Propane Resources
Helping Business Partners Create Opportunity

¢apital Communication$

HELPING YOU ARRANGE THE PIECES OF YOUR FINANCIAL PUZZLE. SPRING 2010

Rising Interest Rates and Your Company

Mark Bailey

In the past year, the credit crunch has made loans and lines of credit an important part of retailers' business. We are in times of record-low interest rates — and the industry has enjoyed the benefits. Those lower interest rates have allowed retailers to grow their business with additional tanks, trucks, and storage, at a much lower cost. In addition, day-to-day operating expenses for things like financing accounts receivable have also been lower. Many industries have felt the negative impact of unusually low interest rates and the over-reliance on cheap money (the real estate market is one that comes to mind). Retailers need to take stock of what higher interest rates and tighter credit will do to their operations.

The low interest rates in recent years has allowed retailers to focus on being effective rather than efficient in the way they run their business. When tanks were needed, they were purchased. In many cases, tanks were purchased when the ones in the field with gas going through them were fine. As interest rates rise, which they are bound to do in the next year or two, the cost of those inefficiencies will hit home. The question to ask is, "As a company, are we prepared for the impact of higher interest rates?" On the surface, many companies might feel like they are prepared. The increase in interest rates will have an effect that makes those assets purchased in recent years more expensive. Tanks that were purchased for new customers need to burn enough gas to provide a strong return on the investment to offset the increasing interest cost. As rates go up, the additional interest expense on the line of credit used to fund your accounts receivable will need to be offset by increased efficiency or higher gross margin.

Other ways to offset the rising interest rates could be to raise tank rent fees and enforce the tank usage information in your contracts (You do have them don't you?). You might also look at the rate you are paying. Investigate lockeding-in a lower rate for a longer term, while rates are still at record lows. Or, possibly explore moving your loan somewhere else — your local bank, a leasing finance company, or maybe the tank manufacturer.

Company Challenge

Daniel Dixon

Many of you had record years due to the winter and margins of 2008-09. Winter 2009-10 remains to be seen, but with the early January pull back in wholesale prices, an assumption can be made that margins are increasing at the most opportune time.

What have you done with the increased profits? Have you paid down debt, bought new rolling stock and/or paid yourself a big bonus? What about using some of that money for future expense savings?

Many have put off the investment in a new accounting software package, as well as routing and scheduling software. Advocates are touting the savings they are earning through having the reports they've always wanted to better run the business, routing the drivers more efficiently (fewer miles driven, larger drops) and using other key facets of the software, such as propane usage reports, tank finders by size, among others.

Change can and will be difficult. There will be some headaches along the way, but the savings will be visible and the payback time will be short. Some in a couple of years, others a little longer. You may not need that extra bobtail any longer. Overtime may be cut. There are many others. It all depends on how much you are willing to use the data available to your company. It's time to buck the system and challenge your company to meet new goals.

How Do You Compare?

Tamera Kovacs

Companies always want to know how they compare with other companies. Unfortunately, for the retail propane marketer, finding good comparisons can be difficult. The information that is publicly available is often meaningless. Comparing a 200-million gallon company to a two million gallon company loses some of its credibility. It's not always as simplistic as striking zeros from the equation to make it comparable.

Companies are typically valued (bought and sold) on a multiple of EBITDA (earnings before interest, depreciation, and amortization). A commonly asked question is, "Why can a 200 million gallon company show a company value multiplier of 9.5 and my company delivering approximately two million gallons only garners a multiple in the 5.0 to 6.0 range?" It is an excellent question. However, it's one that doesn't lend itself to a single, simple answer.

Company multiples start at a base multiple, and key criteria often raises or lowers this base. Key criteria includes gross margins, company trends, company tank ownership,

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How Do You Compare? *(Continued)*

percent of residential business, growth in the area, percent of customers on routed schedule, asset quality, potential buyers in the area, or buyers that are interested in making acquisitions in the area, as well as other variables.

Large companies have specific benefits: economies of scale, quantity of gallons, and geographic diversity, to name a few. An acquisition of a company of this magnitude can have a significant impact on the acquiring company. For a company delivering 200 million gallons, adding a two million gallon operation helps, but the impact to the base is minimal. A two million gallon company acquiring another two million gallon company, however, significantly impacts the base company. It often comes down to scale and impact. As an example, if the fifth largest propane company were to purchase the ninth largest propane company, the acquirer would increase their size by approximately 25 percent, yet if the fifth largest company purchased a company delivering two million gallons, the impact would be less than one percent.

When determining the value of a company, the factors in the chart are taken into consideration regarding what multiple to apply.

Valuation Factors	Affect on Multiple Positive	 Negative
Gallons trends	Increasing good gallons	Decreasing good gallons
Market segments (gallons)	High residential	High agricultural (industrial)
Percent of volume with top five customers	<10%	>20%
Customer growth trends	Increasing good customers	Decreasing good customers
Growth/Market opportunities	New building growth	No building growth
Gross margin trends	Increasing	Decreasing
Other income trends	Increasing & tank rent	Decreasing & not tank rent
Operating expense trends	Decreasing or maintaining	Increasing in excess
Company owned tanks	>80%	<70%
Routed customers	>75%	<60%
Systems	Good accounting/routing	Poor accounting/no routing
Asset quality	New/good	Older/need to be replaced
Staff quality	Performs with little direction	Requires constant direction
Safety	Good records/procedures	Good accounting/routing
Image/customer perception	Good clean image	Poor image

Another consideration is “Whose multiple is it?” The seller’s multiple, the adjusted multiple, or the buyer’s (consolidated) multiple? These are three different numbers and without understanding all the aspects of the businesses (both buyer and seller) you can easily be comparing the wrong multiples, which can render your information meaningless.

Lastly, the least discussed factor regarding multiples is the strategic multiple. This is when an acquirer has a unique reason for acquiring a particular company. The reasons vary and may or may not be readily apparent based on the buyer’s agenda. It may be that they are looking for an entry into an area, or it could be that there are outside forces like capital markets that require they make important acquisitions at some point in time. Strategic multiples help sellers realize an increase in value that they would not normally be able to realize with the sale of their company.

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Timing is Everything


Denny Carroll

This Spring could be the perfect time to do a little "customer" spring cleaning. Most software systems can generate a report that analyzes tank utilization. This report can help retail propane marketers determine tanks that are being under utilized or more importantly, tanks that had zero gallons pass through this past winter season.

Most areas of the country have seen record cold temperatures this winter which should make the initial part of the analysis easy. If a customer has not ordered gas this winter for heat, most likely they won't order in the future. This is a perfect opportunity to evaluate your customers' usage and either correct the tank size or remove the tank from service. This allows you to put the tank at a new location where it will be utilized and you receive cash flow from your asset. Another alternative to "right-sizing" the tank could be to adjust the amount of tank rental.

It will be easier when you meet with your bank and request a loan for tank purchases if you can assure them you have already exhausted your own internal opportunities. This process does several things. It helps you clean up your system regarding active customers and identify steel opportunity, as well as increase your cash flow and improve efficiencies by properly utilizing the tank size.

This may not be the most fun project, however, it is one that can pay big dividends. And the timing couldn't be better.