run out,” what is really driving the customers to “go shopping?” Could it be that their neighbor is paying \$2.799/gallon and that you are charging them \$3.399/gallon? Could it be that last year you fixed

their price at \$2.799/gallon, and then as prices fell, their neighbor was paying \$2.099/gallon?

People get upset when prices are high, but they get really upset when someone else is paying a whole lot less! Being realistic, a customer who is paying \$3.00/gallon won’t be nearly as upset if he knows that his neighbor is paying \$4.00/gallon. As the matter of fact, the same customer, who was just happy paying \$3.00/gallon, will be miserable paying \$2.00/gallon IF his neighbor is paying \$1.00/gallon.

It’s not easy being an oil dealer with the volatility that we have had for the past few years, but if volatility is the reality, then it has to be dealt with. However, if the hardship is self-imposed—either by offering a program and not hedging against a rise in costs, or by telling your customers that programs are not in their best interests—then, as my dad used to say (okay, he still says it), “You made your bed, now you have to sleep in it.”

Keeping with the theme of “reality,” there are basically only three ways to price oil to your customers. The first is to just charge a variable, rack-plus price. The second is to sell the customers a fixed-price that will not change, no matter the market price of oil. The third is to offer a capped-price, a price level that will not be exceeded, but a price that will fall if market prices fall. Last year, those with variable prices did very well, as prices fell about 80 cents from the summer highs, into the lows in January. The fixed-price customers saw that price collapse, and were “stuck” with a much higher price. Since the lows of this past January, heating oil prices have moved up by over a dollar per gallon—bad news for the variable customer, and good news for those who had signed up for fixed prices. So, in the first year, the fixed customers saw their neighbors paying a much lower price, and whined to the oil company—or chose a different oil company. So far this year, the variable customers are seeing their fixed-price neighbors paying a much lower price than they are, and (go figure) they are whining to their oil companies.

If you can accept the reality (yeah, more of that “reality stuff”) that prices can move by a dollar per gallon (or more) each year, you have to figure that each year will find half of the variable or fixed customers paying a much higher price than the other, and we all know what happens then.... A cap is akin to an insurance policy, in that if prices increase, there is a cap on the amount that will be paid by the customer. That approach would be working very well this year, as cap prices—as of this writing—are well below the average retail (variable) price. However, the real benefit to cap programs was seen last year, when prices fell. As opposed to fixed-price programs, which don’t vary in delivered cost (without a lot of yelling and screaming by customers, and lost profits by companies), capped-price customers saw their prices fall last winter, as the market price of heating oil fell.

So, if caps are so wonderful, why doesn’t everyone offer them, and why doesn’t everyone buy them? Not everyone wants to write out the check to pay for the “cap premium,” and rationalizes their way out of the decision—“It’s too expensive.”; “I can’t pass along the cost to my customers.”; “I like the idea, but I’ll wait until prices drop.” etc. When protection costs 10, 15 or 20-cents per gallon, all of those reasons are sound, or at least they seem to be. However, if the gyrations in the markets are causing half of your customers to shop around every year—or all of your customers to shop around every other year—and if the cap will keep you “in the game” price-wise (or at least within 15 or 20 cents per gallon), wouldn’t you and your customers sleep better at night?

There are companies out there—several hundred that we know of—that planned a pricing program for their customers, hedged properly in order to make that offer and then offered the program to their customers sometime during the summer. What did they do that was so special? It wasn’t that they made an offer to their customers—lots of companies did that (unfortunately, lots didn’t...), and it wasn’t that they picked the right day, week or month to buy all of their oil. It was simply that they set up a plan and STUCK TO THE PLAN.

As we approach the end of the year, the time to start to plan for NEXT winter is NOW. □