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Tail wagging the dog?

The final numbers are in for the winter of '06-'07, and contrary to the predictions of all of the alarmists, it didn't turn out to be the worst winter in history for heating oil dealers. After suffering through the immense pain of the everlasting summer, all the way through the beginning of January, the weather turned not only "seasonal", but downright cold. From mid-January through the end of April, heating oil dealers had much to celebrate—if only they could focus on the good, not the bad. Regardless of whether you sold oil to your customers on a capped, fixed or variable (rack-plus) basis, the second half of the winter should have represented "found volumes"—extra volume thanks to higher than normal HDDs—and increased margins. Prices from January through April AVERAGED about 65 cents per gallon lower than where they were "projected" to be in the middle of last summer. Last time we checked, increasing volumes with declining prices should lead to significant net margin enhancements. If that isn't a cause to celebrate in our industry, we really need to do a lot of re-thinking.

Of course, as has been the case for the last few winters, those with perfect 20/20 hind-sight are trying to find what they SHOULD HAVE done differently. This year, it was pretty simple: You SHOULDN'T have bought any fixed-price wetbarrels, you SHOULDN'T have bought any call options, and you SHOULDN'T have made rash decisions last summer based upon the news. The real question is whether any of this looking into the past can help us as we prepare for the future. Without a doubt, if prices fall precipitously from the last summer throughout all of next winter, you SHOULDN'T lock in any wetbarrels. You also shouldn't buy calls. However, if any of us were good enough to predict what prices will do (let me clarify, WAY TOO MANY of us do predict—I was referring to predicting ACCURATELY) next winter, what would be the point of running an oil company? I am sure that someone with such clear insight into the direction of commodity prices could find some very-well compensated employment somewhere on Wall Street. However, the third "shouldn't", the one dealing with rash decisions, is definitely a valid lesson learned.

Another lesson learned is that unless you believe that prices will never again increase during the winter (and are willing to bet the success of your company on that belief), your customers will not be happy without some protection against an increase in price. I, personally, am not a very big advocate of fixed price programs. My issue with the offers are not the offers themselves. If a company wants to offer a fixed price of "x", and a customer is satisfied paying the fixed price of "x", then all is well in the world. The real issue arises in the event—such as how things played out this past season—those prices fall sharply. That's where the "revisionist" clients suddenly appear. They recall—very clearly—how you suggested that the fixed price was the way to go, or they seem to recall that although you put the offer in writing, and they signed a promise to buy all of their oil from you, somehow there was an implication (by you, of course) that if prices DID fall sharply, that you would pass along some of the lower pricing to them. Unfortunately, some dealers chose to address these few squeaky wheels, and then it just became easier to give money away than to hold customers to their obligations. All that said, however, if a customer chooses—and understands—that their price is fixed, it does mean that prices cannot go up for them. There is a lot of value to that.

The preferred approach would be to offer a capped price, not because prices WILL fall—we don't EVER know what prices will do—but because they MIGHT fall. However, if prices do increase—yes, that can happen as well, despite the amazing string of "two years in a row" of lower winter prices than the prior summer. For those who forgot, the winter of '04-'05 (yes, waaaayyy back then) started (September) with prices at about \$1.10 per gallon, before reaching \$1.66 later in the season. Not too many fixed or capped customers were complaining that year. Actually, the complainers were most likely those without any pricing program offered to them. The prior heating season saw prices as low as \$.70 per gallon, before peaking at \$1.05 during the season. Not real complaints from fixed or capped customers then, either. Do we need to mention the 53 cent jump from September during the year before

that? The simple fact is that prices have moved, do move and will continue to move in a very unpredictable pattern. Offering no protection puts your customers at risk that prices might spike (although that might be okay with some of them—others will seek a 'better deal'). Fixed prices are fine, except for years with collapsing prices. Capped customers get protection against spiking prices, and relief when prices fall—but all for a price. Premiums are not cheap by any measure, and MUST be borne by the customers. If not, they will come straight out of your profit margins.

Here's an idea for you in dealing with your customers: tell them that (a) next year's cap will be the same, or lower than this past year's, and (b) tell them that their budget payments (likely being calculated for '07-'08 off of lower assumptions than for '06-'07) for next winter will be lower. How many of those customers will be running to seek refuge in the arms of another heating oil dealer? Those customers who are still looking for "the best deal", and those who are shortsighted, are likely not as large a percentage of your customers as you might otherwise believe. Chasing those vocal but few customers is really the classic tail wagging the dog. Think about it—the customers who feign (or really act with) dissatisfaction with how things turned out this year—what would have made them happy? A freezing winter from October through April, with prices at \$4.00/gallon? \$5.00/gallon? What level would have made THEM happy? Did some customers whine because they felt that even though prices fell, they didn't fall enough? I'm sure some did. But, didn't most customers continue to make their budget payments, and didn't most appreciate that the cap acted as a cap—not as a fixed price?

We all talk about the "value" of a customer. We calculate that as a combination of predictable volumes with predictable margins. Now, let's look at the value that you have TO the customer. Value is very often more perception than reality. You can believe whatever it is that you would like to believe, but until the customers perceive that there is value—there is absolutely none. Do customer perceive value in a company who is constantly changing what its "offer" is, or will they perceive (and embrace) stability and predictability? Shoppers, for the most part, are never satisfied. They are constantly on the prowl for the next "better deal". Surveys have concluded that customers DON'T like too much choice, and that they are happier with the status quo, than with having to make new decisions.

Make the customers' status quo fair and reasonable, and make your volumes and margins predictable. The end result is mutually beneficial value. □