

# How Much Per Gallon is Your Fuel Company Worth?

Getting beyond the cents per gallon mentality

BY STEVE ABBATE

IT HAPPENED AGAIN. I WAS ATTENDING AN INDUSTRY FUNCTION, and I was asked how much per gallon heating oil companies were selling for. I answered by saying that it depends on how much the company sells their service policies for. I went on to explain that some companies are still charging \$99 and others are charging \$299 for the same service policy. I explained that there would be a substantial difference in the value of each company. The gentleman I was speaking with said he understood the point and said he would rephrase the question. What multiple of margin are companies selling for, he asked?



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It was at that point that I realized how ingrained we have become as an industry in the cents per gallon mentality. I have tried unsuccessfully for years to find another industry that values its business based on unit sales of just one of its revenue sources.

I can understand how this valuation method developed. Back in the '60s, '70s and '80s, most heating oil companies looked simi-

lar. They lost money on service to secure the fuel sales, builders were still putting in oil fired systems, there were no price protection programs and the price for fuel was relatively inexpensive and stable. I often hear stories about meetings where the former owner of the "big guy" would meet at a diner, write a cents-per-gallon number on a napkin and sign the deal on the back of the place mat. Today, however, much of that has changed and so has the methodology for valuations.

To understand the point about why businesses can not be valued on a cents per gallon basis, let's look at two retail marketers (A & B). Both have the following: sales of 2,000,000 gallons annually; 2,500 customers; 75 percent automatic delivery; 70 cent margins; 1,500 service policies; same percent of budget customers; same percentage of price protected customers.

## NOW LET'S LOOK AT THE DIFFERENCES:

	Company A	Company B
Service Policy	\$299	\$99
Service Charges	Flat Rate Billing	\$60/ \$79 OT
Area Covered	20 mile radius	50 mile radius
Drivers in Jan	5	7
Vehicles Registered	15	20
Average Pay Rate	\$20	\$25
Average Vacation Weeks	2.5	3.5
Total Employees	15	22
Health Insurance Employee Pays	30%	0%
Square Ft of Office	2,500	10,000

There are many other items that would need to be considered in comparing these two businesses, but I believe I've made my point. Company A is much more profitable and valuable than company B. The reason is that company A makes more money.

Over the last 20 years, I have worked with six buyers valuing heating oil businesses five different ways, and in my experience it typically comes down to two factors. The first is how much money the buyer is willing to invest as compared to how much money the business makes for them (the income approach), and the second is

how much they think they can buy it for (the market approach). The "for them" part is critical in valuations. A buyer who can reduce overhead through operational synergies (cost reductions) will make more money and will typically value the business higher.

The market approach and the income approach are the two most recognized approaches when valuing a business. The market approach is based on the idea that supply and demand for the assets determines the value. This is similar to how homes are valued with the exception that homes use comparison sales data, which is typically not available in the retail fuel industry.

The income approach considers the value in relation to the future benefits derived from owning the assets of the business. This approach is based on how much money the purchaser will realize as compared to how much is invested in the assets. Different purchasers will use different methods such as internal rate of return (IRR), return on equity (ROE), distributable cash flow (DCF) and multiple of earnings before interest, taxes depreciation and amortization (EBITDA).

If you are not one of the big boys looking to make a multi million dollar acquisition, then take a look at your income statement or profit and loss statement from your accountant. Calculate how much gross profit you would project and what expenses you would have to service the customers. Use your current line item expenses as a guide. See what the bottom line profit would be to you and determine how much you would be willing to invest to realize the profit.

Retained gallon deals help to reduce your risk, but many sellers will shy away from not receiving a partial payment upfront at closing with some guarantees that you will not ruin the business and drive away customers and the resulting gallons. The better, more profitable companies are the companies that have the highest demand and are typically less receptive to retained gallon purchases.

Another major consideration a buyer should examine is additional capital needed to be invested. Capital items include vehicles, computers, telephones, office facility and bulk plant compliance. These items can have a substantial impact (positive or negative) on the value of a business. Think of it as buying a house that needs a new roof, carpets and kitchen appliances vs. a newly remodeled home with stainless steel appliances and granite counter tops.

In valuations, let's not forget about the structure of the deal. Sometimes a lower purchase price that is structured to allow for certain tax benefits will lead to a higher net payout for the owner. This can be particularly true if you have a C corp. (Note: If you are a C corp., check out the Martins Ice Cream IRS ruling; it could save you substantial tax dollars).

Recently, there has been a concern that the number of buyers in our industry has declined. The big name companies have scaled

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down their acquisition programs and even those that have purchased businesses recently have made fewer acquisitions. There is no doubt that the volatility in the markets and weaker than expected earnings have caused companies to be more cautious in their acquisition activity. The global financial situation is another factor in businesses being able to fund acquisitions and the related working capital needs.

There is, however, good reason to be optimistic about the near future. I attended a meeting recently with a major bank who is very involved in energy lending to our industry. They were in the process of hiring an additional staff member as they wanted to continue to grow their energy lending portfolio. They called our industry "recession proof," and they specifically spoke about funding acquisition lines for their clients.

My discussions with several fuel marketers have indicated that this year will see a return to more profitable times. Margins have increased and successful marketers have been able to make adjustments for conservation and working capital needs. All indication is that the competition for acquisitions will bring business values back to a reasonable level.

Keep in mind that the funds available for acquisitions will continue to be looking for profitable businesses with full service automatic delivery accounts, profitable service departments, strong fuel margins and low operating costs. | FON

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