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Trader's Corner

This week's Trader's Corner shows why it's important that our financial and physical supply activity work together.

We had a good conversation with a client who was trying to figure out the best way to manage the supply price risk for a proposal to a school board. The school board was seeking a fixed price over the next 12 months.

It is not uncommon for commercial accounts or government entities to want to establish a known cost for their expenses, like energy. Sometimes establishing a known expense is even more important than the lowest price.

Unfortunately trying to work with boards, like school boards, can be very difficult. They tend to want a very one-sided relationship, putting propane retailers and other service providers in a position to sometimes take more risk than can be justified to obtain the business.

Our client was looking to use financial swaps to manage their supply side price risk so they could provide the bid to the school board.

Normally swaps are the perfect tool for providing fixed-priced offers like the school board desired -- but perhaps not in this case. We think many of you may face the same situation, so we wanted to share this discussion.

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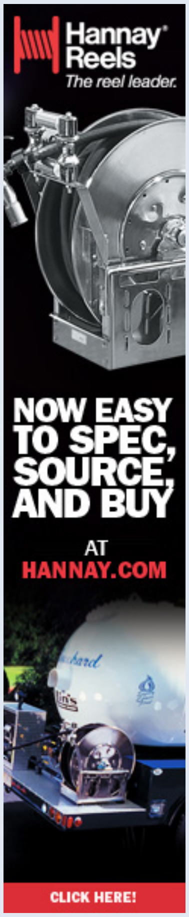

The problem was the school board knew it needed a certain volume of propane for the year, but it was not willing to state firm volumes for each month. Trying to use swaps in this scenario can have too much risk for propane retailers.

Swaps are written for a specific month and volume. To cover the school board for the year, 12 swaps would be written. Retailers are often confused by the common practice of quoting price strips, where the strike price over a given series of months is the same. For example, a one-year strip would mean the strike price is the same for every swap in a 12-month series of swaps. But the volumes remain month specific.

When we buy a swap, we are paid if the monthly average for propane at the hub turns out to be higher than our strike. However, we must pay if the monthly average is below our strike.

We must remember the physical side of this transaction. If we are selling to our customer at a fixed price and propane prices are falling, we will be paying our physical supplier less for the propane we are delivering to the school board, so our margin is increased over what we budgeted. But we must use that extra margin to pay our obligation on the swap. That is where the problem with unpredictable volumes comes into play.

Let's say we wrote a November swap with a volume of 20,000 gallons to fix the price to the school board. When November comes, temperatures are mild, propane prices fall and the school board only pulls 15,000 gallons. In that case, we are only going to earn extra margin on 15,000 gallons, but we are going to have to pay on a swap of 20,000 gallons. The fact we didn't make extra margin on 5,000 gallons left us short the dollars we will need to pay the swap obligation. That shortfall eats directly into our margin and profit.

Obviously using a traditional pre-buy, which gives us flexibility on when we can pull the volume, is superior to a swap in this scenario. If a pre-buy isn't available and we are forced to use swaps, we must build a significant cushion in our bid to cover the potential for scenarios like the above to occur. Otherwise it is essential to hold our customer to contracted volumes.

There are many different tools that propane retailers have at their disposal to manage supply price risk. The variety of tools allows today's propane retailer to solve the supply problems that most concern their customers. But it is essential that they know the strengths and weaknesses of each of these tools so that we can apply them correctly.

It is also important to understand how the financial and physical sides of the business work. The swaps, options and other financial tools a retailer uses are totally independent of the physical side of our business. By

physical we mean actually buying propane from our normal supplier and having it delivered to our tank.

Even though the financial and physical activity are totally independent, it is essential we understand how they work together to give predictable results. In today's example, we illustrated why it is important that the volume of the financial hedge and the volume of physical gas delivered to or billed to our customer match as closely as possible.

If you have specific customer needs and need help identifying the best tools to use, please give us a call.

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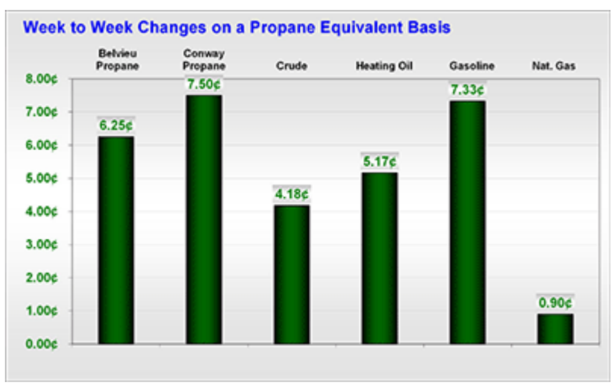
WEEK IN REVIEW

Energy prices moved higher despite more concern about the global economy. Tension in the Iran nuclear standoff with world powers was a key driver for crude.

Propane got its primary support from another light inventory build.

We go into the week neutral. We expect a lot of volatility with crude as investors try to balance supply threats with the overall weak macroeconomic picture. Propane may have a little more upside price risk with the light inventory builds of the last two weeks.



LAST WEEK'S DAILY HIGHLIGHTS

Monday: Crude was up with Belvieu and Conway. A Norwegian oil worker's strike over pay and pension was the main support for crude.

Tuesday: Crude and propane were down on the day as the strike from Monday ended. Propane tracked crude fairly well on good trading volume.

Wednesday: The EIA report had bullish news for crude and propane. As a result, Belvieu, Conway and crude all gained more than 2 percent on the day. Propane inventories had a light build for the second week in a row,

starting to show a trend. Crude had a 4.7-million-barrel draw.

Thursday: Both propane hubs had strength, while crude was only up slightly. The light inventory build from Wednesday was the main driver for the strength in propane. The volatility remained in crude; prices hit lows early, as investors worried about macroeconomic conditions. Initial claims for state unemployment benefits decreased by a surprising 26,000 last week to 350,000.

Friday: Energy markets had good gains, primarily on the better-than-expected report on China's gross domestic product. But propane was still more aggressive, outpacing the gains in crude, as the market continued to find momentum from the light inventory build on Wednesday.

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Cost Management Solutions LLC (CMS) is a firm dedicated to the analysis of the energy markets for the propane marketplace. Since we are not a supplier of propane, you can be assured our focus is to provide an unbiased analysis.

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The Propane Price Insider, an e-mail service that provides:

- Three Daily Price Flash Wires
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- Wednesday Inventory Data Updates around 11 a.m. ET
- Evening Report with Executive Summary, Trader's/Hedger's Corner, Weather maps and complete review of energy prices that are based on Propane's Btu Equivalent

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Client Services

Many retailers simply don't have time to analyze the large amounts of data to make an informed purchasing decision. **We offer:**

- Detailed market recommendations on hedge and pre-buy entry points
- Prompt market execution of hedging strategies
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- Because of the volume of transactions we place annually, we receive large volume consideration when we place your hedges

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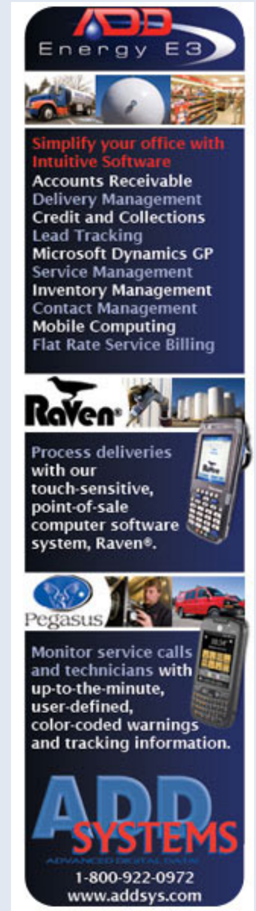

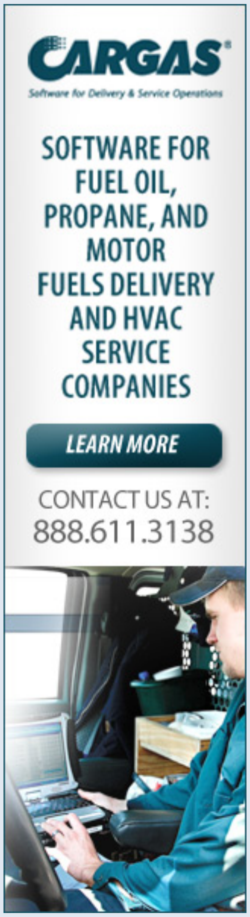

Contact us today to see if you can benefit from having the Energy Price Watchdog working for you.

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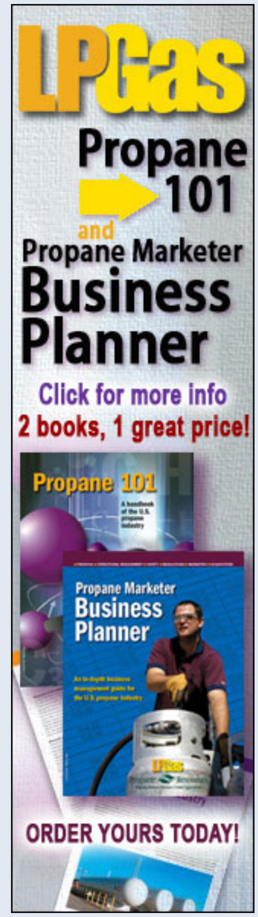

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