FUTURES $ OPTIONS

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Knowledge is power

As the winter season winds to an end, there are echoes throughout the heating oil land that range from *"This is the worst year ever; so happy it's over,"* to *"Wow, I never really realized how profitable this business could be."* The range of emotions (from owners) has never been wider, and seems to be just another in the series of "new reality" issues. With the withering economy, the staggering number of job losses and the unavailability of credit, most retailers suffered greatly over the past 6+ months. However, those who sold a basic, needed, commodity (i.e. heating oil), in an environment that saw falling prices (i.e. heating oil), were spared not all, but a good deal of the pain that other retailers suffered through. For the most part, the dropping prices of heating oil fuels staved off much of the anticipated fuel conservation, and demand for heating oil remained fairly steady—in line with what might be anticipated when considering the weather.

As far as program offerings go, the clear winners this winter were price cap offerings. Most (not all) customers were very happy to see the steady price declines, and did not seem to take notice that the drops in the wholesale cost of heating oil were steeper than the drops in the delivered retail price to the cap customers. It did take a while to get used to the pricing mechanisms for cap customers, as we hadn't had a winter that saw delivery prices at lower levels than the cap price in a number of years. However, once the mechanics to track the actual costs (including all pieces—hedging, etc.) were understood, margins started to be enhanced, and dealing with the few unhappy customers became less of a burden.

In contrast with capped program offers, fixed-price programs were very problematic (putting it politely) this past winter season. The issue was not (only) that many dealers over-hedged, under-hedged or simply speculated on the price of oil. The issue was that regardless of "the teeth" of a fixed-price contract's Terms & Conditions, when prices fall by $2.00+ per gallon, and fixed-price customers do not see any price relief (despite the obvious fact that they do not deserve any relief), all logic takes a vacation, and customers lie, cheat, threaten and do whatever they can to get out of the contract. Sometimes there was a fee to "break" the contract, but even that fee rarely came close to the losses sustained by the oil dealer who was still the proud owner of very high-priced oil. The ill-will that resulted caused much frustration, and caused many clients to leave for "better deals" (which weren't any better, but certainly were with another company).

Regardless of the program offered, thanks to receivables issues, "being in the bank," tracking pre-paid wetbarrels and rack purchases, accounting for hedging costs and trade settlements, etc., for some it was quite hard to really know "where they were," Most smaller oil companies have an internal controller/bookkeeper and an outside accountant. While all is tracked, reporting can be difficult, confusing and delayed.

Below is a very basic list of what you really need to do in order to properly plan and to execute, in order for you, your accounts and your banks to know "how you are doing." You need to know that before and as it happens, NOT well after it has happened.

What is needed?

- **Clear plan** (detail)—what program are you offering? When are you going to make the offer? How are you going to protect (hedge) yourself as your offer is made?
- **Information BEFORE making an offer**—what are the proper tools YOU need to make the offer? Should you buy wetbarrels? Should you buy options? Should you buy nothing?
- **Clearly followed plan** that matched up to transactions—how are you going to be certain that the plan you have devised is actually executed, and that you know what your costs and risks are?
- **Tracking throughout the month and the season** of actual costs, including all hedge parameters—how often will you be able to tell what your "all in" costs are—daily, weekly, monthly...or not until after the season is over?
- **Tracking of sales prices and related margins**—it does sound pretty easy, but with different prices and different programs, it is very easy to think that "the bucket" will turn out okay, without knowing how you are doing with each type of customer and program.
- **Monitoring and forecasting of banking needs**—borrowing, paying down, getting "the float" from your supplier, etc. These can no longer be done by the seat of your pants. If you haven't noticed, banks are a little more concerned about to whom they lend money, and how sure they are about getting repaid.
- **Supply and storage opportunities**—there are certain opportunities that exist in contracting with suppliers and in taking advantage of available storage—without speculating on the price of oil. You need to know what those formulas and parameters are.

There is a convergence that is going on in the oil marketplace. Many items that were previously looked at as unrelated are now recognized as having impacts on one another. You need to understand supply, banking, marketing, hedging, etc. You don't need to do all of this on your own, as there is a good deal of expertise out there. You need to get comfortable with whom you are working, and be willing to be perfectly honest and open with them. The more they know about your business, the more they may be able to help you put all of the pieces together. Also, it is important to try to avoid overkill—you don't need to kill an ant with a sledgehammer. Spending a million dollars on a system might tell you everything that you could possibly ask for—if you knew what you needed to ask for—but cost you almost a million dollars more than needed.

Information is THE key to successfully remaining profitable. Put the pieces together, work with those with the requisite knowledge and do what you do best—keep your clients warm and competitively priced.