What You Need to Know

The United States is on a path to energy abundance for the first time in decades. Thanks to hydraulic fracturing and directional drilling, American industry has unlocked previously unimaginable amounts of energy from shale formations. In just a few short years the nation has leapt from declining production to record production of oil and natural gas.

The propane industry without question has been a beneficiary of this surge in energy production. At present more than seventy-five percent of all propane flows from natural gas production. And in 2013 the nation topped all prior records for propane production. Projections suggest that this increase in production will continue into the indefinite future.

While certainly beneficial to the propane industry and its customers, this dramatic increase in propane production has also proved to be disruptive in a number of ways. Traditionally most fossil fuels were produced in the Gulf Coast states and transported to Eastern, Midwestern, and Western markets by means of pipelines. Shale formations defy these traditional patterns; they are found in many different geographical areas, including those much closer to energy-consuming markets. As a result, increases in shale production have led to a vast "re-plumbing" of America's energy infrastructure. This process, which is not yet complete, has had major, irreversible effects on propane markets. The Cochin pipeline, which had brought significant volumes of propane from Canada, is no longer in propane service. Another major propane pipeline serving the American heartland has been reversed and now delivers products to the Gulf Coast. These infrastructure changes were major causes of the dislocations in propane markets in the winter of 2013-2014. While there was an abundance of propane this past winter, it was often in the wrong place.

Increases in propane production have also outstripped increases in domestic propane demand. As a result, propane producers and traders have been compelled to seek new outlets for their rapidly growing supplies. They have largely found these markets outside the United States. For a number of reasons foreign markets will pay a premium over the prices in U.S. markets. There is no doubt that the rapidly increasing volume of propane exports has changed U.S. market dynamics.

Compared to liquefied natural gas export terminals, however, the construction of propane export terminals is relatively inexpensive and expeditious. No government permit is required to export propane, again unlike natural gas. It is likely that this trend will continue. Importantly, there is considerable popular and political sentiment in favor of expediting exports of natural gas and even lifting the current ban on exporting crude oil. As a result, there is little, if any, political will to arrest accelerating propane exports.

These market dynamics, together with record crops and record cold, led to massive dislocations for propane marketers and propane consumers this past winter, particularly in the Midwest and Northeast, but certainly in other parts of the country as well. Crops may grow and shrink, and cold weather can come and go, but these new market realities are here to stay. While more market changes are certainly in store, the trends we are seeing are the new reality. Propane industry players must assess what these market changes mean for them, and what changes must be made to their business models to ensure future success, perhaps even future survival.

What You Can Do

NPGA is making a number of recommendations for future action on the part of industry and the government to avert a repetition of last winter's distribution challenges. These recommendations make a variety of suggestions intended to aid marketers in creating and implementing their own propane supply plans. There are no silver bullets to the problems that occurred, and all propane supply planning must be customized to each marketer's region, sources of supply, customer base, and numerous other factors.

Demand Forecasting -- Supply planning for the propane marketer begins by creating a forecast of projected demand for the coming year. This can be done by considering past gallon sales and a review of future weather forecasts, among other factors.

Supply Contracting – In contracting with mid-stream companies selling you propane, you should evaluate their strength and reliability; create a comprehensive supply plan; contract for a significant portion of your anticipated needs; prepare a contingency plan if your needs exceed your forecast; diversify; track your progress and modify your plan through the season; and commit to you supplier(s) in the same way they commit to you;

Transportation and Logistics – assess whether your ability to transport the gas to your plants is adequate, including whether to own transports, subcontract to someone else, or some of both.

Primary Storage -- explore opportunities for maintaining propane storage in primary caverns, even if it's something you've never done before. This will protect your supply needs, and also serve as a long hedge.

Marketer Plant Storage -- evaluate your plant storage situation, particularly if you turned your storage more than 20 times per year. This places stress on the transportation and supply systems, which then affects all other marketers in a given region. A range of ten to fourteen days of supply on hand in owned or directly controlled storage during peak season should be considered.

Customer Storage -- all marketers should implement programs aimed at ensuring customers are full prior to peak season. Areas of focus should include eliminating "will call" accounts; creating budget or pre-pay programs to eliminate credit concerns; offering promotional pre-season fill rates; working customers on schedules and routes.

Capital Funding/ Cash Flow Management -- With emergency supply last year costing up to $3 to $5 per gallon, a marketer could be faced with $30,000 to $50,000 for each transport load. If customers take 30-60 days to pay, small marketers may face a serious cash flow imbalance. Governmental programs exist and should be understood, but all marketers should be proactive in revisiting and strengthening their banking relationships and access to capital prior to the next peak season.

NPGA has links to many other existing resources on our website at www.npga.org.
