What's Driving Oil Prices?

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<u>How do oil prices affect how your business operates?</u>

One segment of our business is transportation or a trucking operation. We operate an over the road fleet of 33 trucks and another group of 5 trucks operate locally shuttling loads to our various distribution centers either from our customer's plants or making local pickups and deliveries. Oil prices have a major impact on our business. It has risen to be our single largest expense item.

During the last 4 years our Fuel expenses were the following as a percent of revenue: 32.7% in 2007, 41.7% in 2008, 29.7% in 2009 and 31.6% in 2010. Now in the first quarter of 2011 that expense was 36.7% as a percentage of revenue.

Over the years we have tried various techniques to better control our exposure to the fluctuations in fuel costs. We had our own fuel tanks until the EPA regulations made it uneconomical for the size of our fleet. We hedged a portion of our anticipated purchases to lock in the pricing for several months. We contracted with certain fuel service providers to buy at a fixed rate over their costs or off the listed pump price. We have set our trucks top speed at 65 miles per hour, installed on board auxiliary power units to eliminate idling, gone to wide based tires with an Airgo system to keep tires properly inflated at all times, and installed on board scales to eliminate out of route miles to find scales to insure properly loaded trailers. And of course we have contracts with our customers that include fuel surcharges to help offset the fluctuations of fuel costs.

For a fleet our size hedging and contracting fuel purchases are extremely challenging and very time consuming. Small operations quite frankly find themselves at a disadvantage to try to find the time necessary to stay informed and educated on the constantly changing

pricing structures and formulas the vendors try to institute. And at the same time address the many other factors to run your business.

The fuel surcharges that customers have agreed to, is the least cumbersome to manage. The bigger challenge is that accounts want you to lock your rates in for a minimum of one year. Depending on how their business is doing and whether they will take the time to renegotiate annually can also be an impediment. Because of our small size in some instances we don't provide enough impact on capacity to get their attention.

Roughly speaking, how much money in profit does your business lose when gas prices rise to levels like we are seeing today?

The best way to explain how much profit we lose to fuel prices at the current levels is to explain how Fuel Surcharges are implemented. Fuel Surcharges only apply to loaded miles. We run about 15% empty miles. Our average truck runs 2,700 miles per week. Our fleet average is 6.6 miles per gallon. 15% of the miles are equal to 405 miles per truck per week that we see no reimbursement for the increase cost of fuel. The impact from an average cost of $2.50 per gallon for fuel, last seen in the fall of 2009, to the recent average of $4.00 per gallon is $1.50 per gallon on 62 gallons it takes to run those 405 miles. Roughly speaking that is $92.00 in lost money per truck. Remember I told you we run a total of 38 trucks therefore that is almost $3,500.00 per week. At the current rate it could be $180,000.00 in a year.

If it weren't for higher gas prices, what would your company do with that extra money?

There are four potential uses that come to mind initially for extra funds. First we could invest in more trucks. Secondly look to increase technology. Third to increase our drivers pay and finally to reduce the debt on our equipment.

Since 2008 many fleets have reduced the size of their operations and a significant amount of others have simply gone out of business there is starting to become a shortage of trucks to deliver products on time. Some of our accounts are requesting more trucks from us daily. With the capacity shortages we would utilize the extra money to increase the size of our truck fleet. This would create more jobs at our company. We could immediately grow our fleet 10% if the prices were at the $2.50 per gallon versus the current level of $4.00 per gallon.

A primary objective for our company is to look at and invest in new technology or innovations that can help improve our fuel mileage of our fleet. It has been our practice to do a cost benefit analysis on proposed improvements to justify the expenditure. It is imperative that the payback period is shorter than the useful life of the equipment and will not hinder the resale value at trade in.

During the down turn in the economy most truck fleets, including ourselves, found it necessary to reduce driver's wages to remain competitive. Since there was a shortage of freight to be hauled we needed to alter the mindset of drivers to encourage them to take longer runs. Unfortunately that also impacts their home life and their family time. If fuel costs could back in line I believe you would see an increase in driver's pay across the board.

Our final option would be to reduce the amount of debt we still have on our equipment. Solidifying the net worth our company would enable us to secure better financing terms in the future. It's certainly no secret that bankers today are taking a closer look at company's debt to net worth ratio.

<u>Has your company had to lay off anyone as a result of higher gas prices?</u>

During the fuel spikes in 2008 we elected to gradually reduce our fleet down from 64 trucks to the current level of 38 trucks. If prices continue to vacillate we will definitely reduce more to prevent losses in the range of $3,500.00 per truck per week.

We certainly do not like to be put in this position, but we cannot continue to put the remainder of the company at risk. Since it is our largest expense item stabilization in the cost of fuel prices is extremely necessary to provide the ability for trucking operations like ourselves across the country to remain in business. We have absorbed the cost increases due to regulations of the EPA on our truck's engines and fuel storage facilities. As well as the escalation of other government regulations and enlarged payroll taxes caused by the high unemployment in all sectors of the workforce. We cannot continue on this wild ride created by speculators and some in our government holding back on drilling opportunities that would reduce our dependency on foreign oil.