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

Stop encouraging bad behavior!

When you try to take a look from a 10,000-foot view, it would seem that this would be a banner year to be a heating oil dealer. To date, although only in early December, we haven't had any extended warm spells (remember golfing in January two years ago?), we haven't had any basis blowouts (remember paying 20- and 30-cents over the NYMEX for rack gallons?), we haven't had any supply disruptions, and—oh, yeah—prices have come crashing down since the summer, hopefully leading to a widening (in some cases, a BIG widening) of margins from customers who buy at either a street-price or are buying as part of a cap program. This is not the time, or the place to (yet, again) talk about the negative results of fixed-price programs. If you don't know what the problems are, you probably aren't selling fixed-price, and if you are, then the "issues" are quite apparent.

When you look at companies that are having financial problems, there really aren't that many categories they fall under. Either companies offered fixed-price programs and lost customers (which is really a shame, especially when some "officials" are encouraging customers to renegotiate prices—I can't picture too many assemblymen recommending oil companies to renegotiate prices higher with their customers when prices go up!), or maybe they are still paying for "past sins." Many companies fall into one of those two categories, but the main reason, whether we want to look ourselves in the mirror or not, is that companies were not properly hedged.

I should start by saying that I do not know of a single company that can say they are so well hedged that absolutely nothing can happen to impact their profitability. Changes in basis (spread between the NYMEX or NY Harbor posting versus the rack), small or large swings in weather patterns, changes in the economy impacting collections, changes in banking policy causing a credit crunch or changes in supplier policy regarding down payments or other requirements will always be lingering, requiring constant monitoring. However, even with that list of things that can go wrong, generally, we see that the impact of that "list" pales in comparison to those who just couldn't get out of their own way, and had an opinion—to hedge or not to hedge—and might be suffering from the consequences of those opinions. Hopefully, as harsh a lesson as this will be to some (if you are reading this, and wondering if you are the ONLY one having a great, full-margin+ year, you are not. Fortunately, many companies are in the same successful boat, but there is still much to be done to make the "industry" less of a group of "knee-jerk" reactors, and more of a for-profit industry), once you can come to grips with the notion that hedging DOES cost money, that it DOES require discipline and that it DOES (sometimes) make you more expensive than your competition, you will realize that speculation is exactly that—speculative. Being protected (hedged, insured, whatever word you would like to use) might be a little expensive and a little boring, but do you know ANYONE who can successfully predict the price of oil next month, let alone next year? Speculating is fine, if you are prepared to accept the results, but hedging is always available for those who wish to do so.

The issue that all too many oil dealers are finding themselves facing is that a small group of oil dealers, in a never-ending quest to build up their customer count, have thrown away profits in return for new sign-ups. We keep hearing about the "offer du jour," whether it be a one-year cap at $2.79 per gallon or a six-month fixed price at $1.89 per gallon. Each offer, when investigated closely, probably does make a small profit for the one offering the program to the "new" customer, but the price—and that is all these dealers are pitching—might only be a good one for a few days, until prices fall even further. If prices increase, those few who signed up for the new offer did get lucky, but who knows what will happen to prices over the next year?

In today's environment, it is a little difficult to actually pin a value on a heating oil customer, but the simple notion of thinking that every time you sign someone up your company is worth more, needs close scrutiny. It is not novel in our industry to find that new customers often get special prices, and that "old," long-term customers pay the highest margins. What we see happening is that the best customers are often leaving for these "low-ball" offers. The customer feels like he or she is saving money, despite the fact that price is not and should not be the only reason to buy from a full-service heating oil company. The "new" company thinks they are acquiring a customer that will be a bit of a loss-leader for a year, but then turn into a full-price, full-margined customer. Why would a customer who went to you just because that day's price looked good bat an eye leaving you next year, for another low-ball offer? Isn't it quite possible that you are just "renting" a customer for the year, not bringing in someone that will stay until they sell their house and move?

There is so much talk over the lack of customer loyalty, and the talk is not misguided, but how many customers would be "disloyal" if they weren't getting barraged with low-price offers? Once a customer sees that he can save 20-, 40- or 60-cents per gallon, why wouldn't the customer leave? The economics in running a full-service oil company are not all that difficult to understand, so it can't really be that in the same area two companies can be profitable if one needs a 70-cent per gallon markup and the other is willing to try to get by on 35-cents. While all of this is going on, the oil customer is being trained to think that oil is just a commodity, that every company has the same truck and that you can't trust the oil company that has been faithfully delivering oil and servicing your equipment for years. The frustration that the vast majority of the "good operators" are going through is quite understandable. Is there any way that swapping good customers for "rentals" can make a company more valuable?

Just so we are all clear, I am not, in any way, shape or form, advocating that competition and marketing are bad. No, they are good, and often result in the best operators and marketers who are the most successful. Also, there is no place for collusion on prices, so each company needs to do what they have to in order to remain profitable, and to try to maintain and grow their business. The issue is that if too many customers become rental property, where will the real profits be, and what kind of multiple can you actually get when it is time to pack up shop, grab the golf clubs and move to Scottsdale?