Out and About the Industry

Building a high value fuel distribution business takes discipline. By Mark Radosevich

Marketers competing for fuel distribution contracts are facing an increasingly tough environment to garner profitable dealers business. In an attempt to rapidly build gallons, many marketers have been passing through the prompt pay discount (PPD) to dealers in order to garner branded supply agreements. Other marketers are forced to match these deals to preserve long standing business or to maintain current volume levels. Many things can be said about independent dealers, but ignorance is not one of them. Like opening a Pandora's Box, retention of the PPD has now become one of the top negotiating points in exchange for a long term fuel supply agreement.

In other articles, I've written about the generally low margin environment that fuel distributors operate even when they keep the PPD. With the typical rack plus one cent, plus freight and the PPD, per gallon margins are at best around 3.5 to 4.5 cents (depending upon the rack price). Compared to other industries, it doesn't add up to much when you consider overall product cost, responsibility to the supplier, transportation risk and governmental regulations. Being forced to lose the PPD further compounds the situation. Marketers that regularly relinquish the PPD may aggregate significant gallons but the value of those gallons, in terms of how much incremental business value they deliver is limited. Furthermore, having a preponderance of supply contracts void of the PPD limits the number of potential buyers when one is ready to sell and exit the industry.

Control the Real Estate:

The best method to insure optimal fuel supply profitability is to control the real estate, requiring a disciplined and deliberate approach to growing dealer volume. By controlling the real estate, a marketer has maximum leverage to negotiate highly ratable fuel supply agreements. With the primary objective being the maximization of overall business value, this approach will eschew the relinquishment of the PPD for future fuel supply negotiations.

This does not necessarily mean that the real estate has to be owned for the long haul. In some instances it may require ownership only for as long as it takes to enter into a long term dealer lease and garner an optimal fuel supply contract. At that point the store can be divested either through a sale to that dealer or another real estate investor, subject to the lease. In other instances, a marketer could negotiate to buy a store and control the property through due diligence up to closing, whereupon the purchase contract is assigned to a dealer, subject to a prearranged fuel supply agreement.

The "Lease, Sublease and Assignment" approach entails a marketer entering into a favorable (and assignable) long term lease as the primary tenant. At the time of closing, the store is then subleased (at a higher rent) to a dealer with a pre-negotiated fuel supply agreement. Later the marketer assigns the lease to the dealer while maintaining the fuel supply. As a result, the dealer will enjoy reduced rent while the marketer eliminates the contingent liability of the lease and retains a highly ratable fuel supply agreement.

Make Smart Acquisitions

When considering an acquisition of a book of established dealer supply agreements, focus on quality deals that offer solid ratability in terms of margin, credit risk and remaining contract term. Let someone else buy unprofitable gallons.

Oil companies love volume aggregators. The higher the volume, the more they love you. Just push the juice and you're their best friend. Overall profitability and accrued business value is really not their concern. Grow smart gallons by avoiding supply deals that give away the PPD. It takes discipline, but the best approach is to slow down and focus on a steady path to build long term business value.

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