SPECIAL EDITION

Volume: X

Propane Market Pulse

Preparing for an industry transformation

by Adam DeLawyer, vice president, CHS Propane

You've heard it here before. We've spoken a lot these past few years about the changes expected to alter the propane world and how those shifts would impact our industry—with increased exports (and their ability to drive prices and change supply flow) at the top of the list.

We may have predicted these headwinds years in advance, but I don't think anyone expected the amount of change we've seen or how quickly that change would take shape (two full years of unprecedented events around the world have certainly expedited things).

The fact of the matter is that our industry is in the midst of a transformation and we all need to be prepared for changes yet to come. After all, today's market forces are no short-term hurdle. In fact, we anticipate these headwinds to continue and even pick up speed moving forward, especially as export infrastructure and propane production continue to grow.

Having been a leader at a propane retailer, I know all too well that higher operating costs will require higher margins to pay for not just the product, but the equipment and the wages of the employees that keep your business moving. A look at raising your margins while finding efficiencies in your deliveries will be crucial for success. Having—*and managing*—a daily position to mitigate price risk will be more important than ever. Last but not least, the more storage you can arm your operation with, the more control you'll have when it comes to weathering these market shifts.

With all of this change in mind, the topics featured in this edition are focused on steps you can take to set yourself up for success and best prepare for this changing world. The good news in all of this transition is that CHS is here to help. We've designed specific tools and programs to support you and help provide direction. We know there's more change ahead, but we look forward to navigating this together with you.

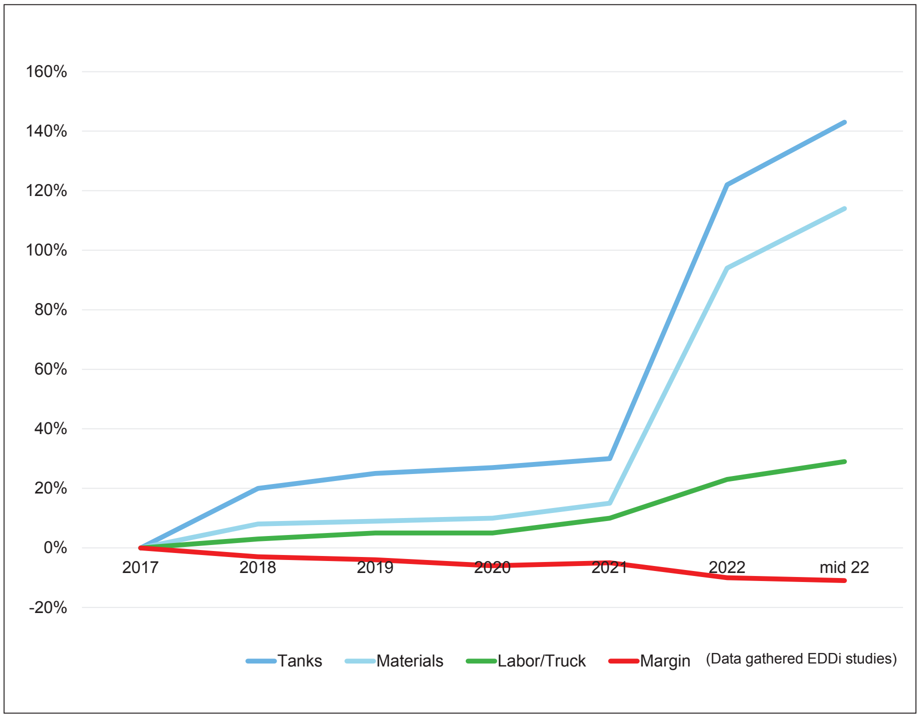
Are your sales margins keeping pace with rising operating costs?

Just about everywhere you look lately, prices seem to be going up. That's certainly no different in the propane industry. One of the biggest challenges for businesses today, in these times of high inflation and rapidly changing markets, is keeping track of your true operating costs and profit margins.

Residential propane prices across the U.S. increased an average of 15% between October 2021 and March 2022, according to U.S. Energy Information Administration data. "Typically, retail price will follow product costs fairly closely, but historically, we have not seen the significant increase in asset costs at the same time," says Dennis St. Aubin, CHS propane western sales director. "What we have seen in the past few years is that some operating costs have risen sharply, while margins have been on the decline."

Since 2017, average margins for propane retailers have declined by 11%, according to information gathered by the CHS Energy Delivery Dialed-in (EDDi) Study. EDDi is a service offered by CHS Energy Distribution Solutions to help marketers explore opportunities for improved efficiency with their bulk refined fuel and propane businesses.

The first step in combatting eroding margins is analyzing all operating costs and, in the case of recent years, understanding the impact to earnings if gross margins are set on a cents-per-gallon basis and have not kept pace with increased costs, says St. Aubin.



Tracking higher costs

Propane is an asset-heavy business. The cost of maintaining and expanding tertiary storage, bulk secondary storage and rolling stock has increased significantly over the past two years, thanks to increasing raw material costs.

Global steel prices have surged over 200% since early 2020, due to pandemic supply chain disruptions. The cost of new propane tanks is up 121% since 2017 and expected to increase another 22% by mid-2022, according to EDDi data. "A 500-gallon tank that cost 38 cents per gallon five years ago is projected to cost 72 cents per gallon by July of this year," notes St. Aubin. "And there are currently significant delays to receive new tanks."

The price of most equipment and materials has shot up, as well, with the price of copper pipe and fittings jumping nearly 300% the past two years. Overall material costs have nearly doubled, leading to major price increases for tank fittings and other installation products. Labor and truck costs have gone up an average of 20% since early 2021, according to EDDi data.

There are plenty of other operating costs that are often overlooked but will eat into your company's profits, including:

- Fuel costs
- IT services
- Labor overtime
- Depreciation (increased tank prices)
- Property and casualty insurance
- Licenses
- Advertising
- Staff education and training
- Uniforms and plant supplies
- Increased accounts receivable
- Legal fees

"It's important to make sure you're capturing all expenses in order to know your true costs," says St. Aubin.

Boosting operating efficiencies

Once you know your costs to operate, you have to consider your historic returns and what it will take to maintain a sustainable margin going forward, St. Aubin says. "When it comes to product pricing, are you testing the market? Will the market follow? Or are you watching the competition?"

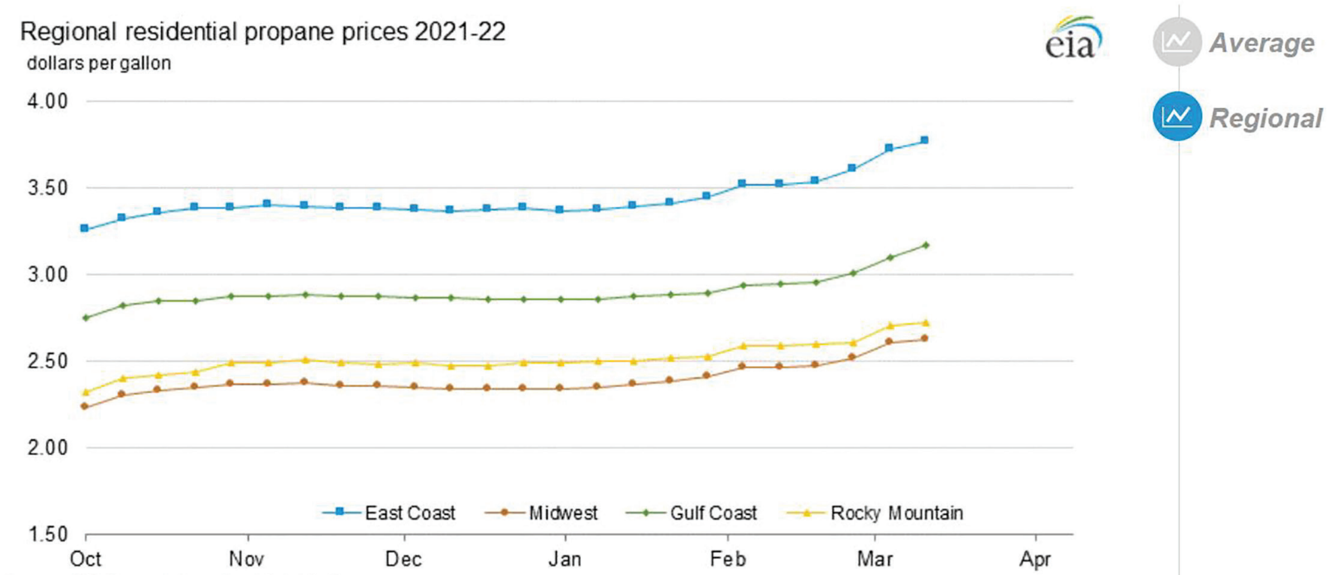
"It's definitely a balancing act, especially if you're in a competitive marketplace," he notes. "Competition can pull the market lower even when increasing costs should be pushing it higher."

One solution is to track and improve your internal operating efficiencies, says St. Aubin. "Set benchmarks for efficiency measures, such as total gallons delivered, gallons per delivery, and tank-fill percentages and track them on a regular basis."

He says that operational efficiency benchmarks will assist with controlling costs, and developing a growth strategy will set a plan for growing new gallons that best fits your company's strengths.

Later this year, watch for new resources from CHS Propane to help your cooperative develop strategies to become more efficient and profitable.

Residential propane prices *(dollars per gallon)*



Source: U.S. Energy Information Administration

*Last updated on March 31, 2022

Managing daily positions is key in today's volatile markets

Propane markets have become less predictable over the last decade. Larger and more frequent price swings can make for nerve-wracking times for buyers.

"Even just five years ago, propane markets typically followed weather-driven demand and inventories," explains Dennis St. Aubin, CHS propane western region director. "But over the last few years, we've had to become more focused on propane export volumes. The doubling of U.S. export capacity over the past 10 years has created the potential for market volatility."

He says one of the most effective ways to minimize the impact of that volatility is to develop a detailed and diverse supply plan, then manage it on a continual basis.

Shifting focus to supply risk

Today's changing propane market requires retailers to transition from being mostly price-focused to better understanding their supply risks, says St. Aubin. "Managing price risk will always be the priority, as a retailer takes positions that will meet budget and margin goals. But as U.S. supplies have become more variable, developing a supply plan concurrently with managing price risk is essential, and work on that should start in the coming month."

"It's a good idea for retailers to start layering in propane contracts in Q1 of the calendar year, building an average that supports the volumes they expect to presell," St. Aubin says. "Staying active in the market through layered purchasing helps to reduce overall risk and improve cost averaging."

He notes that each retailer's or marketer's business governance has its own risk management policies that usually include a percentage of total market positions that can be covered prior to transferring that sale to the end user. As gallons are sold, retailers can adjust their positions based on the current market. "Keeping an accurate daily positions report is an effective tool for managing risk. It allows a retailer to align their contract positions with their supply needs."

In the next month, wholesalers including CHS, will be presenting their product cost forecasts for the propane industry for the 2022-23 supply year. This is also a good time for retailers to review their company's historic propane volumes, plan for any anticipated growth or decline in sales, and establish a target for procured volume that meets the company's risk policy, recommends St. Aubin. "It's also important to benchmark your goals and regularly check in with your wholesale account manager to measure your progress against prior established contract volume goals."

A unique tool in the CHS Propane Control Room

Reviewing and revising your supply plan frequently is key to staying on top of today's often volatile propane markets. The CHS Propane Control Room (PCR) offers CHS customers a convenient way to simplify supply planning.

As a first-of-its-kind online tool, PCR helps customers manage all aspects of their business with CHS, including forward contracting. "The tools provided in the Control Room help our customers manage their day-to-day business more efficiently," St. Aubin notes.

Customers can:

- Monitor remaining contract volumes and calculate average costs
- Manage contract source points
- Prioritize contracts and manage manifests
- Review pricing by hub and terminal, including current market prices
- See how the supply planning and nominations feature can align supply needs with anticipated demand
- Use the PCR LookBack® feature to apply yesterday's load to their contract or rack gallons

This last unique tool, LookBack, gives you added flexibility, says St. Aubin. "You may know first thing in the morning that you'll need 10 transport loads that day, but you don't know yet what the market is doing. This feature gives you 24 to 36 hours to watch the market for a cheaper rack price or to decide to pull those loads from existing contracts. It allows you to be more reflective in your supply management."

Years ago, CHS developed PCR to help customers better manage their supplies in order to be more profitable and to reduce the stress levels of those making supply decisions, St. Aubin says. "Those remain core goals. And we're constantly working to improve the portal's features to adapt to the changing domestic and global propane markets."

Propane marketers should work with their CHS account managers to learn more about the features of the CHS PCR and how to use them to more efficiently manage their daily positions.

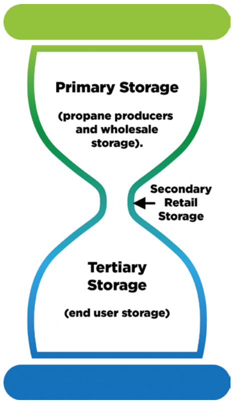
Do you have enough propane storage capacity?

Are you able to make it through crunch times without running out? Can you keep all your customers supplied without delays or interruptions? Or could your business benefit from having additional propane storage to ensure reliable supply for current customers and expand to new ones?

Recent changes to global propane markets, including continued new U.S. production and the steady increase in domestic propane exports, are impacting how and when you buy propane, says Alan Groene, CHS Propane senior account manager for Wisconsin and Michigan. "The tighter U.S. propane inventories we've seen in the last year could become a more common occurrence."

Add to that the continued truck driver shortage impacting most industry supply chains in recent years, he says. "All of these major changes are out of a retailer's control. The one thing you can control is the amount of storage you have locally. Now is a good time to reassess your current propane storage capacity to make sure you're right-sized for your local market and the industry's evolving supply chain factors."

A good way to visualize today's propane industry is to think of it as an hourglass, he says, with the top chamber representing primary storage (propane producers and wholesale storage), and the bottom chamber representing end user tertiary storage. The thin middle point reflects the secondary storage level, and its limited amount of retail storage currently available. It continues to be the biggest pinch point in today's supply chain. Adding storage may be the best way for many accounts to widen that bottleneck."



How much is enough?

Twenty years ago, the propane industry recommended 14 days of storage capacity during peak demand. "That's not affordable for many businesses, but a good current rule of thumb in most U.S. geographies is to have at least seven to 10 days of storage capacity. Those in cooler northern climates need at least eight to 10 days of supply. Currently, only about 5% to 10% of propane retailers have enough storage based off their geographical region and logistics," notes Groene.

Right-sizing storage for your company's specific needs depends on a variety of factors. As the chair of the Wisconsin Propane Gas Association Supply and Infrastructure Task Force, he recommends answering these questions:

- How many times do you turn over your existing tanks each season?
- How many reliable supply sources do you have?
- How far away are those sources?
- How many carriers do you regularly use?
- Do you have a winter only source and carrier(s) to get that product?

"Your CHS account manager can go over each of these points to help determine if additional propane storage would pencil out for your business," says Groene.

Making expansion affordable

Retailers don't have to shoulder all the burden of expansion costs upfront. The CHS Storage for Pennies program provides a lease-to-own option on new bulk fuel storage and equipment, explains Kenton Sonnenburg, CHS Propane energy equipment manager. "Customers can lease equipment, then pay for it over an extended time with payments included in the price of propane purchased from CHS and at a manageable rate. We can also help customers choose the equipment and features that best fit there operaiton solution, then source the equipment and line up installation with reliable vendors."

CHS coordinates financing through a third-party source but handles all the payments to make the process convenient. "Most customers pay off their investment in five to 10 years," says Sonnenburg.

The cost of steel continues to increase, adds Sonnenburg. "A new 30,000-gallon tank now costs 20% more than it did two years ago, and that trend could continue."

Learn more about the CHS Storage for Pennies program at **Storage-For-Pennies.pdf (chsintheknow.com)** or call 1-800-852-8186 and press 1.

5 facts about renewable propane

Chances are, you've heard much more about renewable fuels lately. Alternative energy options like renewable diesel have earned plenty of headlines for their environmental benefits, but many have yet to learn about another promising alternative: renewable propane.

Like renewable diesel, renewable propane is poised to play an increased role in powering vehicles and heating homes more sustainably in the years to come. But what exactly is renewable propane? We've got answers to the five most commonly asked questions about renewable propane.

1. What is renewable propane?
Renewable propane is a fuel that can be made from a variety of feedstocks, including soybean oil, used cooking oil and animal tallow. The most common form of renewable propane today is a byproduct from the same process that creates renewable diesel from soybean oil. The use of soybean oil in renewable propane and renewable diesel will likely mean increased opportunities for soybean growers in the future.

2. How is renewable propane different from conventional propane?
Although both are chemically identical, renewable propane is made from biomass-based feedstocks, while conventional propane is produced from liquid components recovered during natural gas processing and the process of refining oil into gasoline. Both conventional and renewable propane are reliable, portable, clean, low carbon-based energy products that can be used to reduce your carbon footprint, but only renewable propane is made entirely from sustainable raw materials.

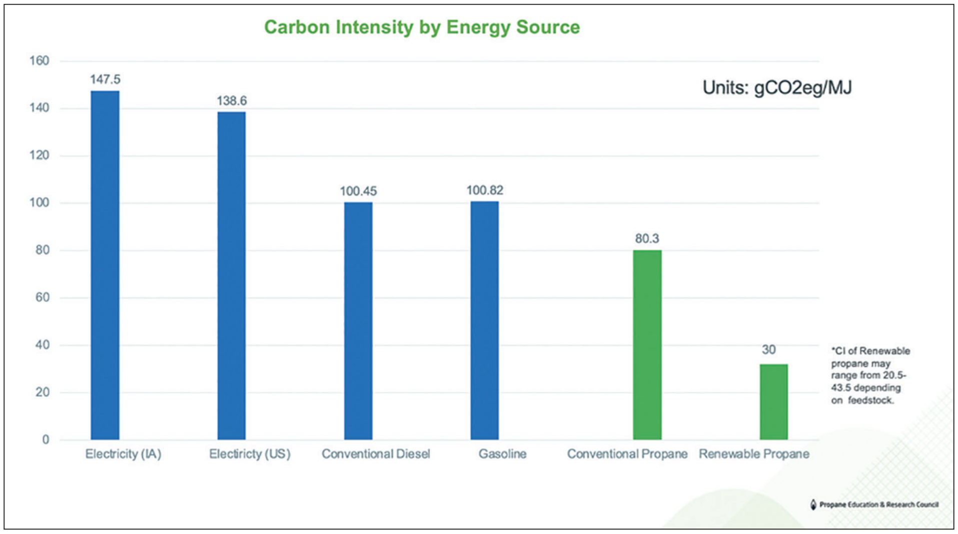
3. How is renewable propane used?
Renewable propane can be used in all the same applications that the more traditional propane molecule is used today. With incentives like the California Low Carbon Fuel Standard (LCFS) driving motor fuel applications versus general use (i.e. home heat), renewable propane is used today primarily to power truck fleets. Because of the numerous incentives California legislation provides for the use of renewable fuels, the state is currently a major user of renewable propane. Renewable propane has not been widely adopted yet.

4. How does renewable propane compare with other energy sources?
Renewable propane has lower carbon intensity than conventional propane and many other energy sources. According to the Propane Education & Research Council (PERC), renewable propane can have a carbon intensity that may range from 20.5 to 43.5 grams per megajoule (the standard unit of greenhouse gas emissions measurement). Conventional propane, gasoline and conventional diesel fall in a much higher range. The smaller the number, the better the energy source is for the environment.

5. What could renewable propane hold for the future of transportation?
U.S. fuel processors are already making millions of gallons of renewable propane, but a larger move toward cleaner liquid fuels like renewable diesel could lead to an increase in renewable propane production. **The WORLD LPG ASSOCIATION** estimates that by 2050, renewable propane could meet half the world's demand for propane.

At CHS, we're keeping track of the opportunities that renewable propane and renewable diesel could hold for our customers in the future.

Have more questions about renewable or conventional propane? Email me at **andrew.ernst@chsinc.com**.



Discover the newly enhanced Cabela's Gift card program

Now you don't have to wait to receive Cabela's gift cards earned through the Energy Equipment Rewards Program. Earn a $25 Cabela's gift card for qualifying orders placed through the **CHS Propane** or **Petroleum Equipment** online stores and receive your gift card(s) the following month. Please see details below for important changes to the Cabela's Reward program:

- Earn a $25 Cabela's gift card for every $2,500 in merchandise purchased through either the **CHS Petroleum** or **Propane Equipment Store**. Rewards for each online store are based on total purchases from September 1 through August 31.
- For the **CHS Propane Equipment Store**, purchase $2,500 in merchandise between September 1 through August 31 from one of the following vendors, Bergquist, FEI, or GEC and qualify for a $25 Cabela's gift card. Multiple vendors may be used in placing an order, but orders will only qualify for a gift card with total purchases of $2,500 in merchandise from a single vendor.
- Purchases are automatically tallied and at the beginning of each month your earned Cabela's gift cards are shipped to the parent location.

Sign up for the CHS Propane Equipment online store at **www.chspropaneequipment.com.** Click on the "Login" icon and follow the instructions. For assistance call CHS Energy Equipment at 800-852-8186, option #1.

What's new in 2022 for the CHS Safety Reimbursement Program

Tank monitors are the latest item eligible for the CHS Propane Safety Reimbursement Program. All tank monitors purchased through CHS Energy Equipment now qualify for the CHS Safety Reimbursement Program rebate dollars, including Otodata and Anova tank monitors.

Your rebate dollars are calculated beginning with September 1 propane purchases and updated daily based on your cumulative purchases. Safety Reimbursement dollars will continue to accumulate through August 31.

To learn more about using your Safety Reimbursement Program please visit the "Rebate" tab in the CHS Propane Control Room. Here you can see how many dollars you have available and how they can be used. Or call CHS Energy Equipment at 1-800-852-8186, option 1, and they can help answer questions and assist with your tank monitor order.