

ICPA Memo to Heating Oil Retailers - Capital



July 29, 2008

MEMORANDUM FOR: ICPA Member Heating Oil Retailers

FROM: Gene Guilford

SUBJECT: Capital Borrowing/Financial Issues

This coming heating season is likely to be the most challenging financially in the heating oil industry's recent memory. ICPA's 58th Annual Meeting on June 16-17, 2008 highlighted the problems and potential solutions, and this package brings you a sense of that as well as some new loan guarantee information available to those of you who will need to use banks or other private lenders to meet your capital needs.

Our survey of late June points to only 9% of marketers believing they will have adequate capital for the coming season. *Of the remaining 91% - about ½ believe they will be short of capital by varying amounts and the other ½ are not sure yet.*

Given that this is almost August, time is short. This informs you of what ICPA has been doing to find ways to help you bridge capital gaps as you prepare for the coming season. Working together and keeping our eye on the ball we will make it through this tough period and help consumers to do the same.

1. [The Small Business Administration \[SBA\]](#), is changing its definition of a small business for heating oil and propane dealers, effective August 21, 2008. The new definition is a company of 50 or fewer employees. This means that the SBA 7 [a] loan guarantee program, allowing a private lender to apply for a loan guarantee for your lender credit lines, can be done up to 75% of \$2 million or 50% of \$4 million. This critical change means your SBA-approved lender bank should be willing to not only extend you a credit line, but also hopefully a larger line than would be the case without an SBA loan guarantee.
2. [The Connecticut Development Authority \[CDA\]](#), also has a loan guarantee of up to \$500,000 through its URBANK program. This program, like the SBA program, operates through Connecticut participating private lenders and once you go to your bank for a credit line, your CDA-participating lender can apply for a CDA loan guarantee for your credit line. Again, your ability to access a CDA loan guarantee hopefully makes it easier for your private lender to extend a needed credit line for you.

The SBA and CDA loan guarantee programs are not exclusive of one another, if you qualify for a bank loan, you can use both guarantees at the same time and the two agencies work together. You work through your private, SBA or CDA-approved lender for these guarantees. Don't panic if your bank replies that they've never heard of any SBA rule change or use of SBA 7[a] guarantees - See the letter from the SBA at the end of this memo, show it to your banker.

ICPA Memo to Heating Oil Retailers - Capital

The Hartford District Office of the SBA is headed up by

Mr. Bernard M. Sweeney, District Director, U.S. Small Business Administration
Connecticut District Office , 330 Main Street 2nd Floor, Hartford. Ct. 06106
phone: 860-240-4670 / fax: 860-240-4714 / Email : Bernard.Sweeney@sba.gov

- SBA 7[a] Loan Guarantees >
<http://www.sba.gov/services/financialassistance/sbaloantopics/7a/index.html>
 - SBA private lender partners in Connecticut >
http://www.sba.gov/idc/groups/public/documents/ct_hartford/ct_julylist.pdf

 - CDA URBANK Loan Guarantees >
http://www.ctcda.com/CMSLite/default.asp?CMSLite_Page=52&Info=URBANK
 - CDA private lender partners in Connecticut >
<http://www.ctcda.com/partners/default.asp>
3. Small Business Development Centers [SBDC]. The SBDCs operate as a part of the SBA through the campuses of the Connecticut State University system [CSU]. Here, a marketer will be able to sit one-on-one with SBA's financial professionals to help you get your balance sheets and financial information in shape before you go to your bank for loans and loan guarantees. This is a critically important process for every marketer, is done at no cost to you, and provides you with solid financial guidance given the uncharted territory we are all in. *Those who participate in the SBDC process will either [a] be fully packaged at the end to see a bank and get financing and loan guarantees, or [b] be found to not be qualified for either.*

ICPA will be setting up the SBDC process for marketers during August. Both the SBA and the CDA regard marketers going through this process as very, very important in preparing marketers to deal effectively and quickly with banks.

4. Won't my own cash flow and wholesaler credit lines be enough? For some, perhaps. For most, no. Imagine the average Connecticut heating oil retailer at 2.5 million gallons per year. In 1998/99 that retailer needed to capitalize about \$1.1 million for wholesale oil. In 2008/09 that same retailer will need to capitalize \$9.1 million. That retailer will sell, on average, 500,000 gallons in just January, 2009 - requiring capital exceeding \$2 million.

Look at what John Nardoizzi showed on June 16th at our annual meeting -

| | 1998 | 2003 | 2008 | Today |
|-------------------|----------|----------|----------|----------|
| Sales per Gallon | \$ 0.937 | \$ 1.183 | \$ 3.356 | \$ 4.120 |
| Cost per gallon | \$ 0.586 | \$ 0.782 | \$ 2.790 | \$ 3.640 |
| Margin per gallon | \$ 0.351 | \$ 0.401 | \$ 0.566 | \$ 0.480 |
| Margin Percentage | 37.4% | 33.9% | 16.9% | 11.7% |

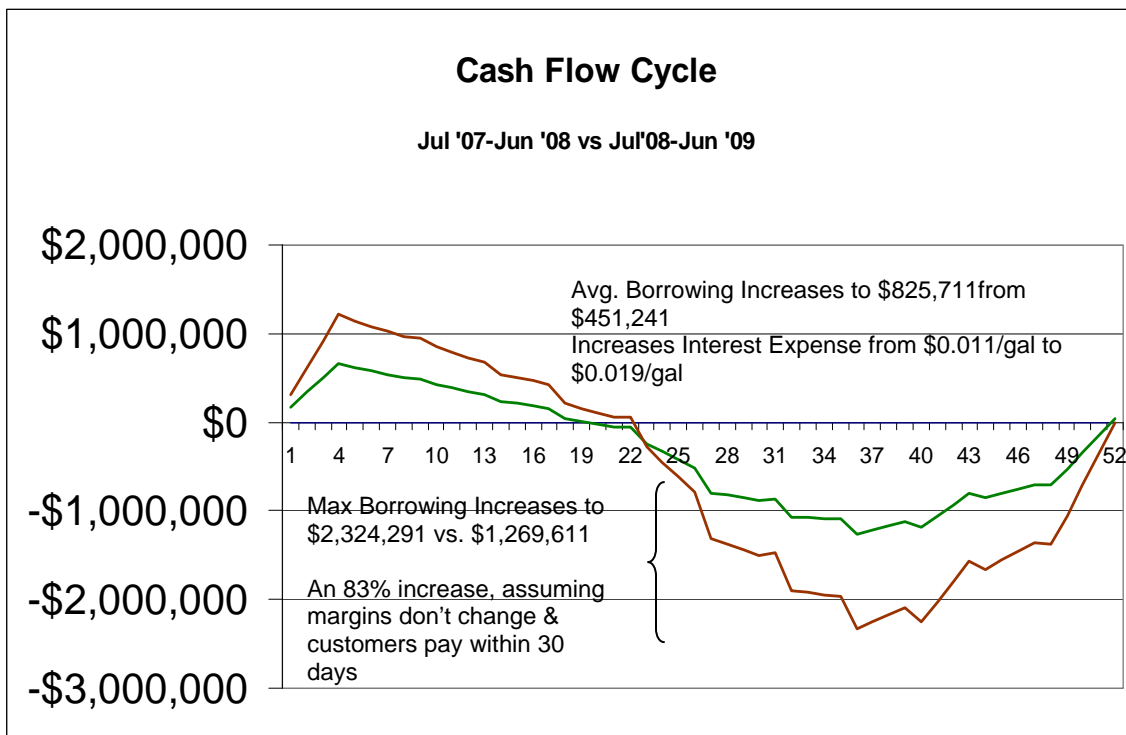
ICPA Memo to Heating Oil Retailers - Capital

Declining margins and increasing capital needs is not a picture most who finance retailers like to see. Be prepared, use these tools we are assembling for you, and be prepared early.

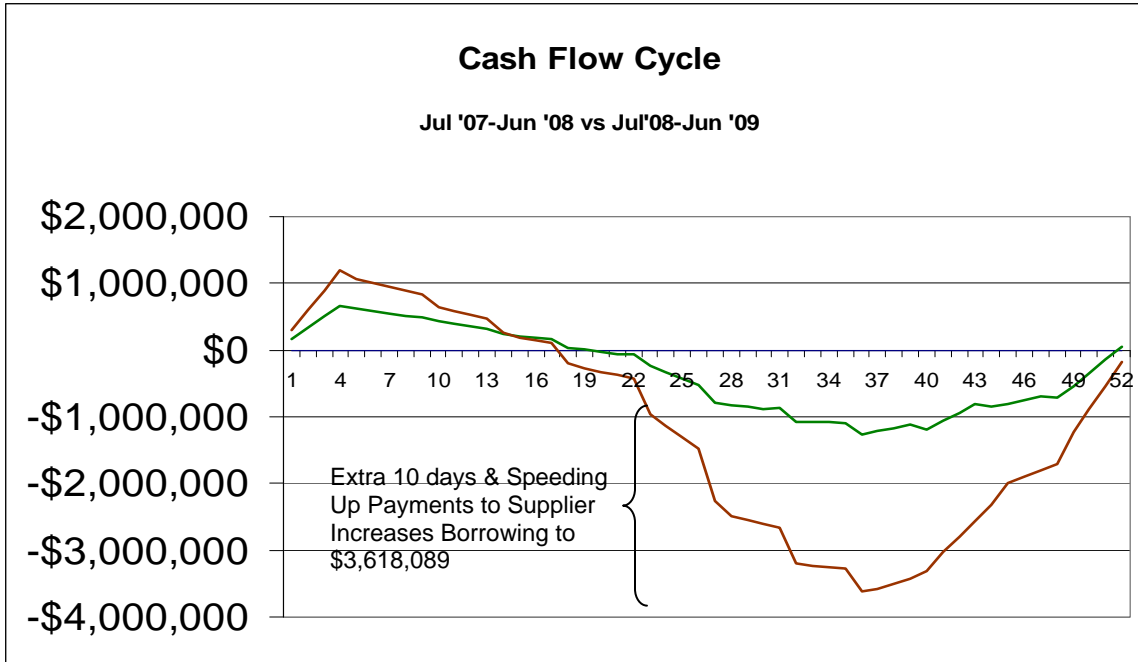
5. [What's a typical cash flow cycle?](#) Matt Ide from Citizens Bank on June 16th went through a variety of scenarios with us at our annual meeting. On the next page you can see what a typical cash flow cycle is, and how short it is likely to be given what the projected needs may be for the coming season.

You and your banker will likely need to focus on four areas [at least], in preparation to consider your lending needs. These are also a part of the SBDC process before you get to a bank:

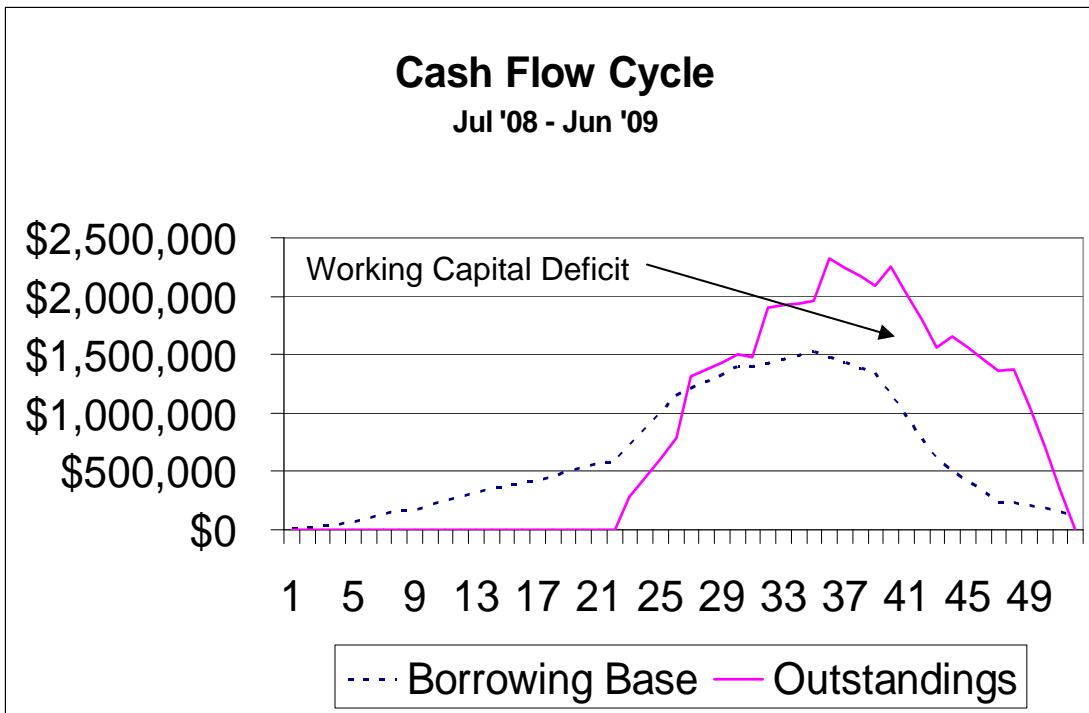
- *Impact of Prices*
- *Impact of Margins*
- *Impact of A/R Turnover*
- *Impact of Weak Working Capital*



Citizens Bank Charts - Green Line is Last Year - Red Line is Projection for 08/09



Citizens Bank Charts - Green Line is Last Year - Red Line is Projection for 08/09



ICPA Memo to Heating Oil Retailers - Capital

Citizens Bank Charts

The bankers are illustrating that with **[a]** commodity cost increases, and **[b]** the recent history of the industry regarding average gross margins actually deteriorating over time, and **[c]** consumers taking 30 or more days to pay for their deliveries, and **[d]** wholesalers shortening their line requirements to net 10 or less, and **[e]** historically retailers have been under capitalized - all adds up to ballooning the working capital requirements. Before you sit with a lender about your private capital needs and a loan guarantee, make sure you've gotten your balance sheets in order and have a plan for dealing with

- *Impact of Prices*
- *Impact of Margins*
- *Impact of A/R Turnover*
- *Impact of Weak Working Capital*

6. **Appraisals/Documentation.** Your financial institution may want to see a number of things as you apply for loans and loan guarantees. If you need an appraisal of your business, give ICPA a call and we can assist you in finding a qualified appraiser to get with you. Don't delay your work as finding a qualified appraiser and getting that person with you could take 45-90 days. You'll need to have arrangements in place well before Thanksgiving. Here is what many private lenders will likely need to see:

- Previous 3 years of financial statements (Consolidated)
- Previous 3 years of financial Statements (By Business Line if Possible)
- Trial balance with reconciliation to financials
- A/R recovery plan - A/R management
- Quarterly results
- 2 years of tax returns
- Fixed Asset listing
- Amortization/Depreciation Schedules
- Accounting system and financial statement close process
- Accountant name and contact information

7. **Self-Diagnostic Tools.** On June 16th we provided everyone with links to John Nardoizzi's self-diagnostic online calculators. You can go to his website, plug your data into his online tools and measure where you are. These are not hard and fast measurements but will give you an idea of what you're facing.

See:

Delivery Cost Calculator >

<http://www.nardozziconsulting.com/calculators/delivery.htm>

Margin Calculator > <http://www.nardozziconsulting.com/calculators/margin.htm>

ICPA Memo to Heating Oil Retailers - Capital

Customer List Calculator >

<http://www.nardozziconsulting.com/calculators/customer.htm>

8. **Mezzanine Financing.** If you go through wholesalers and private lenders, and consider loan guarantees and you still may need additional assistance. ICPA is discussing mezzanine financing options with a number of different private capital firms.

What is mezzanine financing? Mezzanine financing is unsecured debt (or preference shares) offering a high return with a high risk. This type of debt generally offers interest rates two to five percentage points more than that on senior debt and frequently gives the lenders some right to a share in equity values should the firm perform well.

Mezzanine finance tends to be used when bank borrowing limits are reached and the firm cannot or will not issue more equity. The finance it provides is cheaper (in terms of required return) than would be available on the equity market and it allows the owners of a business to raise large sums of money without sacrificing control. It is a form of finance, which permits the firm to move beyond what is normally considered acceptable debt/equity ratios (gearing or leverage levels).

Since mezzanine financing is usually provided to the borrower very quickly with little due diligence on the part of the lender and little or no collateral on the part of the borrower, this type of financing is aggressively priced with the lender seeking a return in the 20%-30% range. Failure to repay this financing within the agreed time limits results in the lender having an equity stake in the company. A high degree of discipline is needed before considering this as an option.

9. **Have a solid A/R Plan.** Unless you're independently wealthy, the key to surviving is a solid A/R plan. Recovering receivables in the environment of \$4 + product will be the line between success and failure. Virtually everyone's working capital will be stretched to the limit even under the best of circumstances so given where wholesalers will be in tightening their limits, your customers can't get too deeply into you.
 - **OilWell, LLC - Consumer Credit Risk Management** This tool, available at a 50% discount to all ICPA members in good standing [dues paid] enables you to prevent the hit-and-run consumer who grabs you for a delivery, doesn't pay for it, then moves on to grab another supplier. Don't get burned. *The objective isn't pushing gallons, it's getting paid.*
 - **Credit & Collections - Transworld Systems** For receivables difficult to recover, use a professional. **Transworld** is an ICPA-endorsed receivables management company that you can contract with to go after the difficult collections issues and help you stay on top of your toughest cases.
10. **Extending Credit.** Everyone needs to, few make full use of the tools available as the understandable need to be generous and keep a customer runs headlong

ICPA Memo to Heating Oil Retailers - Capital

into extending credit to someone who ends up burning you for one delivery of \$1,000 and needs another before the first one is paid for. How do you know?

- **Have a credit application.** There are many ways to improve your success when dealing with this issue. Checking a customer's credit history can be as simple as knowing who to call, or it can be much more complex. It can be very scary for a small business to loan resources or product without immediately seeing something back. To get a good idea on your potential customer's credit history it's important to access their business Credit History Report. While pricing ranges from \$15 (standard one page outline) to \$1000, the credit report will give you background into their financial history. Starting with a risk rating, you can start to predict how likely you are to get paid in a timely manner. These credit reports can be received through fax, mail, and even online. If you chose to deal a lot with Credit Reporting Agencies (such as Transunion, Equifax, or myaaacredit.com) it would be wise to establish a relationship with one so that you can eventually reduce your cost based upon the number of requests that you submit. *Understand credit scores for what they mean - a typical cut-off for extending credit is a score of 650 - though the details of the credit report need to be taken into account as well.*
- **Get a credit card.** Have the consumer give you a valid credit card number and keep it on file with authorization to hit the card for deliveries. Yes, credit cards eat into your margin; then again so do losses from non-payments. Reduce your credit card fees by using [COCARD](#), *ICPA's endorsed credit card processing firm, we use it and it cut our credit card processing fees by more than half.*
- **Checks.** Don't get burned by bad checks - ICPA has endorsed a company called [eCashflow Systems](#). You don't pay anything to [eCashflow Systems](#) to have them collect the full value of these checks- they make their money on the bounced check fee from the customer. It's all processed electronically, with no hassle or time spent by your staff on collections.
- **Budget Plans.** While technically not credit, this allows you to get your customers on a regular, standardized payment schedule with you so that the shock of single-large deliveries is minimized and the consumer places more emphasis on making the budget payment and doesn't focus on the \$1,000 delivery just made. Stay on top of these and make sure the payments get made on time.
- **Prompt Payment Discounts.** Example "X"% discount for payment within 10 days.
- **Invoicing.** Accelerate, leave an invoice and return envelope at time of delivery.
- **Reduce standard terms.** If you are at 30 days, reduce that to 15 or 20 days.
- **EFT.** Draft customer account a day or two after delivery - offer a discount.

Everyone wants customers and volume. Everyone needs customers who pay them in order to stay in business.

How you run your business is up to you. We will do everything we can to help you get through a tough period. John Nardozi and Matt Ide have given some great advice and we've put some solid tools in your hands and new financing mechanisms to use. Very little about capitalizing a heating oil operation today resembles what it took 10 years ago.

John's opening statement at our Annual Meeting was a quote from Charles Darwin,

"It is not the strong of the species that survives, nor the most intelligent that survives, it is the one that is most adaptable to change."

July 25, 2008

Mr. Eugene A. Guilford, Jr.
Executive Director
Independent Connecticut Petroleum Association
10 Alcap Ridge
Cromwell, CT 06416

Dear Mr. Guilford:

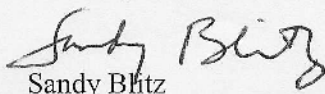
I am pleased to inform you that the U.S. Small Business Administration recently approved a rule change that clarifies the size standard for the heating oil industry which will enable most businesses in this industry to qualify for SBA loan guarantees. Effective August 21, 2008, the size standard has been revised from \$11.5 million in average receipts to 50 employees. This new definition, based on the number of employees, clarifies the size standard in an industry where revenues drastically change with the fluctuation of volatile heating oil costs.

In light of increases in energy prices, dealers may find it difficult to purchase product from wholesalers and to carry their accounts receivable. The SBA offers a range of loan guaranty products as well as a number of services that may be of interest to your membership. SBA guarantees lines of credit as well as term loans to finance the purchase of inventory as well as for other business-related purposes. SBA does not offer direct loans but backs loans made by participating lending institutions. Your members may contact their lenders directly or call their local SBA office for guidance.

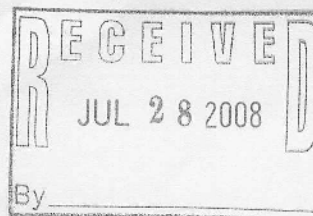
SBA also offers training and counseling through our resource partners, SCORE, *Counselors to America's Small Business*, Small Business Development Centers, and Women's Business Centers. These counseling services are available to help your members with any business-related issues.

Feel free to contact the Connecticut District Office at (860) 240-4700 for more information.

Sincerely,



Sandy Blitz
New England Regional Administrator
U.S. Small Business Administration



cc: Bernard M. Sweeney, District Director