

## Set Your Margin Before Setting Your Price

by

John H. Nardoizzi, CPA  
Nardoizzi Consulting, LLC

One of the constant struggles faced by retail fuel oil dealers is the issue of setting a price per gallon. There are dozens of factors that go into determining the "right" price - cost of product, projected volume, contract rates, price caps, competitive pricing. On the other hand, some dealers still set prices the old-fashioned way, by gut instinct.

What every fuel oil dealer should be doing is figuring a proper margin before adopting a retail price.

I can hear the denials now. "Of course I know about margin. I've had the same one for years!"

The fact is, few dealers take into account all the factors that go into - or, more accurately, are taken out of - their margin. The basics are understood: payroll, taxes, office expenses, selling costs, insurance, vehicle leases, employee benefits.

But what about owner's salary? Do you still wait to pay yourself out of remaining profits? What about your retirement? Your employees may have a 401(k) plan, but you need to save on your own. Both of these should be factored into your margin, not left for later.

Another "hidden" cost that comes straight out of your margin is the loss incurred by your service department. Unless you are unusually diligent about pricing your service contracts properly and refusing to give away free service, you are likely to be running a deficit in service. You must adjust for that when determining your margin.

Finally, let's talk about the weather. It affects your sales, it affects your costs and it affects your margin. Do you factor in variations in temperature when planning your margin?

With all that to consider, it is a wonder that any oil dealer has the time to sit down and figure out what his or her margin should be. Fortunately, this is a fairly straightforward mathematical calculation. Simply take all general and administrative expenses (including payroll), add any increase in owner's salary, add an increase in the retirement plan contribution, add (not subtract!) the projected loss from the service department, and, finally, add the increase in insurance costs almost every fuel oil dealer is experiencing this year.

Now divide the total by the number of gallons of fuel oil you expect to sell in the coming year. The result is your target margin.

But let's not forget the weather. Consult an authority such as the Farmer's Almanac or the National Weather Service to estimate the expected change (up or down) in degree days for the coming year. Now multiply your expected gallons sold by this factor to get an adjusted margin.

To help you visualize this simple process, let's take a look at a hypothetical oil company, John's Oil. John's is a full service company with 2,000 customers, selling 1,700,000 gallons of oil each year. The owner pays himself a salary of \$90,000 and makes a contribution to a retirement plan of \$10,000 each year. Last year John's general and administrative expenses were \$491,785, and the company's service department lost \$32,000. Historically, John's Oil has operated on a margin of \$0.28 per gallon.

Here is the calculation of margin for John's Oil:

|  |                   |
|--|-------------------|
| General & Administrative Expenses:           | \$491,785         |
| Owner's Salary Increase:                     | \$ 40,000         |
| Increase in Contribution to Retirement Plan: | \$ 10,000         |
| Increase in Insurance Cost:                  | \$ 55,000         |
| Loss from Service Department:                | \$ 32,000         |
| Total:                                       | \$628,785         |
| Divided by gallons sold:                     | ÷ 1,700,000       |
| Projected margin:                            | \$0.37 per gallon |

As you can see, the new margin is well above the \$0.28 margin that John's Oil had settled for in the past. Too many "hidden" factors had been left out of the planning process.

Now let's say that the weather gurus predict a warmer than average winter, with degree days down about 10 percent. That would reduce John's oil sales to 1,530,000 gallons, which changes the calculation:

|                                  |                               |
|----------------------------------|-------------------------------|
| Total costs:                     | \$628,785                     |
| Divided by REDUCED gallons sold: | ÷ 1,530,000 (1,700,000 x 90%) |
| Adjusted margin:                 | \$0.41 per gallon             |

The weather adjustment is critical, as the fixed costs that are paid out of margin will generally not change with fluctuations in the weather. Therefore, margin per gallon must be higher to adequately cover those costs.

What is your target margin this year? Plug the numbers from your own company into the formula described above and see if you are on target to cover your real costs. The real beauty of determining the right margin for your company is this:

With the proper margin, adjusted for variations in temperature, you'll make money no matter how cold or warm the winter.

John Nardozi of Nardozi Consulting, LLC provides valuation, transaction advice and business management services for fuel oil retailers and distributors. He can be reached at (617) 487-4752, or [jnardozi@nardoziconsulting.com](mailto:jnardozi@nardoziconsulting.com).