

# Propane Resources Letter

## Supply & Risk Management

A monthly resource of supply and distribution opinions for the propane industry.

July 15, 2006

Issue 174

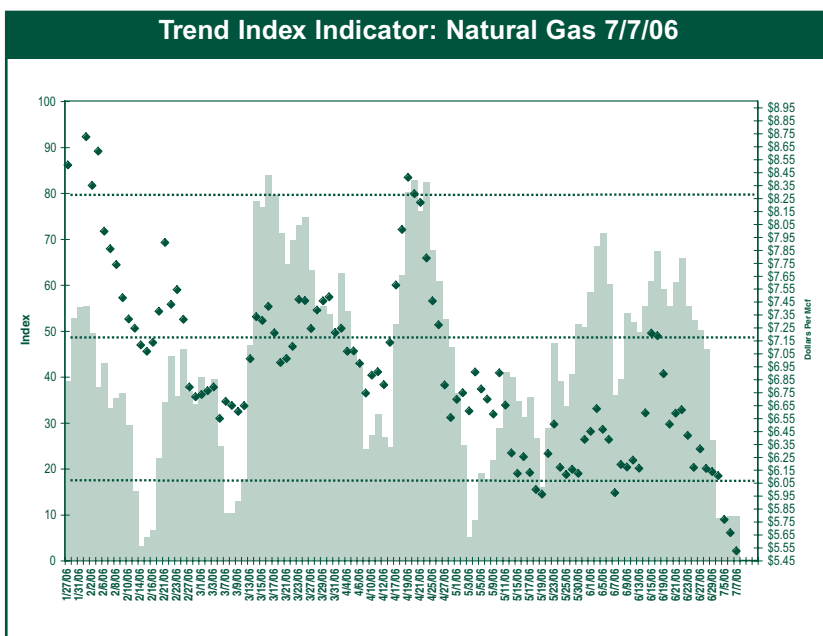
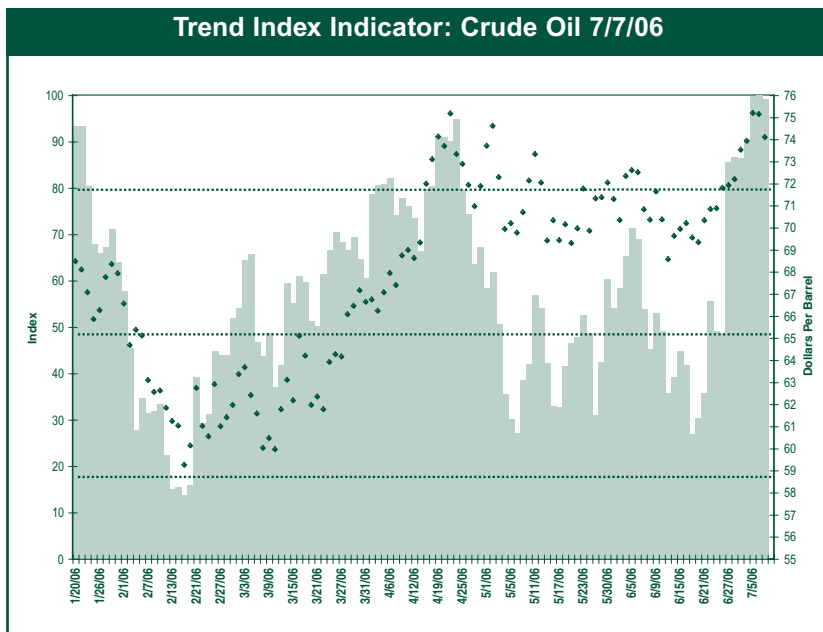
### DEAR PROPANE DECISION MAKER:

Looking at the Trend Index Indicator charts that we put together on crude oil and natural gas, you can see that each tells a different story.

The trend index depicted by the grey daily bars shows us the price momentum direction. When the trend index gets over 80, as it started to on June 27th on the crude chart, it tells us that we are in an overbought market and the prices are looking for a reason to move down. You don't want to be buying crude or propane when the trend index is over 80 as the market is getting ready to look for some type of correction. The dots on the crude graph are the ending prices for crude on each day.

Notice that since January we have only seen the crude trend index under 20 for a few days in February. When the trend indicator goes under 20 it is telling us that the market is oversold. It will be looking for reasons to move up — which it did in February. February's dip in the index happened to be the low price for crude and propane for the year.

The natural gas trend indicator looks the opposite of crude as the price of natural gas looks for a level that will work off the excess inventory overhang from last winter. Notice how many times the index has moved below 20 on the graph and how the price jumps on short covering as it becomes so oversold. This is a good time to look at natural gas as a hedge or speculative position. Natural gas is very undervalued compared to other energy BTU's. We have had 8 weeks of below normal builds and the real demand for electricity is just now showing up!



Propane Resources provides supply services to help retail propane marketers manage the price risk associated with market volatility and ensure physical supply availability. Helping retail propane marketers protect gross margins and build company value are primary goals.

**Propane Resources**  
*Helping Business Partners Create Opportunity*

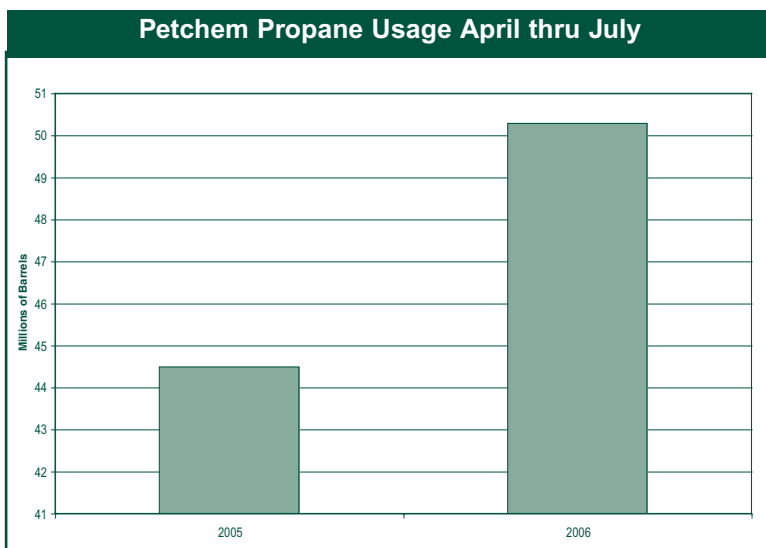
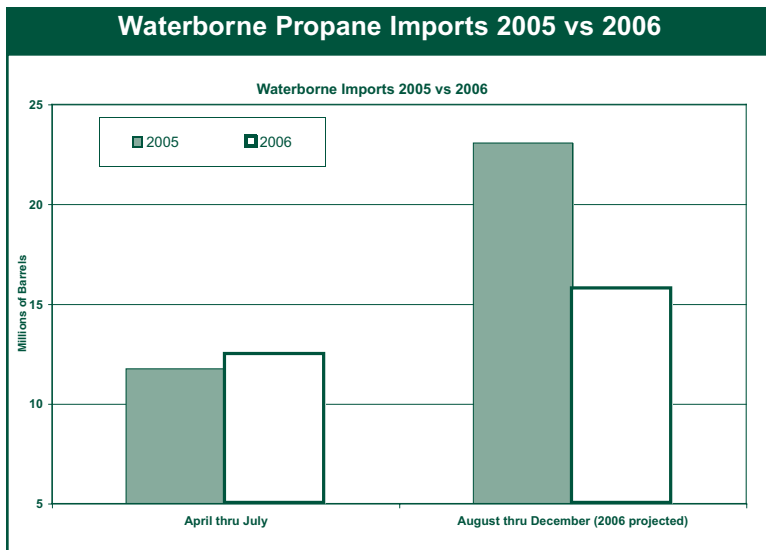
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**WATERBORNE PROPANE IMPORTS:** Waterborne Energy, Houston Texas, 713-526-1555 are the world's experts in waterborne NGL's. This chart shows two different stories. From April through July, the U.S. actually had 12.5 million barrels of propane imports, .75 million barrels above the record setting pace we saw last year.

From August to December last year, we had 23 million barrels of propane imports, this year we are projecting 16 million based on current inflows. This would be 7 million barrels less in inventory than we saw last year!

Propane prices around the world show the Mideast at 98 cents per gallon (cpg), Algeria 98 cpg, China & Japan \$1.09 and U.S. Gulf Coast \$1.16.

Ships that transport LPG's are getting record freight rates that further push prices up and shows how tight that market is. With higher world production of LPG's looking for the best economic net backs around the globe, available ship capacity is shrinking and thus pushing prices higher. The higher shipping rates have affected deliveries between Algeria and the US Gulf Coast for the time-being, that route is closed due to the lack of incentive economically. The stronger economic incentive is to deliver the product to Europe, where right now, deliveries are scheduled through August. The import/export market is sophisticated and it wouldn't take much movement in the market (in the United States' favor) to see that door reopen once again and the possibility of at least a portion of that product ending up in our direction later this summer into the fall.



**PETCHEMS:** Look at the Petchem propane use graph, it shows the Petchems have used 6 million barrels more propane during this build season than last build season!

Petchems have historically averaged 330,000 barrels a day of propane use, in July they are using 410,000 barrels a day, versus 350,000 a year ago.

This is the main reason the Gulf Coast inventory is 25% below levels that we saw last year.

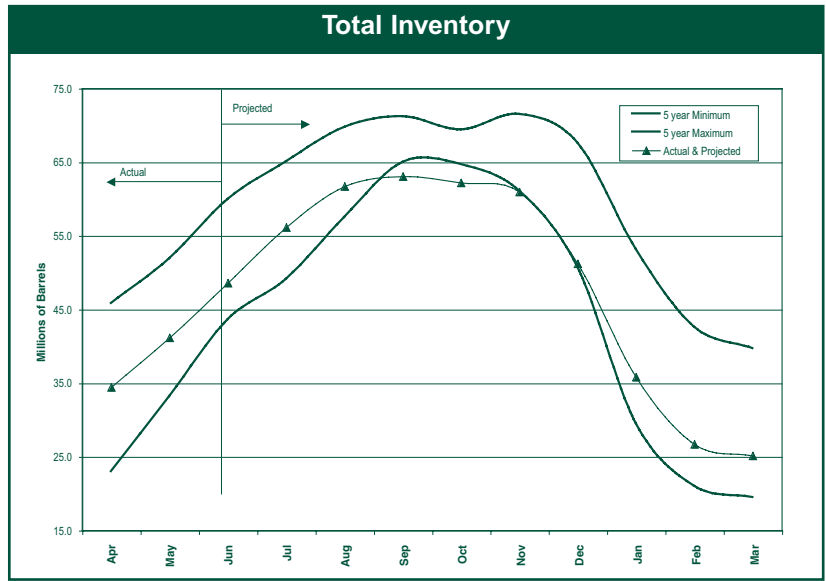
And now a recent development for the Petchems is that ethane, their main feedstock is getting tight. Ethane prices have been escalating fast and the Petchems are looking seriously at propane to replace more of ethane as a feedstock. This would put more upward pressure on propane prices and further decrease Gulf Coast inventory as we head into the winter.

Petchem operating capacity numbers have moved from 87% to 91%, this is not exactly bearish. It is telling us that plastics, a building block of the economy, has higher demand and that the economy is growing. This translates into more energy demand.

Based on history strong Petchem demands reflect a strong economy going out 6 months. So we should see good economic growth into January. This is in spite of the EIA lowering energy growth figures for the 3rd Quarter. The key operative is lower *growth* figures not lower demand!

**TOTAL INVENTORY:** July started at 48.6 million barrels in inventory. This is 3 million barrels below the 5 year average. We expect to be 5 million barrels below the 5 year average when the build season ends in September, in the 60-63 million barrel range.

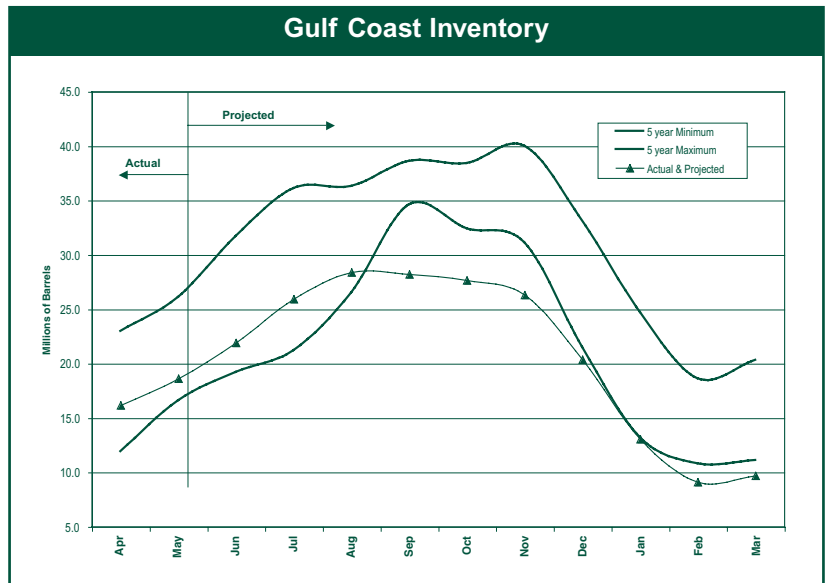
Last year peak inventory hit in November at 71.5 million barrels due to lower Petchem propane use and strong imports. This year based on the current trends we look to be 10 million barrels lower which would give propane fundamental price support.



**GULF COAST INVENTORY:** This is the story — look at the graph in September, we are projecting inventory 10 million barrels under last year and 7 million under the 5 year average.

Petchems are showing no signs of cutting back their propane use, as a matter of fact they are looking at increasing propane use because the ethane market is tight and expensive!

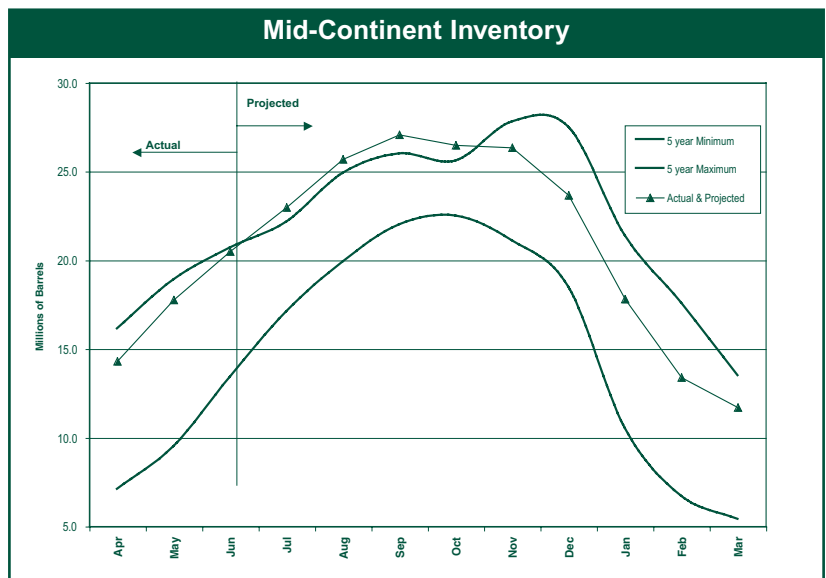
We will need record propane imports, which we saw last year, as we go into the 4th Quarter to push this inventory back up. Low chance!



**MID-CONTINENT INVENTORY:** Just the opposite of the Gulf Coast, the Mid-Continent inventory is setting up to move above levels we have seen in the last 6 years.

Conway winter prices have been above Mt. Belvieu, but will soon be below them.

For those of you that read this box in our April letter and positioned propane in Mt. Belvieu instead of Conway, you have already lowered your cost by 3 cpg and are likely to pick up another 2 cpg in the next month.



## Bulls

1. Bears say look at fundamentals. Bulls say look at technicals and amount of speculative money betting on supply disruption!
2. We are not short of crude inventory, but those dialed in know we are short of production capacity.
3. Strong Petchem propane demand will keep propane prices strong.
4. Geopolitical risk and speculative monies are not going anywhere soon!

## Bears

1. Natural gas floor for propane is currently 60 cpg, that's a long way to fall!
2. No sustained heat in U.S. or hurricanes in July and August and watch risk premiums fall out of energy prices.
3. Saudis have cut back crude production seeing excessive global length building — \$60 this fall?
4. Global length in propane supply will continue to flow to the U.S. to meet Petchem demand and keep inventory building into the 4th Q.

**SWAG:** Here is one of the best quotes we've heard this month from a propane retailer in the Midwest, "I have 35 years of 1 year experiences in the propane business!" It couldn't have been said better, every year is different. We have different opportunities and pit falls each year. Recognizing them is the art, positioning for them is the science!

The mindset of "I'll buy 1/4 cent per gallon cheaper from XYZ company on a given day in a market that moves 5 to 10 cpg a week" doesn't do much for your bottom line. Find a company that can help you position in the bottom 25% of the market that supports your marketing plan!

Here is a sobering thought on seasonal trend averages, summer low to average fall high rallies, that end around October 1st:

- ◆ Heating Oil average gain is 43% that would take the price up another 70 cents.
- ◆ Unleaded Gasoline average gain is 37% that would take the price up another 50 cents.
- ◆ Natural Gas average gain is 114% that would take the price to \$11.53/mcf.
- ◆ Crude Oil average gain is 35% that would take the price to \$92/bbl.
- ◆ Propane average gain with crude oil would take the price from a current Mt. Belvieu price of \$1.17/gal to \$1.42 if propane continues to trade at 65% of crude oil, at 70% of crude look for \$1.53/gal.

From a technical stand point, traders are looking for a minimum move from now into the 4th Quarter for crude oil to \$85/bbl — more than likely there will be a move to \$92/bbl. Obviously this is not only bullish for crude oil but for propane as well.

**ACTION PLAN:** Many factors in the energy sector are keeping traders anxious and the market highly volatile. With world crude oil supply/demand so close together, any production or supply disruptions due to geopolitical events and the seasonal fear of hurricanes in the Gulf Coast will keep propane prices strong as it follows crude oil prices. With such wide market swings, cover what you sell. Front-load your purchases, weighted more heavily in the 4th quarter. You can move hedge gallons into the 1st Quarter if the market remains strong. In case winter weather doesn't develop and the market peaks in the 4th Quarter, you can more easily get out of your Mt. Belvieu or Conway hedges as the market moves down — then look for repositioning opportunities in the 1st Quarter.

We're always glad to hear from you!

*BAIRD*  
*Walter Marty* *Jeff*

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