End of a Decade

PROPANE RETAILERS DISPLAY BUSINESS AGILITY TO OVERCOME INDUSTRY'S CHALLENGES OF PAST 10 YEARS

Do you recall when, as a youngster, what a long, long time it seemed between one Christmas and the next? These days it feels like Santa barely has had time for a long nap when here we are again, rummaging in the basement for boxes of ornaments and lights after seemingly just having dragged last year's tree out of the house.

PROPANE EDUCATION & RESEARCH COUNCIL

So it shouldn't be surprising that with hopes for the new millennium still not far out of mind, we are already ending its first decade and beginning another. This end of year also marks a decade of our publishing *LP Gas* Magazine's annual State of the Industry report.

The survey of retailers we conduct every year as the basis for the State of the Industry report provides unique perspectives and insights into the business of propane retailing. Instead of merely looking from the outside in, retailers like you have allowed us a look from the inside out.

Community-centered, family-owned businesses. Locally-managed offices of major, multi-staters. Propane operations of farm-servicing co-ops. Over the years of surveys, we've reported how propane retailers of all types and sizes across the country deal with the seemingly never-ending new challenges put in their way and the level of success they've had in facing these challenges. What retailers have shared with us has also allowed us to report each year how they feel about the future of the industry and the prospects for their individual businesses. We expect that many times as you've read through our reports, you couldn't help saying, "Yep."

Titles of State of the Industry reports, by themselves, put this decade of propane retailing in perspective. Titles like "An industry in cost crisis" . . . and "How much are your customers really costing you?" . . . and "Is your business heating up? Or are you watching your profits go up in flames?" Hopefully, you found each issue of State of the Industry reports over the years to be far more than a recap of numbers against which to compare your business, but a collection of business insights and ideas as well . . . insights and ideas that added to your success in creating an agile business.

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A look back on the decade

The September 11 terrorist attack in 2001 had what you might consider the most significant impact on propane retailing of any event during the decade. Survey forms for that year's State of the Industry were already in the mail to retailers as that horrific event unfolded. Our survey questions thus focused on the fore-going business climate, and overall retailer responses were optimistic. When we asked about pressing issues and the future of the economy, nothing in their answers, shown below, bordered on panic.

2001

What development will most impact your business in the next 12 months?

Percent of responding retailers:

Price	14.4%
Regulations	8.5%
Supply	8.2%
Insurance: cost/availability	5.3%
War/terrorism	2.7%
The economy	2.1%
Safety	1.4%

December 2001, *LPGas* Magazine, State of the Industry Report

Although the issues that retailers noted may have been prophetic, their relatively low level of concern drastically underestimated future impact.

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FROM THERE TO HERE

The character of propane retailing

Looking at a snapshot of today's propane retailing business, one could reasonably conclude that the industry is indeed different than it was early in the decade. However, it's not as easy to describe just how it is different.

One comment we received from a State of the Industry survey a few years ago captures a bit of the different "feel" of the business: "This is turning into a commodity business that is only about price. It isn't fun anymore!" Because this wasn't an isolated comment, we could reasonably conclude that "fun" was an important part of the business – an enjoyment that to a great degree had been the satisfaction derived from years-long personal relationships with customers.

And that fun of a personal relationship went both ways. Back during the height of acquisitions, we were chatting with a woman who lived in a rural area of central Texas shortly after her long-time "gas man" had sold out to a large, multi-state retailer. It was obvious from her attitude that she wasn't pleased with the change, and she was happy that we were interested in hearing about it. "It used to be that if we needed a special fill-up, we'd just call Billy and he'd come out and fill the tank. Or, if we had a problem with a valve or something, you could count on Billy being here to fix it right away, day or night. Now we have to call some 800-number to someplace, maybe even in another state, and they put us on a list. Even worse, if you need something on a weekend, you can only leave a message on their phone!"

Despite retailer wishes for "the good ol' days," and despite acquisitions and consolidation over the decade, the average life of retailing businesses and the tenure of those involved is much the same. From early in the decade to present day, the average propane retailing operation has been in business over 30 years. And, likewise, retailers have long been personally involved in the business – early surveys indicating more than 20 years, this year's survey reporting more than 24 years on average. Propane retailing continues to be a steady business staffed with experienced people.

But even further descriptive of this industry are the beliefs these experienced retailers have of what are their important competitive advantages. Low price is not at the top of their list of competitive advantages – especially since propane retailing is essentially a commodity business. Instead, it's customer loyalty that is the year-after-year chart topper, quality service following directly. We think it's safe to assume that retailers put customer loyalty first and foremost because it is reciprocated – through trust built by caring enough

2009

Commitment & Continuity within Propane Retailing

Averages of 2009 retailer responses from across the U.S.:

Business Longevity 31+ years

Average years operation has been in the delivered propane retailing business under its current ownership and type (owner-operator, investor-owned, or farm co-op)

Personal Longevity 24+ years

Average years personally involved in propane retailing

75.8% survey respondents say customer loyalty is a primary advantage they have over competitive propane retailers

Figure A

about customers to consistently provide quality service and go the extra mile.

To whatever degree such traditional customer service is consumed by acquisitions and consolidation, marketing ploys of competitors and enormous demands on time from government regulatory agencies, we can't ignore how many propane retailers feel that the character of the industry is moving in the wrong direction from being the community's "gas man."

It's a commodity business

By definition, propane retailing is a commodity business. Simply put, propane is propane – essentially always the same, meeting required product specifications that typify commodity futures trading.

The importance of that definition lies in the marketing of a commodity against other marketers. As a standardized product, one gallon of propane cannot be differentiated from another. It's not a candy bar that tastes better than others. It's not a computer that runs faster. It's not a sports car that is flashier. Propane is propane.

Consequently, the most important driving force in selling propane is your product cost. You probably also think of it as the most

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'Mixed messages'

2002 could be labeled "the year of mixed messages."

The first regarded competitive impact of other forms of energy. While over 50% of the retailers responding to our survey reported losing customers to other forms of energy, 47% viewed other energy as having minimal impact on their business.

The second was a theme from level and volatility of prices. "Price" was rated a distant third to "Customer Loyalty" and "Quality Service." Yet, with the exception of a regional price spike,

2002

High-volume retailers looking to acquire:	51.6%
Low-volume retailers looking to be acquired:	23.7%

December 2002, *LPGas* Magazine, State of the Industry Report

retailers reported generally stable, if not exciting, levels of supply cost during the 2001-02 heating season, prices charged and gross margins.

And the third arose from the loud chatter about acquisitions. Over half of high-volume retailers responding to the 2002 survey were looking for businesses to acquire . . . and a significant 23.7% of small retailers expected to be acquired! Yet only 16.1% of responding high-volume retailers had acquired businesses during the previous year . . . making their stated acquisition objectives perhaps a bit "pie in the sky!"

Cost of doing business

Again in 2003, there were inconsistencies between retailers' feelings about their current situation and their expectations.

While they voiced "cautious optimism" regarding their expectations for the future, operating margins were down as the cost of doing business was being fueled upward – a direct result of 9-11.

Here are telling outtakes from 2003 retailer comments:

2003

> **"If we're not in an insurance crisis right now, we're very, very close" . . . "The cost of providing employee benefits, especially health insurance, is out of control" . . . "Insurance company demands, along with the growing federal and state regulations are smothering us" . . . "Price spikes are driving customers away from propane" . . . "Those who are chopping prices in order to compete are diminishing the credibility of the industry."**

Of course, these voiced fears were only a precursor to harsh realities of coming years.

2009

Average % of Retailer Sales by Source

	2005	2006	2007	2008	2009
Propane sales	71.4%	70.2%	66.9%	68.5%	77.4%
Propane-related sales/service	7.2%	7.0%	5.9%	6.0%	6.1%
Non-propane-related sales	7.0%	7.8%	11.8%	12.0%	6.7%
Other forms of energy	10.9%	13.2%	15.4%	13.5%	9.8%

Figure B

Continued from page 21

stomach-churning aspect of retailing, because cost determinants are out of your control. Our surveys show that propane sales, on average, consistently account for around 70% of retailer revenue. And, being that your cost subsequently drives what you charge customers, it's not surprising that cost of supply is a major stress for you.

The graph and chart in Figures C and D (pages 23 and 24) depict the average wholesale and residential retail propane prices over the last decade of heating seasons. The space between the two lines on the line graph is obviously the gross margin a retailer earns on residential sales. The line graph suggests that the relationship between wholesale and residential retail prices of propane are relatively stable on average, though at times it may not feel that way to you.

The more detailed perspective over the decade in Figure D, however, shows how the differences between high and low wholesale and high and low residential retail prices can vary considerably during a heating season.

Weather, another uncontrollable factor for which you can only blame Mother Nature, can be understandably the most significant determinant of a successful heating season for retailers – or perhaps for a calendar year. Figure E (page 23) recaps heating degree-day averages by decade for each geographic region, providing a unique view of weather trends.

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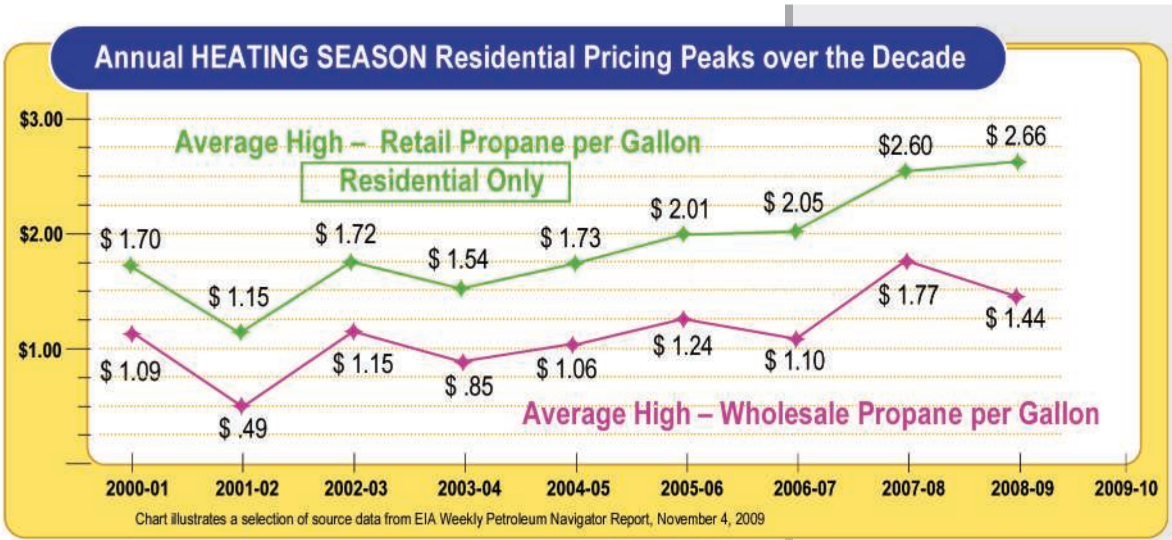

Figure C

Decade-to-Decade Annual Heating Degree-Day Averages

	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific
1980-1989	6,619	5,875	6,455	6,594	2,927	3,619	2,323	5,224	3,080
1990-1999	6,358	5,581	6,236	6,487	2,729	3,404	2,157	5,095	3,004
2000-2008	6,374	5,603	6,189	6,380	2,739	3,396	2,139	4,858	3,055
Norm	6,612	5,910	6,498	6,750	2,853	3,603	2,286	5,209	3,226

ME • NH • VT • MA • RI • CT
OH • MI • IN • IL • WI
KY • TN • AL • MS
LA • AR • OK • TX
WA • OR • CA
PA • NY • NJ
WV • VA • NC • SC • GA • FL
CO • NM • AZ • UT • WY • NV • ID • MT
MN • IA • MO • KS • NE • SD • ND

Chart illustrates a selection of source data from EIA Annual Energy Review 2008

Figure E

As far back as 2003, our State of the Industry survey has asked retailers for detailed information about their cost of doing business. It has allowed us to provide you with insights into competitive advantage, marketing strategies, and effectiveness, efficiency and productivity.

Price spikes

The actual dollar amount of the $2.60+ high price average for residential propane in the 2007-08 and 2008-09 heating seasons can't be minimized. However, in the context of low-high variance during a period of time, the price spike during the 2002-03 heating season of 60¢ was truly considerable!

60¢ price variance over 1 heating season

$1.32 total price variance spread over 5 heating seasons

Heating Seasons:
RESIDENTIAL PRICING Volatility Comparisons

Season	Period	WHOLESALE PROPANE (Average wholesale price per gallon) Low	High	Variance	Residential RETAIL PROPANE (Average retail price per gallon) Low	High	Variance
2000-2001	Oct - Mar	.62	1.09	.47	1.27	1.70	.43
2001-2002	Oct - Mar	.33	.49	.16	1.12	1.15	.03
2002-2003	Oct - Mar	.53	1.15	.62	1.12	1.72	.60
2003-2004	Oct - Mar	.63	.85	.22	1.28	1.54	.26
2004-2005	Oct - Mar	.81	1.06	.25	1.57	1.73	.16
2005-2006	Oct - Mar	.94	1.24	.30	1.92	2.01	.09
2006-2007	Oct - Mar	.93	1.10	.17	1.93	2.05	.12
2007-2008	Oct - Mar	1.43	1.77	.34	2.13	2.60	.47
2008-2009	October	.98	1.44		2.53	2.66	
	November	.81	1.07		2.41	2.50	
	December	.70	.86	.74	2.32	2.40	.44
	January	.82	.91		2.31	2.32	
	February	.77	.96		2.29	2.32	
	March	.73	.76		2.22	2.27	
2009-2010	October	.99	1.19	.20	2.06	2.16	.10

Prices have been rounded to the nearest cent

Charts illustrate selections of source data from EIA Weekly Petroleum Navigator Report, November 4, 2009

Figure D

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The search for the silver bullet

For many years and into the new millennium, the "hottest" things in business were books written by management gurus who promised a "silver bullet" – a trendy panacea that would put an end to all of your business problems. Team building. Time management. Balanced scorecard. Management by walking around. The books were full of promise, but unfortunately, the only silver bullet belonged to the long-gone Lone Ranger.

Even a small business is a complex combination of interrelated factors that must work smoothly together for the business to be a success. In your business, where commodity specifications of propane are fixed, and your product cost is largely driven by a world market, effective management of all of your controllable factors is key to achieving competitive advantage within your territory.

That said, and lacking any silver bullet, we don't doubt that trying to deftly control your "controllables" has robbed you of sleep, especially in the last three years. Pricing, for one, may be your nightmare. Long-time retailers from across the country report customer loyalty being put to the test these days by propane "poachers" who are offering cash-strapped consumers cheap propane, often by ignoring regulations, insurance requirements and accepted practices. While hoping poachers in your territory will soon be out of business, you might be finding yourself competing on price – a margin-eroding dilemma.

On the other hand, holding firm against price-chopping requires focused attention on controllable factors in your business. Some are, admittedly, at a cost, like infrastructure factors that directly contribute to your ability to provide good, loyalty-building service. Others merely require a planned effort, like money management practices and providing further training and responsibility to drivers for customer relations – the vital frontline face of your business. So can a consistent program of customer communications provide competitive advantage – a factor many retailers miss, as you can see in Figure F to the right.

Competition you're experiencing in your territory these days may not only be from other retailers. When this year's survey asked retailers to rate the strength of other retailers and other forms of energy, on average they considered competition from electricity nearly as great as from owner-operators in their territories.

Keeping customers loyal to propane may be as vital to your business as keeping them from straying to cheaper retailers. A smile and handshake from you is undoubtedly more than they will get from a municipal utility!

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Keeping current customers

We wouldn't be surprised if you think of communicating with customers as a customer service effort. How about considering it instead as a retention marketing effort? After all, keeping a current customer is a lot easier and less costly than finding a new customer to sign up. A customer often seeing a face or hearing a voice of a real person from your company can be more powerful than any promotion or advertising you buy.

Only **46%** of survey respondents said they make personal contact with their retail propane customers

2007

Average Frequency of Retailers' Customer Contact

Percent of those retailers contacting customers:

	In Person	*By Phone*
Monthly	13.5%	10.1%
Every other month	9.8%	14.7%
Twice annually	22.6%	19.4%
Only annually	54.1%	44.2%

December 2007, *LPGas* Magazine, State of the Industry Report

Figure F

One controllable factor that retailers have pursued over the decade is use of technology to achieve greater efficiency and cost savings for their operations. As one would expect, computerized accounting systems comprised the first application adopted with single-digit percentage in early-decade years. Today's fleet routing software and remote tank monitoring are an up-front cost but a long-term savings in delivery costs.

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FROM HERE TO THERE

What goes up must come down and vice versa

Since the beginning of the 2008-09 heating season, the industry has had ups and downs and "up agains." While both the cost of supply and prices charged consumers were lower this September than September of 2008, surveyed retailers say their margins increased an average of 11.5%.

It does appear that, while 92.0% of retailers reported lower supply cost in this year's survey (naturally, depending on their contract terms and duration with suppliers), only 82.3% reported they had lowered customer price.

You've already seen EIA's historical figures for residential retail pricing in Figure D on page 24, showing the differences between the

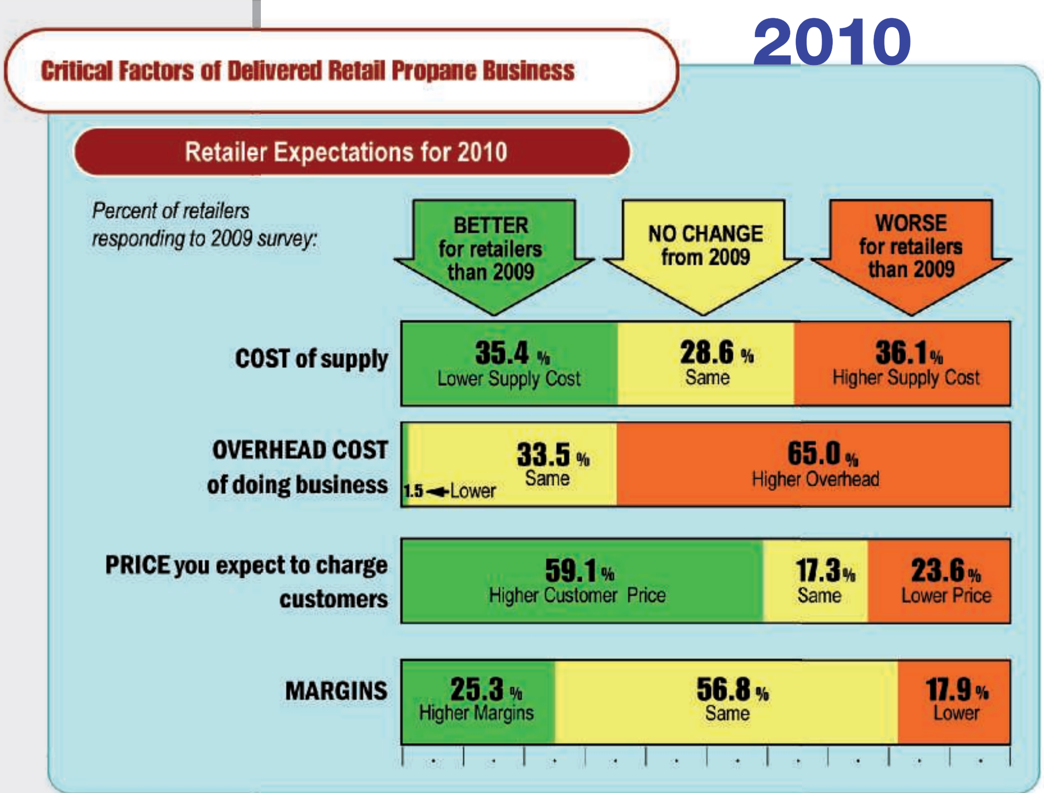

Figure G

2008-09 and current YTD heating seasons. The average low and high for the 2008-09 heating season were $2.22 and $2.66, respectively ... YTD this year, $2.06 and $2.16.

While much of overhead in running a business is a collection of costs over which you generally have control (like hourly wage and benefits you choose to pay staff), these days overhead is being driven by uncontrollable mandates of government, banks and insurance. About 63 percent of retailers responding to this year's State of the Industry survey have watched their overhead stretch skyward.

And, a note for this heating season's residential propane sales: nearly 60% of retailers report customers trying to conserve energy. That's not surprising amid the current economic worries and consumer job losses, and it's an uncontrollable propane sales factor in an environment that may last many months to come.

Certain uncertainty

Every year we ask our State of the Industry survey respondents to tell us what they think will happen to the industry during the next year. As long as most have been in the business, like you, they've seen it all before. Of course, asking retailers to be crystal-ball gazers is especially unfair these days, considering all of the factors significantly influencing their businesses that are out of any retailer's control.

Impact on business of the 9-11 World Trade Center terrorist attack was inescapable for propane retailing, as well as long lasting and deep cutting. Arguably, however, the presidential election, as an event of this decade, may prove to be just as enormous for the industry in decades

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2009

Technology applications retailers are currently using

Percent of retailers using technology in 2009:

Computerized accounting systems	78.9%
Online supply price monitoring	53.9%
Fleet routing software	36.0%
E-mail customer communications	24.6%
Online personnel training	23.5%
Online hedging	22.2%
Remote tank monitoring	12.8%

Figure I

2008

50% rated their fleet routing software as Very Effective in reducing delivery expense

Choice of Fuel for Household Heating

Households using fuel as primary heating source:

	HEATING SEASONS 2007-08	2008-09	2009-10	Forecast 2009-10 Percent Change
Electricity	38,153,000	38,898,000	39,722,000	+ 2.1%
Natural gas	56,640,000	57,053,000	57,459,000	+ 0.7%
Heating oil	8,169,000	7,903,000	7,739,000	– 2.1%
Propane	6,026,000	5,820,000	5,679,000	– 2.4%

Chart illustrates a selection of source data from EIA Short Term Energy Outlook, November 2009

Figure H

Regulatory compliance

Whatever size of your retailing operation, if you're feeling that your business is being driven more from outside your territory than the market within it ... well ... you're not imagining it. How much has Washington, D.C., cost you lately? Have you put a pencil to figuring it up? We're not talking about taxes! No, we're talking about all of the "gotta-do-it-because-they-said-so" costs.

This decade has seen regulatory compliance as we hadn't ever dreamed it before 9-11. Business has become management by alphabet soup ... DOE, DOT, DHA, OSHA, NFPA, FBI, DHS. And more.

Next year's State of the Industry will undoubtedly report on how retailers are managing amid Washington's economic "corrective" measures, business and health insurance mandates, cap-and-trade costs, a sluggish new home market, and energy drilling policies.

Then again, a frigid heating season, an abundance of customer loyalty and great margins could do wonders!

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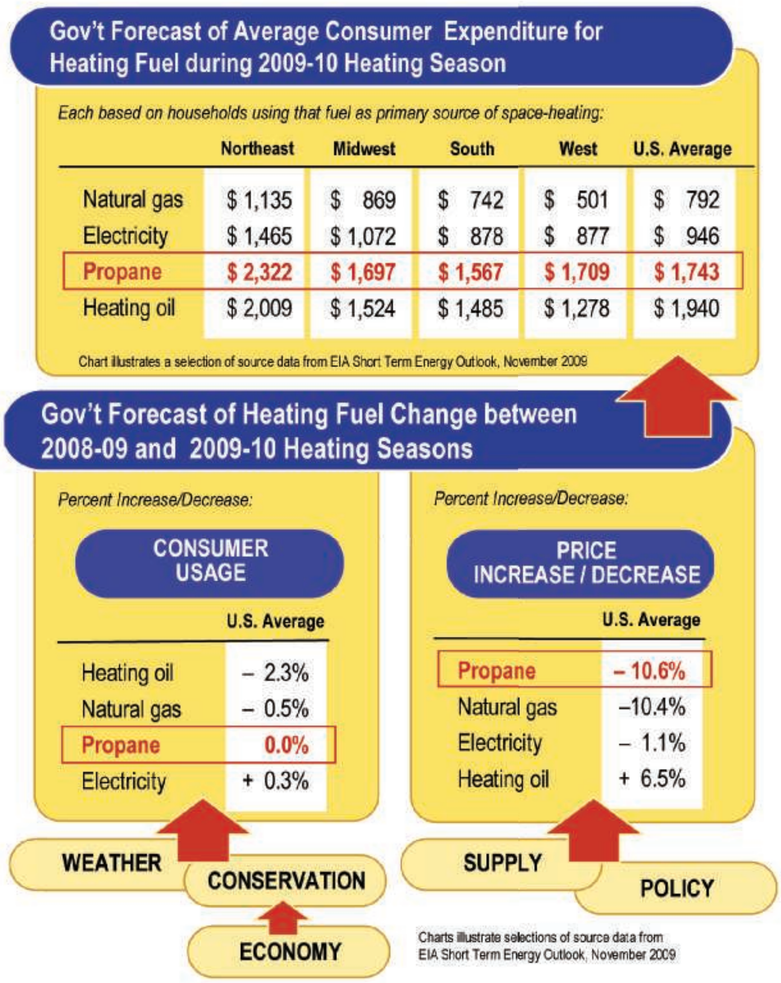
to come. Bailouts. Fiscal policy. Health policy. Energy policy. Global-warming mandates. All undefined at this point, businesses and consumers, side by side, will be "trying on for size" many new outcomes, hoping to find "the right size."

In the meantime, as shown in Figure G (page 26), 64% of retailers responding to our survey tell us their 2010 prognostications for propane include supply prices being either better or the same as this year – while 59.1% expect to raise the price of propane to their customers. Interestingly, despite that optimism, only 25.3% see higher margins. **LPG**



Figures J (top), K