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Complexion of the Fuel Landscape

As an alumnus of Big Oil and now a consultant, my role is to provide key analytical and financial advice to independent fuel, convenience-store and service-station business owners, operators and distributors. Given my involvement in numerous acquisition activities, I have a burning need and desire to hypothesize about the future of retailing fuels in a stagnant demand environment. The soon-to-be-experienced paradigm shift in fuels retailing, I believe, will reward the well-educated and well-informed distributor, jobber and/or fuel marketer.

Within a few years, most large integrated oil companies will no longer manage their brands beyond the terminal gate. Once all their retail assets are sold, U.S. motorists will purchase fuel through networks of distributors. And these distributors, some made larger through their hard-earned acquisitions, may face unsteady management of change issues.

The newly engaged jobbers, flexing their retail might with newfound real estate and operations, carry with them challenges complicated by contracts signed with the investors and partners who backed them. In this crazy, never-before-seen credit market, finding the money in the base case (and really the right investors and partners) is like running the New York marathon with high hurdles (and the usual potholes) on every block: Only the determined win, and with far less than historic bank debt. Buyers must consider all their financing

options, including an equity partnership, a joint venture and selling some or all of the underlying real estate to an investor.

Unlike large, publicly traded oil companies, these players generally have a relatively short-term view of return on capital, and an exit strategy. They want to make their return (and their money back) within five years. They perform their due diligence, accept the analytics and forecasts presented by the buyer, run their models, sign a deal that works for them (and, with hope, their new partner)

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and show up at closing with a tank farm of cash. If you are fortunate, they may have even shared the “hard money” deposits along the way to closing. They have projected a return of 10% to 20% or more depending on the structure, which they fully expect to achieve, one way or another. And, depending on actual performance, their exit may be invoked sooner than later.

Cautious Optimism

Therein lies the great challenge. Without the upstream girth that has buttressed Big Oil’s downstream marketing operations, how will these smaller yet supersized fuel marketers of today generate the necessary short-term cash flow

to meet tight credit demands and ensure stability in the critical supply-chain relationship?

Moreover, I predict that while the majors will be competitive, there could be an overall shift upward in the price curve. During the now-famous barrel-price increase of 2004 to early 2008, downstream marketing suffered gigantic losses. Accordingly, jobbers could pay higher wholesale prices, perhaps as much as 2 to 3 cents per gallon more. Producers will now want to make 3 to 5 cents per gallon or more at the wholesale marketing level, whereas their historical average margins have been in the range of 1 to 3 cents after expenses. Their pricing strategy will likely shift from a rack-based model to something else, possibly Platt’s or OPIS spot-based. Yet marketers/distributors could face margin challenges in many markets from aggressive, independent brands and operators, which will continue to exist at lower street prices.

So what does this mean to the jobber? Approach acquisitions with cautious optimism. No one wants to be the jobber who paid too much and overleveraged to get the deal. These companies may find their margins compromised and their backers impatient. The point here is that there are important lessons learned that must be considered by buyers in advance of the next merger or acquisition to ensure steady growth.

In my next column, I’ll discuss why the future is bright for the well-informed jobber.