



Volatile Reaction

As retailers and marketers face shorter fuel profit cycles, it's time to grab the opportunities

BY SAMANTHA OLLER || soller@cspnet.com

Volatility is often considered beneficial and even a friend of fuel retailers, providing opportunities to recoup margin lost during profit-squeezing price spikes. If the past several months are any indication,

it's evolving into a frequent houseguest—for better and for worse.

“This has been the third-worst year in the last 20 years in terms of the magnitude of price changes,” says David Zahn, vice president of marketing for Houston-

based FuelQuest Inc., which provides fuel-management automation products. The company came to this conclusion after crunching Department of Energy figures on retail gasoline and diesel prices and ranking the results. The only two years with greater price changes were 2005 and 2008, notable for Hurricanes Katrina and Ike. (See “Charting the Retail Price Swings,” p. 163.)

Zahn cites unrest in Africa and the Middle East as “the spark that has lit this big fire.” Add in speculation and the steadily increasing demand for fuel worldwide, and the result is feverish price swings.

So far, it has played to retailers’ advantage.

“It’s been a pretty good year for gasoline retailers thanks to two ‘big innings,’ which were the follow-ups to volatility,” says Tom Kloza, chief oil analyst for Oil Price Information Service (OPIS), Wall, N.J. Gasoline margins were temperate from January through April, but the first “big inning” surfaced in May and persisted through June when wholesale values dropped even as gasoline demand increased. The second inning arrived with the late July/early August slide in wholesale prices.

“The dark side is that gasoline demand has been sluggish—down about 2% by our calculations,” says Kloza. “So, with several months to go, 2011 is shaping up as a decent year for fuel margins.”

There are some exceptions. Florida, Pennsylvania and some Rocky Mountain states have been stressed, Kloza says. The Great Lakes region, meanwhile, saw gasoline prices hit all-time highs.



“With several months to go, 2011 is shaping up as **a decent year** for fuel margins.”

“There are always periods where you have to maintain a squeeze in margins, and others where the market allows you to fix that,” he says. “It’s just much more extreme now. The squeezes are more and longer, and the pickup, the upsides, may be higher margins ... but not necessarily [last] for a long time.”

With this in mind, following are some underused areas, from buying to delivery, that may provide retailers and marketers with an opportunity to ride the waves successfully.

MIND THE HEDGES

While hedging has not been widely embraced by marketers as a means to insulate themselves from volatility’s downside, it has proven to be a useful profit tool in 2011. Dominick Chirichella, a founding partner of New York-based energy market specialists Energy Management Institute, says a retailer using crack spreads to hedge gasoline margins “probably did OK” this year.

“During the course of this year, refining margins have gone up and held up relatively strong,” he says.

The optimal time to put hedges on for the first half of the year is generally early in the fourth quarter of the previous year, he explains, so in October and November, consider putting crack spreads on for February through July of the following year.

Timing and sticking to a strategy are keys to benefiting from hedging, Chirichella says. Once people try to game the system and veer into speculation,

► Charting the Retail Price Swings

According to an analysis of Department of Energy figures by FuelQuest, 2011 was the worst “non-hurricane” year in the past 20 for the sheer magnitude of its weekly gasoline price increases. Once you factor in hurricanes, 2005 and 2008 grabbed the lead, thanks to supply disruptions from Hurricanes Katrina and Ike.

An analysis of diesel prices revealed a similar pattern, with 2011 ranking third overall in weekly retail price changes.

Magnitude of Weekly Gasoline Price Changes

Year	Absolute retail gasoline price change
2000	\$0.0238
2001	\$0.0300
2002	\$0.0151
2003	\$0.0242
2004	\$0.0263
2005	\$0.0589
2006	\$0.0454
2007	\$0.0500
2008	\$0.0825
2009	\$0.0438
2010	\$0.0326
2011	\$0.0502

Sources: Department of Energy, FuelQuest

One state is getting an unusual reprieve. California, which typically lands in the top three for states with the highest gas prices, hasn’t even made the top 10 since July thanks to high supply and falling prices, according to retail fuel price

website GasBuddy.com.

But while the size of the swings are bigger, the distance between them is narrowing—and with it, the window to profit, says Bob Stein, president and CEO of KSS Fuels, Florham Park, N.J.

► Retail Volatility: A 2011 Timeline

Patrick DeHaan, senior petroleum analyst for gas price website GasBuddy Inc., Brooklyn Park, Minn., offers the following roadmap of the peaks and valleys of 2011's retail gasoline prices.

► **Arab Spring:** Average prices started at \$3.05 in the New Year. Prices remained relatively stable until turmoil in Libya and Egypt brought concerns to the stability of oil supplies from the Middle East. Average gasoline prices rose more than 30 cents per gallon in just two weeks. Gasoline prices averaged \$3.17 on Feb. 21, rising quickly to \$3.50 by March 8. It was the fastest increase in recent memory; gasoline margins were razor-thin while retailers raced to raise prices as their wholesale cost rose considerably.

► **Summer Driving Season:** Gasoline prices held stable for much of the rest of March before climbing again ahead of the start of the summer driving season. Prices climbed an additional 25 cents per gallon between April 1 and May 5, when they peaked at \$3.958 per gallon. Since then, amid small price climbs and drops, margins at the retail level have improved for retailers after those first difficult months of the year. Average prices will likely remain between \$3.25 and \$3.85 toward the end of the summer driving season.

► **Credit Crunch:** Excluding the Middle East destabilization, prices remained relatively quiet outside the typical spring rally in prices. In August, volatility increased as Standard & Poors cut its outlook on U.S. debt. All eyes have been on the European debt crisis and Wall Street, as well as unemployment numbers and the Federal Reserve's monetary policy.

► **This Fall:** As we enter the autumn months, tradition tells us that gasoline prices will fall from their summer levels; with the country's debt problem and slow-growing economy, this is a near-certainty. The lowest gasoline prices will likely occur in November, with averages around \$3.15 to \$3.50. As the holidays conclude, prices likely will climb.

► **2012 Outlook:** Expect prices during much of 2012 to be similar to 2011, remaining between \$3.50 and \$4.25 on average. As long-term issues continue to dog the U.S. economy, and growth is mostly likely to continue its slow pace, retail fuel margins in 2012 should improve overall compared to 2011.

they get themselves into trouble, he says. Always start with a plan and map out the various outcomes for different market conditions before you put on your first hedge, he advises: "And have a risk policy in place that governs what everyone involved in the hedging process is allowed to do and not to do. Leave nothing to anyone's imagination—you want to make it as mechanized as possible."

Based on today's fuel vicissitudes, Chirichella recommends an options strategy for hedging, "because it's not clear as to whether we will be \$30-per-barrel higher or lower at this stage of the game." Options are considered an "insurance" of sorts against price increases. A hedger buys an option to protect a particular price. If prices jump,

"This has been the third-worst year in the last 20 years in terms of the magnitude of price changes. And the two that beat us were Hurricane Ike and Katrina years."

the option pays out.

"My interest as a buyer of fuel is I need to protect myself to the upside and should be willing to pay a premium for that policy," he says. "If my analysis is wrong or the economy has collapsed again, at least I will still get the benefit of buying my product at a much lower price and reaping benefits of it."

SIGN A CONTRACT

While shopping different racks for the next fuel purchase may offer a feeling of freedom for a retailer, current business dynamics are making signing a contract a more attractive option.

"Branded and unbranded suppliers are doing more contract deals with customers," says Cathy Duncan, executive director of marketer solutions for Telvent DTN, Omaha, Neb. She cites a survey of the company's marketer clients in which 75% agreed or strongly agreed that more gallons are being sold on contract or discount, beyond standard branded contracts.

This same survey found that the three biggest challenges marketers face are increased competition for business (with

► Get a License

Want to shave some costs off your fuel distribution business? Consider becoming a licensed distributor, says David Zahn, vice president of marketing for FuelQuest Inc., Houston.

Also known as a 637 license, the qualification enables retailers to remit motor-fuel excise taxes to the government. The accompanying benefits include a shrinkage allowance in 36 states for gasoline and 31 states for diesel; float opportunity from 21 to 62 days; availability of rack-based pricing; and lower overall freight costs.

"There's a lot of things you can do to nibble away at the cost side, but if you do all things in the right way, it can start to add up to a lot of cents on the gallon, which improves not only your profit margin but is a way to compete at the pump," says Zahn. A client whom FuelQuest assisted in the licensing process saved \$750,000 after becoming a licensed distributor in three states.

superjobbers providing much of the pressure), the need to increase profitability, and decreasing volume demand.

"If there is a decrease in demand and a decrease in volume, then doesn't it make sense someone would give up a little more for a commitment in volume?" Duncan says. "They won't be as willing to do it if they already have the bulk of your business. But if they don't, they may be willing to commit on a lower margin for a committed volume."

A marketer might agree to shorter payment terms, paying on five days instead of 10, for example, if the supplier can provide a better rate, which in turn would grant the marketer a better margin.

The challenge is finding the right contract. Here, Duncan advises analyzing the contract's savings over time, including how they trend over the seasonal demand peaks and valleys, and whether the volume commitment is doable. Keep the long-term view: One out of five loads may not be as profitable if you bought it on the open market, but you may have saved enough money on the other four loads to more than make up for it, she says.

It's also important not to tie all of

your gallons to a contract. "I think marketers should look at their fuel-buying mix like a stock portfolio," says Duncan. "Some things you are going to commit to for a certain return, and other things you are going to be risky at—your rack business—that you move around and shop throughout the day.

"Midsize to smaller marketers are looking at competition that they didn't have [before], and volumes are going down. Doesn't it make sense to negotiate a contract with a retailer?"

"What you really need to maximize profitability now, especially if you're not a big guy, is having a really balanced portfolio of how you're buying fuel."

GO THE EXTRA MILE

For days when a marketer's trucks aren't running constantly, it could pay—by tripled or quadrupled margins—to pull from a rack that is a little further out. "On wholesale fuel, the margins are so small—\$75 for delivering \$8,000 in gaso-

line," says Duncan. "I've seen cases where going 50 miles farther—adding two more hours on delivery time and including freight—might bring you \$250." Multiply this \$175 difference by 10 loads, and the difference is considerable.

"People have a tendency to think 'If I'm in Oklahoma City, I should pull from the terminal in Oklahoma City,' but Tulsa is not that much further," she says. "Sometimes going to one not the closest can really improve margin a lot—especially if trucks aren't that busy." DTN offers Fuel Buyer, a rack price-management system that allows a marketer to compare different rack options and evaluate whether the extra miles will pay off, once freight costs are excluded.

Many of Duncan's wholesaler clients have noticed that their own retailer customers will cancel their orders based on a market jump, then wait to buy until the next day in hopes of getting a better price. Those are ideal days to venture out to further racks.

Similarly, from a retailer's perspective, adopting a just-in-time model for fuel deliveries can pay off. "When you have a lot of high volatility, and prices are so high, decisions about even when to have a tanker show up with fuel become really important," says Zahn of FuelQuest, which offers the Fuel Management System (FMS), a Software as a Service (SAAS) product that automates the fuel-management process, including demand forecasting and fulfillment.

"We're trying to drive more automation to customers so that in some ways, they can take the volatility and turn it into an advantage," says Zahn. "You take 1 or 2 cents off in cost, and imagine your advantage at the pump in terms of price." ■