



North America Propylene Glycol Market Update May 12, 2008

Third Coast Chemicals market update on PG and DPG for the second quarter of 2008.

SUPPLY SIDE – Through the first four months 2008, production has continued to simply meet demand due to the unprecedented feedstock costs. Producers have continued to control production in order to avoid overstock of high cost inventory due to escalating **C3** costs (see “cost side” paragraph below). Imports, due to the weak dollar and high prices around the globe have been minimal. An unplanned outage at Repsol in late April, along with two planned maintenance turnarounds by a major North American producer, kept the supply side of the equation balanced to tight.

Exports should be relatively strong due to the weak dollar and rising market pricing around the world. But, there is a serious supply problem in North America with shipping containers. It seems that, with the declining dollar, and with the U.S. economy sagging, shipping containers that originated in the U.S. are stuck in the rest of the world, particularly in China. Thus, even if U.S. producers had extra product to ship overseas, which is doubtful, those shipments would be adversely affected.

In China, CNOOC started to delivery their local produced PG USP in early April. Reports are that CNNOC is offering their PGUSP at about \$80/MT less than the major importers into China.

PGUSP grade is particularly tight. In fact, the May 1st, 2008 price increase nomination, apparently led by Dow, reportedly only will affect the USP molecule. We, at Third Coast, feel that this initiative is extremely important. While price increases over the past six months have been deemed mostly successful in the marketplace, continually justifying these increases solely on feedstock increases is at it's best, faulty, and at it's worst, downright incorrect. For example, after the propylene oxide shortage of 4Q2004, and the hurricanes in the summer of 2005, PG pricing commonly was greater than \$0.95/lb. At those times, C3, propylene, floated around the low to mid \$0.40's. So, today, using the same old logic of tying PG pricing to propylene with C3 at all time record highs (at least 25% higher than in 2005), PG pricing should be around \$1.20/lb. Obviously, PG is not anywhere near that level.

With seemingly endless quality issues popping up regularly out of China, U.S. producers have to be compensated for the extra costs they incur in maintaining PGUSP to the proper standard. These costs include, but aren't limited to distribution, transportation, logistics and packaging as well as the additional risk associated with not only PGUSP, but all USP products.

DEMAND SIDE – Regular ratable demand would have to be described as sluggish for the first four months of 2008. But, the winter weather was extremely cold in North America, and demand for the seasonal markets was robust, and lengthy. So, the weather has been a large factor in limiting any extra supply that the producer community typically amasses in the early portion of the 2Q. We will have to wait and see what happens over the next few months, with

both the U.S. and the worldwide economies before we can take a definitive position on near term ratable demand.

COST SIDE – Throughout the first portion of 2008, basic propylene (C3) continued to rise dramatically. C3 is again at record highs back to back in October and November, with April's settlement up an astonishing \$0.055/lb. to \$0.65/lb. For the first time in recent history, this April nomination referred to above, was a two month settlement. This is an indication, of course that the large purchasers of C3 forecasted that it was in their best interest to settle for this significant increase over a sixty day period rather than gambling on what the C3 molecule may be worth in thirty days. This pressure continues to force producers to increase all derivative prices in order to avoid limiting production back further, as well as to maintain acceptable margins. Additionally, as of this writing, producers are said to be contemplating a \$0.05/lb increase on C3 for next month.

MARKET PRICING – Due to the above cost pressures and tight market conditions, producers reportedly increased market pricing by at least \$0.04/lb. in both January and March, and most have reportedly announced an increase of \$0.05/lb (on PGUSP only) for May 1, 2008. With the tight supply and limited import activity, it seems that this initiative should be mostly successful. And reportedly, a North American producer has announced another increase for June 1. As pointed out above in the supply section of this report, PG producers still haven't recovered from the dramatic increases in C3 costs that were realized throughout 2007 and 2008.

ALTERNATE CHEMISTRY – While we are always available to discuss any of these alternate chemistries, there is little news regarding these chemistries that is affecting the PG market today. We will continue to monitor the progress of these projects throughout the year.

GENERAL MARKET – In summary, we believe (1) the market is currently balanced to tight in supply (2) record feedstock costs are forcing producers to raise prices to defend margins, and (3) market pricing has firmed in light of these developments (4) the cost of maintaining USP kosher quality continues to rise and must be accounted for, (5) the economy will dictate what happens to PG market pricing over the next quarter.

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