LPGas presents

The Propane Price Insider

"Your Energy Price Watchdog"

View this e-mail online

CMS Cost Management Solutions

[Click here for a free, 10-day trial of The Propane Price Insider!]

Find us on Facebook

Call Cost Management Solutions today for more information about how Client Services can enhance your business at (888) 441-3338 or drop us an e-mail at info@propanecost.com.

Trader's Corner

This week's Trader's Corner discusses using a put option to protect from falling prices.

Last week we completed our hedging workshop with propane retailers from around the country. As always, it was great to share ideas that can help propane marketers have a more profitable business.

One thing we focused on this year was the necessity to exit positions when we are speculating. What do we mean by speculating, and are you a speculator? We are going to bet that many of you do not see yourself as a speculator, but the reality is you are a speculator more often than you think.

Very simply, we are speculating when we have bought supply and have not sold it, or when we have sold something and don't own the supply. If either side of the buy/sell equation is "open," we are speculating.

We have found that increasing market volatility has caused fewer retailers to commit to sales when they don't have supply to back it up. Yet, that same volatility has not caused retailers to back off on speculating on the supply side. It is still very common to fill storage or make pre-buys with perhaps months to go before the product will be sold.

Here is what we have to say about speculation:

***LP Gas* Magazine is also on Facebook and Twitter**

1. Avoid it by buying supply for specific sales programs, such as fixed-priced and budget programs.

2. Minimize the time between buying the supply and selling it.

3. If you have taken a speculative position on the supply side, know how you can get out of the position and set specific guidelines on when you will exit a position.

If you have taken a pre-buy position and have no idea how to protect the position from falling prices, you have taken a huge risk. The same can be said for filling a storage facility.

We do believe that propane retailers will be speculators. There will always be times when we believe the market is giving us a buy opportunity, and we believe you should take advantage because it helps limit the upside price exposure for your customers. By taking these positions, we can eliminate shocking our customers with high prices down the road.

However, sometimes what appeared to be a good buy becomes a liability, so we should have an exit plan. Sometimes you make the right market call and see nice gains on a speculative position only to hold the positions too long and watch the gains disappear.

If you have any supply position, but no sales against it, you should be quick to exit the position should the market go against you and be just as vigilant in taking or protecting gains when they come.

Let's look at a real-world example that the market has just provided to see how this may work.

Conway propane hit 51 cents on June 25, 2012. Let's say a retailer was astute enough to have filled 90,000 gallons of storage on that day. He bought the supply on a Conway index where he paid the Conway price the day of lifting plus 15 cents to get the supply into his bulk storage tanks. His propane sits in his tank at 66 cents.

He has not sold against this supply. He speculated and made a great market call. Conway is now 30 cents higher, at 81 cents, making the product in his tank worth 96 cents.

If you will remember last week, we listed a few reasons why we should be cautious about the gains in Conway propane prices. There is no guarantee on the gains at this point. They are unrealized and subject to being lost if the market falls.

Our retailer is sitting in great shape on Aug. 20. However, he does not plan on selling the product in his tank until the October-to-December time frame. Does he have to continue taking market risk through December? Is there a way to protect the gains he has already realized?

He can most certainly take action to protect his gains by using one of two financial tools -- selling a swap or buying a put option. If he had a very strong bias that prices were about to move lower, he should choose to sell the swap. However, if he feels there is more upside in the market, but wants to protect his gains, he should choose a put option. Let's assume the latter is his bias.

To own a put, he must pay a premium, which will use some of his gains. Let's say he plans on taking the product out of his storage at the rate of 30,000 gallons per month from October to December. He decides to buy three options with a volume of 30,000 gallons to cover each one of those months. The strike price would be 88.75 cents and the premium 7.75 cents. Since he plans on selling the gas this winter, we will use the strike price of the option to establish his unrealized gain on the position.

Currently he has unrealized gains of $24,975 on his storage position based on an 88.75-cent market price for October to December. The three options will have a combined cost of $6,975. By buying the put options, he has just made sure his worst-case scenario is to profit by $18,000 on his storage position.

When we get to each month, the monthly average of Conway will be compared to the strike price of 88.75 cents. If the average is lower, our retailer will receive the difference between the month average and 88.75 cents, making sure he can't make less than $18,000 on his storage position, even after option premiums are considered.

But our retailer really hopes the options don't pay. He hopes the market goes higher. He has no obligation under the option other than the premium he paid. If the market goes higher, the value of the product in his tank goes higher, which will increase his gains.

By buying the options, he has protected gains and still allowed himself to benefit from rising prices. In a rising market, he would be better off not owning the put option. But he chose to manage the risk to falling prices due to market uncertainty.

The takeaway here is to be aware when you are speculating and when you are hedging. If you are speculating, know how to exit a position or to protect gains. If you are speculating, you should never buy a position and forget about it; you should always have an exit plan or exit discipline.

If you need more help in understanding the tools and techniques for managing risk, please do not hesitate to contact us at the phone number or email address below.

Call Cost Management Solutions today at (888) 441-3338 for more information about how Client Services can enhance your business, or drop us an

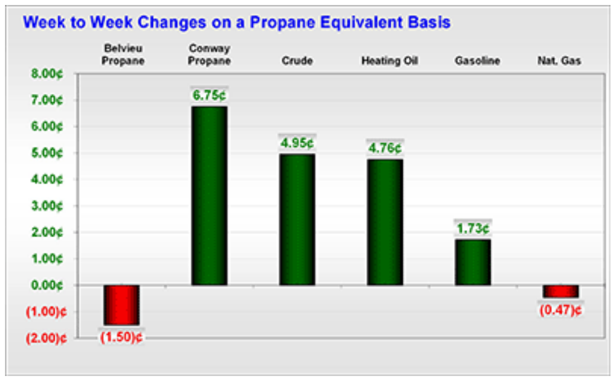
e-mail at info@propanecost.com.

WEEK IN REVIEW

Crude continued higher on low North Sea production.

Propane traded along the inventory data provided by the EIA. Gulf Coast inventory is building, putting downward pressure in Belvieu prices. Midwest inventory is declining, putting upward pressure on Conway prices.

We start this week neutral. Low North Sea production will continue to support crude, but propane seems to be losing some upward momentum.



LAST WEEK'S DAILY HIGHLIGHTS

Monday: WTI crude and U.S. equities indexes fell after Japan reported below expected GDP numbers. Brent continued its strength on low North Sea production and fears Israel is becoming impatient with global initiatives to force Iran to halt its nuclear work. Despite the fall in WTI crude, U.S. propane prices moved higher on follow-through momentum from last week.

Tuesday: Conway propane continued to close its value deficit with Belvieu, with a 1.6 percent gain. Crude keeps moving higher as traders put overall supply/demand fundamentals behind other factors in guiding their buying decisions.

Wednesday: Conway propane jumped sharply following another draw on Midwest inventory reported by the EIA. Belvieu propane prices fell slightly as Gulf Coast inventory continued to build at an above-average pace. Low production in the North Sea remained a key factor in crude pricing as Brent led WTI crude higher.

Thursday: Both WTI and Brent are still on pace to post their third straight weekly gain with another upward move. U.S. jobless claims were reported at 366,000, up by 2,000 from the previous week, which was in line with expectations. Also, housing starts were lower by 1.1 percent for July.

Friday: WTI posts gains as both hubs in propane post losses. Conway posts its first loss since Aug. 2. Belvieu is still feeling the effects of higher-than-expected inventory numbers.

COST MANAGEMENT SOLUTIONS

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.

Market Information Services

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

- Three Daily Price Flash Wires
- Periodic Option Quotes
- 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

Free trial!

For a free 10-day trial subscription by e-mail, sign up online here or call toll-free at 888-441-3338.

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
- Supply cost analysis and recommendation as to effective hedging strategies
- Because of the volume of transactions we place annually, we receive large volume consideration when we place your hedges

Visit us online at www.propanecost.com. Or e-mail info@propanecost.com.

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

Dale G. Delay 888-441-3338, ddelay@propanecost.com
Mark Rachal 318-865-9928, mrachal@propanecost.com

LP Gas Magazine
www.lpgasmagazine.com

For advertising information, contact:
Brian Kanaba, Publisher
bkanaba@northcoastmedia.net
216-706-3745