



Selling Price Programs in a Volatile Market

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cap is a wonderful cash flow option, but few residential customers can pay \$3,000 to \$4,000 upfront these days.

However, dealers may be surprised how many former prebuy fixed customers may desire further information on either a prepay cap or a cap budget because memories of 2008-09 are still fresh in their heads.

If the customer is capable of prebuying their cap or fixed program, but adverse to the fee, why not try offering to budget the fee on a per-month basis as another potential solution? Additionally, dealers may be surprised that their larger commercial and municipal customers may also desire a cap budget. Enrolling them in some type of budget program will also not only ensure timely, affordable payments, but aid them in forecasting their worst case cost scenario for the coming fiscal year.

Recommending and offering a cap budget (or prepay cap) based on edu-selling a stable payment solution in a volatile market creates an image of clear credibility to customers. However, the reason, recommendation and mechanics of the cap budget offer must be understood by the entire front-line team especially customer service reps (CSRs).

Since edu-selling takes more time than simply taking an order, providing CSR training with both the time to practice and the appropriate tools are critical. CSRs must know the details as practiced in a script that is authentic to their style, including a process to elevate a more difficult call to a supervisor will maintain manageable call times and professionalism.

Finally, energy dealers must diligently continue to protect their businesses from price and market risk. Working with both suppliers and risk managers that have the ability to provide non-incremental (less than 42,000 gallon contracts) allows dealers to sell in smaller batches, reprice higher or lower if necessary, and hedge their programs on their own delivery curve to ensure a balanced hedge.

Hedge Solutions specializes in non-contract incremental paper hedging and risk management. Additionally, more suppliers are offering non-incremental physical contracts as well. Over, under or no hedging can prove disastrous when offering price protection commitments, particularly in a volatile market. There is no need for dealers to risk their entire businesses with the vast professional resources and assistance available.

Remember, no one knows where the market is going, and having the courage to admit this fact will allow energy dealers to protect their business and honor commitments to the benefit of their customer base and the entire industry. ☐

THIS ARTICLE IS THE SECOND OF A TWO-PART installment on how to hedge and sell price protection programs in a turbulent and high price market. The broad array of current factors that are liable to push the price of oil in either direction in an extreme sense were outlined in the June issue by my colleague, Adam Kovacs, from our sister company, Northland Energy Trading.

This article will focus on how to sell price protection programs amid extreme economic uncertainty and increasing market volatility, while offering some thoughts on how to convince customers that the fee (juice) is “worth the squeeze.”

Understanding the factors that move this market are important to the extent that the dealer needs to have enough talking points to articulate to their customers that no one knows what the market is going to do.

However, truly buying into this thought process is equally important in order to prevent costly risk management mistakes, such as making physical or paper hedge purchases without having committed program sales on the other side. Unlike the speculator who takes a position on one side of the market, the job of a conservative hedger is to utilize a risk management strategy that works in both an up and down market.

The job becomes more challenging when faced with the very serious reality of a dismal “economic recovery” that has resulted in slower customer payments, anemic prepay programs and tighter credit terms from suppliers, in addition to reduced lines of credit from banks. These cash-flow issues, coupled with current market volatility, amplify the impact that one bad purchasing decision can have on both a company’s gross margin and cash flow.

Therefore, in today’s environment, price protection programs must be able to minimize price and market risk while maximizing cash flows. It goes almost without saying, but the clear winners in this environment are the cap budget and the prepay cap.

Queue the collective groan please. “A cap

program? With these premiums? How is the additional cost justifiable when the customer is already looking at least at a 33 percent increase year over year in their base cost of oil?”

It is important to point out that this strategy does not necessarily increase the price of a gallon of heating oil. The dealer is providing the customer with the option of a much-needed solution: a stable payment that allows for a maximum worst-case monthly payment, but also provides the opportunity to get the lowest street price if the market falls.

Yes, for dual price protection (because it works in both an up and down market), it will cost some additional premium. The premium can be justified to the customer fairly easily when in the course of nine days from March 29 to April 9, 2011, the market went up 33 cents, and then from May 6 to May 9, 2011, the market fell 45 cents.

For an at-the-money option premium that currently costs (hypothetically) around 30 cents, this is piece of mind for the customer, and at the same time offers price flexibility should prices fall. This is especially important when considering the market has moved in such a wide range over the span of just two months.

The key to “selling” the market cap budget is surprisingly and pleasantly simple. The process can be educational as illustrated above and also entails the energy dealer’s trusted recommendation as a resident expert. This type of selling can be referred to as “edu-selling,” because when most customers know that the cap is an add-on feature to a market rate or market budget program, the program recommendation is being made based on the fact that “no one knows what the energy markets will do.”

Also, consider the following: if it is known that many customers are struggling to pay their bills, the sooner the dealer can offer some type of a budget plan (but from a marketing perspective, don’t call it a budget, rather equal monthly payment), the better the results for the dealer and customer. This is a win-win scenario for both parties. Of course a prepay