FUTURES $ OPTIONS

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Who thought it would ever come to this?

Christmas (or Hanukkah), 1997:

"So, Johnny Oildealer, what would you like for Christmas this year?"

"Santa, I would like 3 more months of dry, windy and cold days."

Christmas, 2007:

"So, Johnny Oildealer, what would you like for Christmas this year?" *(Santa never changes his questions.....).*

"Santa, I would like warm weather with forecasts for a very weak economy...."

Say what?!? If it sounds like Johnny isn't the sharpest tool in the shed, look around at your next oil dealers' meeting. There are a lot of "Johnnys" there.

As we entered the New Year, we were greeted—for the first time ever—with crude oil prices hitting the "magical" (and incredibly annoying) $100 per barrel mark. Retail heating oil prices in New York City rose to above $3.60 per gallon, as futures contracts and rack prices set all-time highs. In addition, after months of hearing whispers about "unprotected" (unhedged) oil dealers, it seems that some of those who made promises, but didn't back them up, are finally suffering the consequences of that speculation. A Pennsylvania-based company's misfortune splashed across the headlines after they suddenly shut their doors (and stopped deliveries) after collecting pre-pay money from hundreds of customers and (according to reports) not using the money as it was intended—to hedge the cost of oil.

So, back to Johnny. Why would he (you?) be wishing for—at least some—warm weather? It seems that the focus for oil dealers has shifted from selling as much oil as they can for a reasonable profit margin, to hoping that somehow their customers will be able to pay their bills. Receivables are skyrocketing, even for those with variable-priced customers on budget plans. We did a (very) informal poll, asking a number of our clients whether they would prefer to have temperatures in the mid-60's (as we had for a few days in early January)—if it would lead to a sizable drop in the price of heating oil, or if they would prefer to have strong sales/deliveries caused by cold weather—but that the cold weather would cause prices to go up further. By a landslide margin, dealers said that they would prefer to cut into their sales volumes if it meant that prices would slide. In other words, better not to sell, than to sell to those who might not pay their bills.

No doubt, many of you are nodding your heads, and the logic (we all want to get paid for our products and services) of getting paid certainly makes sense. However, we need to really look at what caused the "receivable issues" and figure out what we can learn from it—hopefully to do it differently in the future. There has been a lot of talk about the reasons that prices have spiked this past year—not to mention that prices have also gone from less than 50 cents/gallon ten years ago to well over $1.50/gallon coming into this year. The U.S. Dollar has been drifting lower, weakening the "true" value achieved by producers, heavy actual and anticipated world-wide demand (led by China), on going tensions in the Middle East and other international "hot spots" and everyone's favorite—speculation.

The unfortunate thing about the plethora of reasons that prices move up and down and sideways, is that the reasons—for those who are selling and consuming heating oil—are not really all that important UNLESS you know ahead of time WHAT will happen, and what the price impact will be. In other words, it is always nice to try to understand why prices did what they did, but the likelihood of successfully predicting price movements, especially when you might be betting your whole business on that prediction, is not that great. Some people look at the word "speculation" and all they can think of is the recent rallying cry of "Close the Enron Loophole," even though few people even understand what is meant by that. Speculation is looked at as a dirty business meant solely to keep heating oil dealers from being able to sell oil and make a reasonable profit.

"If you aren't hedging, you are speculating."

What is too often overlooked is that while oil dealers are busy NOT buying wetbarrels, swaps, futures or options to protect promises that they have made to their customers, *those dealers are speculating*. Although each time there is a delay in offering a program to customers—or a decision is made to not offer a program at all—there is a genuine interest in the best interests of the customer, *there is speculation in that decision*. Hey, why offer a fixed price if prices are just going to fall? The answer is that the assumption that prices will fall is *nothing but speculation*. Alternately, when companies pushed for fixed prices two years ago, with the full belief that prices would go up last winter, the assumption that prices would not fall was *nothing but speculation*.

We all talk about what customers want—reliable service, correct billing, low prices, etc. When prices ARE low, customers want to pay that low price. When prices are high, customers wish they had locked in their prices before the prices rose. None of this is news, but still there are so many customers who are being sold a variably priced product, and these are the customers that are causing the "receivables issues."

The point? Customers who had a fixed price of $2.99/gallon or a capped price of $3.09/gallon haven't noticed ANY price increases since September or October. In addition, since they are paying the "lower" price, there shouldn't be a receivable problem from this group of customers (unless they were never in the position to afford the fixed or capped price in the first place). If prices HAD fallen, the cap customers would be paying a lower price (although the fixed customers would be paying the same price; but that is a separate issue). If you look closely, the customers that should (now and always) cause you the least amount of stress are customers on a pricing program (for obvious reasons, the cap customers should cause less stress than fixed-price customers). Variably priced customers, in all likelihood, "just don't get it" as far as the value of a program is concerned. Are they to blame? Partially. Are you to blame? Partially, as well.

If you can properly convey the benefits of a pricing program in easy to understand terms, you, your staff and your customers will be able to focus more time on running the operational aspects of your business and less time on worrying about how customers will be able to afford skyrocketing costs (or how to deal with irate fixed price customers if prices collapse). If you need help in setting up a program, and/or in conveying the benefits, just give us a call. We'll help you out.

Wishing for a weak economy, just so prices will fall, just is not a recipe for a sunny tomorrow.