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EXCLUSIVE

Gas Prices Soar to Records, but Exclusive Data Show Gas Stations Aren’t the Problem

By Avi Salzman Follow and Marc Lajoie Follow Updated June 12, 2022 / Original June 10, 2022

Illustration by Barron's Staff; (reference) Getty

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As pump prices for gasoline spin ever higher, a motorist could easily conclude that gas stations are making a killing. This past week, the average price of gas in the U.S. hit a record $5 a gallon, up more than 50% from a year ago, adjusted for inflation. You might think that would allow gas stations to hand out free air for tires, free coffee, and maybe free shoulder massages.

Not so. An exclusive analysis by *Barron’s* shows that the profits of gas stations are actually down this year. And that holds important implications for Washington, where President Joe Biden and his allies have suggested that drivers are being gouged by gas stations. Democrats in both houses of Congress have introduced price-gouging legislation that would put fuel sellers, both wholesale and retail, under greater scrutiny.

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Gas stations, at least, are not gouging. That is the overarching conclusion from the data covering some 135,000 gas

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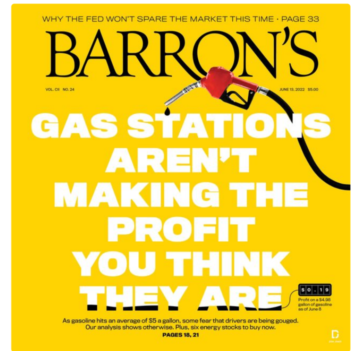
stations across the U.S. If you're looking for the biggest winners from $5 a gallon prices, it might just be refiners, which to the public are little-known middlemen.



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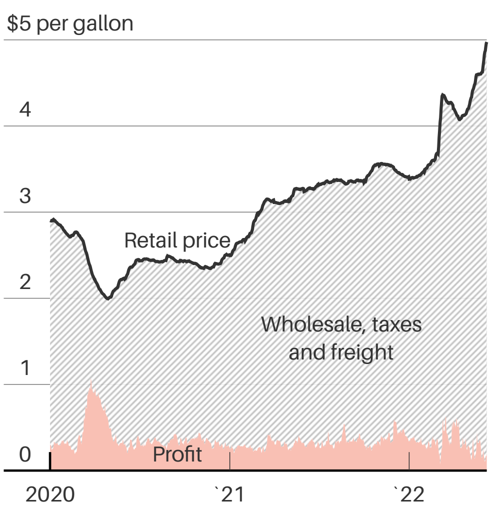
It is true that gas stations' gross profits briefly jumped after Russia invaded Ukraine, reaching 40 cents per gallon by April. But that was still lower than the 46 cents in December, the result of convulsions in the food chain of world oil. In May, gross profits fell to 25 cents, one of the lowest levels in years.

The truth is, gas stations are the minnows in the gasoline food chain. For all their prominence as symbols of gasoline prices, they are constantly whipped around by the giants that supply them—oil producers, refiners, pipeline operators, storage-tank owners, and more. While prices have been surging throughout the chain, wholesale suppliers have raised their prices more sharply than the gas stations that sell their product. In fact, gas stations appear to be constrained by intense competition and the rising ire of the public.

A Drop in the Barrel

Profits earned by gas stations are small compared to the recent rise in retail prices.



Note: All series are for regular unleaded gasoline and are inflation-adjusted. Profits are gross. Freight is estimated at a constant nominal rate of 1.5¢ per gallon.

Source: OPIS

For struggling service-station operators, the situation can feel colossally unfair. Mel Rabadi struggles to understand why "two people shooting at each other in Eastern Europe" is causing him so much grief at the Sunoco station he manages in the otherwise-peaceful Berkshire mountains of Massachusetts.

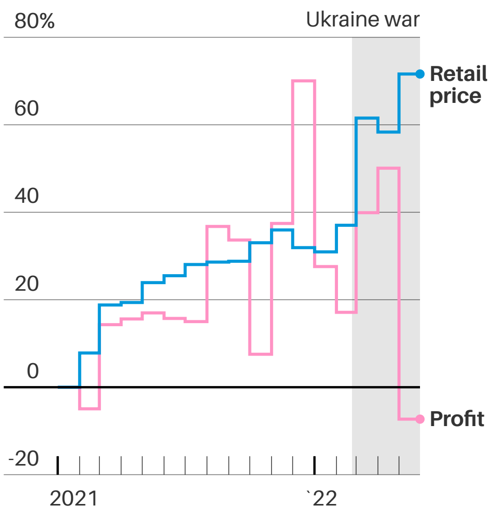
It's nothing but headaches: Customers don't like the prices, and, feeling pinched, they're not buying as much coffee and snacks, a key source of total profits. Scratch the free shoulder rubs.

"We are eating most of the price increase," Rabadi says. "The higher the price, the lower the profit margin, so it's hurting everything."

Weak Link

Gas stations haven't earned a consistently higher profit per gallon since Russia's invasion of Ukraine.

Percentage change since 2021



Note: Profits are gross. Retail prices and profits are for unleaded gasoline and are adjusted for inflation. Profits are calculated with a constant nominal rate for freight of 1.5¢ per gallon.

Source: OPIS

The challenges facing service stations are especially evident when you look at their total gross profits—the per gallon figure multiplied by gallons sold. The average service station reaped a $28,676 profit from gasoline in April. When gas prices spiked in May, they saw their profit fall to an average of $16,424. Once they paid their rent and made payroll, most gas stations were hardly rolling in profits.

The data reviewed by *Barron’s* was provided by Oil Price Information Service, or OPIS, an oil-price reporting agency acquired last year by *Barron’s* parent company, Dow Jones. OPIS tracks real-time retail and wholesale prices for 98% of U.S. gas stations. Using that information, *Barron’s* calculated inflation-adjusted gross profits. The margins accounted for state and federal taxes, as well as an estimate for freight charges.

The effort produced a detailed financial analysis of the business of gas stations. For instance, the data show that since 2016, gas stations have compensated for slower sales by increasing their margins slightly. This trend accelerated when gasoline sales all but collapsed in 2020; sales have yet to recover to prepandemic levels.

Still, there is no evidence that the fuel-pumping industry took advantage of consumers when gasoline prices spiked this year. Instead, their profits rose and fell based on an array of market forces, many of which were beyond their control. Overall, their share of each dollar that consumers spend on gasoline is falling. Marketing and distribution, which includes getting the gas to stations and selling it, accounted for just 12% of the price of each gallon of gas as of March, down from the 14.3% on average from 2012 to

2021, according to the Energy Information Administration, the research arm of the Department of Energy.

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Gas stations are a "silly thing to go after," says Tom Kloza, global head of energy analysis at OPIS. "It's like saying we're going to inspect all the plugs because there are electrical problems on the grid."

The winners in the supply chain today are fuel refiners such as Valero Energy VLO -4.07% (ticker: VLO), Marathon Petroleum MPC -3.67% (MPC), and Phillips 66 PSX -1.68% (PSX)—and the big oil producers.

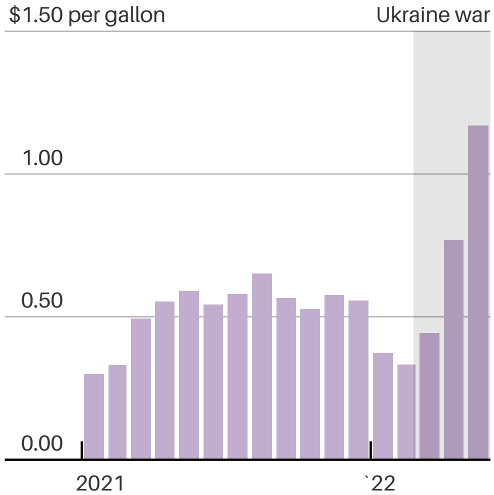
As of March, refiners accounted for 18% of the price at the pump, up from an average of 14% from 2012 to 2021. Producers, which have profited from high oil prices caused in part by Russia's invasion of Ukraine and a supply shortage around the world, accounted for 59%, up from 54.8%.

The refining industry was in good shape to profit from this year's big surge. It had contracted in the U.S. in the past decade, with 20 refineries shutting down. The trend accelerated with the pandemic. U.S. refining capacity is down by about one million barrels per day from before the pandemic, according to Jeffrey Barron, an economist at the U.S. Energy Information Administration. That has left a dearth of capacity just as the pandemic wanes and demand ramps up. Refineries are struggling to supply the 20 million barrels a day of petroleum products that Americans use. They're also sending more oil products overseas than ever before to help Europe transition from Russian oil products like diesel.

Up, Up, and Away

Refinery margins* for gasoline took off after Russia invaded Ukraine.

Refiner gross margins can be estimated by subtracting the price of a gallon of Brent crude oil, the global standard, from the average refiner resale price for gasoline in the U.S. They rose to a striking $1.17 in May 2022, up 98% from a year earlier.



*gross dollar, adjusted for inflation and measured by the difference between average refiner resale price for gasoline and spot price of Brent crude oil

Source: U.S. Energy Information Administration

“Refiners are looking at an absolutely unreal second quarter,” wrote Matthew Blair, an analyst at Houston investment and merchant bank Tudor, Pickering, Holt.

Still, refiners say they are not to blame for the higher prices. “People are looking at margins in a snapshot of time right now,” says Brendan Williams, vice president of government relations for refiner PBF Energy PBF −3.42% (PBF). “Just two years ago, people were losing billions of dollars, they had to sell assets, they had to close refineries.” Government policies, including expensive renewable fuel standards, have made it harder for refineries to meet the needs of consumers, he says.

To the public, confusion about the different roles of oil producers, refineries, and gas stations is understandable. Some of the same names are players in each of the industries. For instance, Exxon Mobil XOM −1.26% (XOM) is the largest oil company in the U.S., with substantial production and refining businesses. In addition, about 10,000 stations in the U.S. have the name Exxon or Mobil on their signs. But Exxon doesn’t own them. The company sold its gas station business in 2008, and now contracts with third parties that use its branding.

There’s little evidence in the data that Exxon is muscling the rest of the industry to raise gas prices. The margins for Exxon-branded stations track the broader market, and its branded stations have to go up against stations owned by discount gas sellers like Costco Wholesale (COST). “No single company sets the price of oil or gasoline,” said Exxon CEO Darren Woods last month in testimony before the House Energy and Commerce Committee.

In statements, Biden and other lawmakers have been vague about who exactly they are targeting with criticisms about gasoline prices. Biden has urged the Federal Trade Commission to look into gasoline prices. In a November letter to the FTC asking it to investigate gas gouging, he argued that the price at the pump kept rising even as the price of unfinished gasoline declined, seeming to implicate the gas stations, as opposed to producers and refiners. But the letter then took aim at Exxon and Chevron (CVX), saying they were in line to double their net income from 2019 levels and were hiking dividends and buybacks. The White House and Department of Energy did not respond to questions about the administration’s rationale.

A bill addressing price-gouging passed the House of Representatives last month, and another bill is being considered by the Senate. The House bill allows the president to declare an energy emergency that forbids fuel-sellers from charging "unconscionably excessive" prices that take advantage of a crisis. To determine whether prices are excessive, the bill says the FTC or state attorneys general should look at whether prices are similar to those that sellers charged in the recent past or to prices charged by sellers in the area. It raises fines for violations of market manipulation rules to $2 million from $1 million. And the bill says the FTC should investigate gasoline prices to see whether pump or refinery prices have been manipulated.

Democratic Reps. Kim Schrier from Washington and Katie Porter from California, who sponsored the gouging bill, say they aren't looking to punish single-store owners. Their bill looks to target enforcement at companies with annual fuel sales over $500 million a year. But it isn't entirely clear who they're blaming for the high prices. Neither agreed to be interviewed. In a statement, Porter said that Big Oil has a "scheme" to depress production, and she believes that companies are "purposely keeping supply low to earn record-high profits, squeezing families—and our entire economy—in the process."

It's true that oil companies have been boosting production more gradually during the latest oil-price boom than in past cycles. But companies say it's part of a plan to become more sustainable and please investors who are tired of the industry's boom-and-bust tendencies. Investors have been pressuring the companies to use cash from higher oil prices to pay dividends and buy back stock, instead of spending it on more production.

A Senate bill that also looks at gouging casts a similarly wide net. Sen. Maria Cantwell, the Washington Democrat who sponsored it, recently said that oil trading firms are also responsible for unfair prices, citing a settlement by trading firm Glencore to allegations that it manipulated oil markets from 2007 to 2018.

Opponents of the bills argue that they cast blame in the wrong direction. The National Association of Convenience Stores says the House bill unfairly targets stations and doesn't take into account market factors, including financial speculation, that affect oil prices.

The American Fuel & Petrochemical Manufacturers, which represents refiners, says the bill misunderstands how the industry works. "U.S. refiners are price takers," the letter says . "They do not set prices for gasoline or diesel, which are established by the global market and largely based on current and expected supply-and-demand fundamentals.”

The FTC did not respond to questions about whether it is investigating gasoline prices and if it has found wrongdoing. Historically, similar FTC investigations have not uncovered much in the way of widespread gouging, though there may be regional price disparities and other inefficiencies that cause pain for consumers.

In a 2006 report responding to price changes around Hurricane Katrina, the FTC found that some refiners, wholesalers, and retailers were charging higher prices during the crisis, but almost all could be explained by market factors, not gouging.

There is precedent, of course, for monopolistic behavior in the U.S. energy industry. John D. Rockefeller’s Standard Oil controlled every step of the process, from well to pump, and gas prices moved on his whims. Today, the industry is much more competitive. More than half of all convenience stores that sell gas are operated by people who control only one outlet, sometimes as franchisees. Less than 0.2% are owned by major oil companies, and about 4% are owned by refiners, according to the National Association of Convenience Stores.

Stats show that these small businesses have not been thriving as gas prices peaked. High retail prices are simply not a good predictor of profits.

Retail prices were already climbing well before Russia’s invasion of Ukraine. However, the invasion triggered a significant jump in the price at the pump—64 cents per gallon from February to March 2022, or an 18% increase. Gross profits, on the other hand, have been much more volatile, responding instead to short-term market forces.

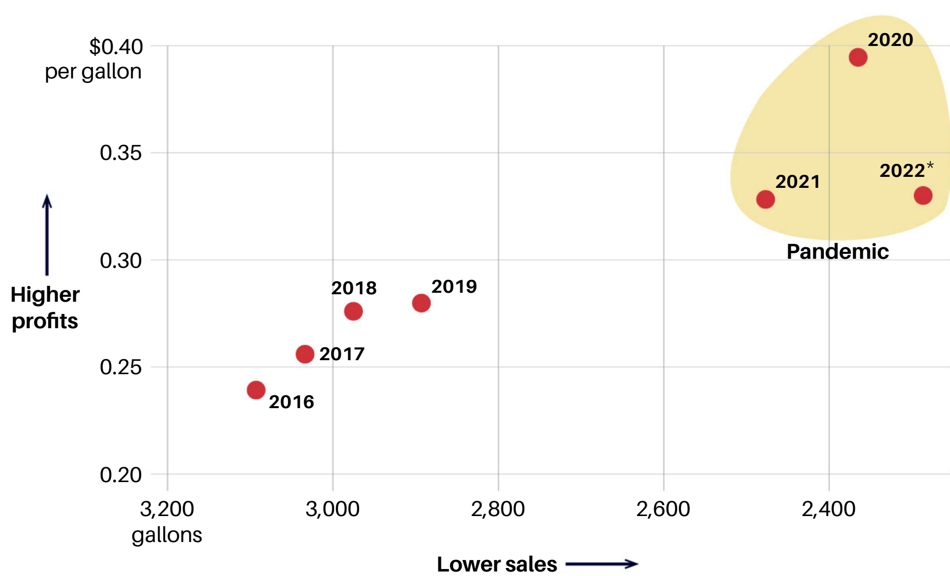
Furthermore, since most gasoline is bought with credit cards, and credit-card fees are assessed as a percentage of the price of sale, higher prices also mean higher credit-card fees. These fees are eating into gross margins, leaving less for retailers. In short, the data analysis by *Barron’s* found no evidence that in the aggregate the recent spike in prices has led to a windfall for gas stations.

That’s not the whole story. Gas station margins and profits may not have benefited from recent events, but there is a multiyear trend of increasing margins, even as gas sales have fallen.

Gas sales have been declining annually since 2016, reflecting the rise of energy-efficient vehicles.The trend accelerated with the onset of the pandemic, as commuting plunged. From 2016 to 2021, sales volumes of regular unleaded gasoline fell by 20%. But over the same period, average gross profits saw a real-dollar increase of nine cents per gallon, or 37%.

Squeezing the Pump

Gas stations are profiting more per gallon to make up for declining sales.



*through the end of May

Note: Profits and sales are for regular unleaded gasoline. Profits are gross and are calculated with a constant nominal rate for freight of 1.5¢ per gallon. Sales are average daily volumes per site.

Source: OPIS

The decline in yearly sales volumes is here to stay, says OPIS analyst Kloza. "Volumes will never get back to prepandemic levels. Never. Not in the U.S."

The retail gas sector operates on razor-thin margins generally. While those margins have become slightly healthier over time, they ultimately have little to do with how much consumers pay at the pump. Whether high or low, the final price has much more to do with the price that gas stations pay for their product at the wholesale rack.

That means any legislation targeting gas-station profits is unlikely to bring significant relief to consumers tired of high gas prices.

Regardless of whether the legislation passes, it's likely that prices will stay high through much of the summer. Drivers may not get relief until the weather starts to cool. Barron, of the EIA, expects refinery margins to start coming down in the third quarter of this year, once summer driving season is over and refiners push their production higher.

That means it could be a tough summer for gas-station managers like Rabadi. For him, the most important number to look at is generally the number on the sign across the street. He's constantly watching what his competitor is doing, he says.

"They set the prices. If you go over by four or five cents, it's OK. Anything other than that, they're gonna drive you out of business."

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