The Bowers Gas Report

Week ending: 12/31/04

Gas storage for the week ending 12/31/04 was 2698Bcf which was a withdrawal of 151Bcf over the prior week. This compares to the year ago level of 2619Bcf and the five year average of 2419Bcf, a difference of +79Bcf and +279Bcf, respectively. With 13 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 130Bcf per week to reach the trough level achieved in March 2004. Next week's report is likely to show a withdrawal between 80-100Bcf as unseasonably warm weather was over much of the country in the first few days of the New Year.

Huge discounts have returned between the futures price of natural gas and its BTU equivalent in crude oil. As I write this, there's a 20% discount between natural gas delivered in February versus its BTU equivalent in February crude oil. Being the efficient animal that it is, the commodity market will not allow this discrepancy for very long. Market participants will either bid up the price of natural gas or sell down the price of crude to bring both commodities back in line. However, sometimes the discount can persist for extended periods of time if the market has reason to believe that supplies, in this case the supply of natural gas, are more than sufficient to meet demand. The last time a huge discount presented itself in natural gas versus crude was in September right before Hurricane Ivan. In that case, natural gas rallied until the end of October and eliminated the discount. At the present time, the market is all comfy cozy with the thought that natural gas supplies are ample for this winter and most likely the market is correct in this assumption. However, the market has yet to factor in the loss of natural gas deliverability as year over year supplies continue to shrink. More worrisome, if natural gas prices temporarily fall because of anticipated ample winter supplies, is the resulting and expected drop in the rig count. I've long contended that a rig count of 1400 is necessary simply to break even between supply and demand. Any fall off in drilling activity will result in an even greater decline in gas deliverability further exasperating the U.S. natural gas problem. Ultimately, the market will grasp the error of its way and deliver higher natural gas pricing. I'm betting that the market finally recognizes the gas problem in 2005 and starts placing a BTU premium on gas versus crude oil which will remain with us for several years to come.

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The Bowers Gas Report

Week ending: 12/24/04

Gas storage for the week ending 12/24/04 was 2849Bcf which was a withdrawal of 178Bcf over the prior week. This compares to the year ago level of 2619Bcf and the five year average of 2491Bcf, a difference of +230Bcf and +358Bcf, respectively. With 14 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 131Bcf per week to reach the trough level achieved in March 2004. The cold snap in this weeks report will definitely carry over into next week's storage report which will again show a withdrawal of more than 150Bcf for the week.

It's been awhile since I mentioned bottlenecks in the energy industry. In addition to my usual list of bottleneck suspects such as rigs and energy professionals, I uncovered another commodity good which will constrain the number of well completions in 2005. The item to which I'm referring is sand, more specifically frac sand. This very basic ingredient which is critical in adequately completing most wells in tight geologic formations these days is in short supply. Unless you're one of the major service companies like Halliburton or Schlumberger, you will likely have greater difficulty in finding frac sand supplies in the near future. Apparently, the excess mining capacity of frac sand has been absorbed with very little ability to expand the quantity produced. The lack of this very basic ingredient will have the effect of limiting the number of wells which can be completed at any point in time. Since the wells requiring frac stimulation are the tight formations containing natural gas, this will constrain the quantity of U.S. natural gas production even further than now being experienced. Already, the estimated decline in U.S. gas production for 2004 is expected to be about 3% to 4% less than in 2003. As we enter 2005 with perceived sufficient amounts of natural gas in storage, the continuing increased demand on shrinking gas supplies will be met head long with higher pricing than we've seen recently. I look for another very strong price year for natural gas in 2005 with $6/MMBtu representing a floor. Any down dip in pricing as a result of a mild winter event causing higher than expected storage levels will be temporary and will represent the bottom of natural gas prices for the entire year.

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The Bowers Gas Report

Week ending: 12/17/04

Gas storage for the week ending 12/17/04 was 3027Bcf which was a withdrawal of 123Bcf from the prior week. This compares to the year ago level of 2699Bcf and the five year average of 2634Bcf, a difference of +328Bcf and +393Bcf, respectively. With 15 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 134Bcf per week to reach the trough level achieved in March 2004. Winter has demonstrated itself with a broad arctic front over most of the country as shown in this week's report. The cold trend continued into the present week which should show a withdrawal of over 150Bcf in the next gas storage report.

Five months ago I discussed the heavy taxation of Yukos by the Russian government as the first step in the re-nationalization of that country's vast energy assets. As we found out this week, Rosneft has acquired the main oil producing unit of Yukos in what can only be described as a sham auction process. Rosneft, coincidentally, is being acquired by the Russian government-controlled company Gazprom as part of a Kremlin effort to create a government-controlled energy giant. Bit by bit, we can expect to see the Russian government take back each of the major components making up the prime energy wealth of Russia. Through veiled quasi-government/corporate appearing actions, the Russian government will be successful in controlling these assets. What else would you expect in a country where the rule of law is non-existent and contracts are meaningless? All of this will take place with not so much as a whimper from the U.S. government since we will very likely be highly dependent on captive Russian gas supplies through future LNG deliveries. I'm also guessing that shivers are being felt and boots quaking in the halls of global energy companies who have made significant investment in the Russian oil patch. Companies such as BP, ExxonMobil, RoyalDutch/Shell, and ChevronTexaco, have to seriously reconsider whether there's any benefit whatsoever to investing vast sums in a country whose government will confiscate the assets before the companies can recoup anything. Shareholders of these companies should be questioning whether their assets should be invested in this manner. Everyone should expect nothing less than to be on the losing end when dealing with countries where laws mean nothing.

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The Bowers Gas Report

Week ending: 12/10/04

Gas storage for the week ending 12/10/04 was 3150Bcf which was a withdrawal of 61Bcf over the prior week. This compares to the year ago level of 2850Bcf and the five year average of 2756Bcf, a difference of +300Bcf and +394Bcf, respectively. With 16 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 134Bcf per week to reach the trough level achieved in March 2004. With cold weather spreading over much of the U.S. this week, we should see our first 100Bcf+ withdrawal of the season in next week's report.

While it appears that we have ample natural gas supplies in storage at the moment, I need to remind everyone about the historical winter withdrawal levels which are highly dependent on the severity of the winter event. With gas storage contributing 20% of all gas consumed in any given winter and the remaining contributions coming from on-going production, weather plays a major role in determining which of the two sources are utilized. Under a mild winter scenario, approximately 1900Bcf has historically been taken from storage. If we have what is considered a normal winter event, then about 2200Bcf will be withdrawn from gas stores. And lastly, under a severe winter event, we have typically seen about 2500Bcf withdrawn from storage. We already know that a peak storage level of 3327Bcf was achieved for the week ending November 5, 2004. The range of storage at the end of the drawdown season would then be expected to be somewhere between 800Bcf and 1400Bcf, based upon the severity of the current winter event and these historical withdrawal levels. However, given that current U.S. gas production is declining at an estimated 2Bcf per day with over 100 days remaining in the withdrawal season, approximately 200Bcf of gas usually provided by the on-going production side of the equation will not be available and will have to come from storage to make up the difference. This increased demand on storage now means that a mild winter event will draw 2100Bcf, a normal winter event will draw 2400Bcf, and a severe winter event will draw 2700Bcf. The new end of withdrawal season storage range now shifts to between 600Bcf and 1200Bcf which is a fairly typical range upon which the injection season historically begins. At some point, the gas market will likely attempt to move gas prices down based upon the perception of having more than adequate storage levels. If, however, the market realized the extra demand being placed on storage because of declining production, a little more worry might creep into trader's minds and maintain stronger pricing. As long as production continues to decline, the extra demands on gas storage will only increase over time.

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The Bowers Gas Report

Week ending: 12/03/04

Gas storage for the week ending 12/3/04 was 3211Bcf which was a withdrawal of 88Bcf over the prior week. This compares to the year ago level of 2984Bcf and the five year average of 2868Bcf, a difference of +227Bcf and +343Bcf, respectively. With 17 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 129Bcf per week to reach the trough level achieved in March 2004.

This week is all about oil. The official news out today from OPEC is that they will be cutting production by a million barrels per day beginning January 1 so as to stem the fall in oil prices. Something very interesting underlies this pronouncement that will be more fully understood by the energy market in the weeks and months to come. Let me explain myself. With just about everyone now believing that OPEC is producing at maximum capacity with little to no excess capacity available, oil pricing is now subject to the economic laws of supply and demand. While in previous years, OPEC could use their excess capacity to increase supplies and push oil prices lower, they have now lost that element of price control. However, they can still affect oil pricing through a reduction in supplies which in a balanced oil market would push prices higher. Essentially, OPEC is telling the world that for the first time a firm price floor will be in place for a barrel of their oil. The OPEC members are now debating what that floor price will be going forward. I'm sure many of the oil producing countries have gotten very comfortable with the economic benefits provided by $30 plus per barrel oil to the point where that will now be the expectation. Back in January, I first predicted that OPEC would likely move the price band from its then $22-$28 range to a new range of $28-$36 and that the change in the range would be justified because of dollar weakness which impacts OPEC's purchasing ability in other currencies. Lo and behold, we have had significant dollar weakness in 2004 with the expectation of continued dollar weakness over the next several years. All of this said, I believe the range will ultimately shift in the near future to $32-$38 with an on-going target price of $35. This will be $10 higher than the old target price of $25. More importantly for U.S. producers and consumers, a barrel of West Texas Intermediate will have a floor price of about $40. At this level, producers will have more confidence in the sustainability of oil pricing in making their capital spending plans for future drilling activities. In addition, the capital markets will be re-evaluating the value of all publicly traded energy firms to reflect the higher price assumptions. Currently, most E&P firms are valued using $30/Bbl oil and $5/MMBtu natural gas. If the market confidence in higher pricing increases, the value of energy firms should increase as well. With $40/Bbl as a floor for U.S. oil, the implicit floor for natural gas would suggest $6/MMBtu as an appropriate level on a forward going basis. Natural gas pricing would receive the added benefit of being a commodity in shrinking supply, as I've discussed many times in the past, which should drive the natural gas floor price to $7/MMBtu. Once the market begins to realize this new paradigm of energy pricing, things will become very interesting in the entire energy sector. Hold on to your shorts!

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The Bowers Gas Report

Week ending: 11/26/04

Gas storage for the week ending 11/26/04 was 3299Bcf which was a withdrawal of 5Bcf from the prior week. This compares to the year ago level 3095Bcf and the five year average of 2968Bcf, a difference of +204Bcf and +331Bcf, respectively. With 18 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 127Bcf per week to reach the trough level achieved in March 2004.

As mentioned in last week's report, the possibility of erroneous storage data in the prior week was confirmed this week by the EIA who revised the previously reported figures to reflect the proper adjustments. I'm just glad that it wasn't me who got whipsawed based on the erroneous reporting. Given the magnitude of the price swing last week, somebody got their head handed to them on a silver platter. I think if it had been me, I would be more than a little miffed right now. However, this situation is a prime example of the market placing too much emphasis on reported data which is anything but a perfect and exact measure of natural gas market supply.

Speaking of reported data, the energy market volatility continues as each week's oil inventory report swings market sentiment violently in the opposite direction to the inventory change. This is a clear indication to me that crude, heating oil, and diesel supplies are tight as a drum when compared against market demand for these commodities. Unfortunately, with so many hedge funds placing energy bets in both directions, this short-term volatility will continue. The longer term fundamentals for the energy sector remain intact, however, which implies higher trend line pricing.

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The Bowers Gas Report

Week ending: 11/19/04

Gas storage for the week ending 11/19/04 was a withdrawal of 49Bcf over the prior week. This compares to the year ago level of 3154Bcf and the five year average of 3009Bcf, a difference of +118Bcf and +263Bcf, respectively. With 19 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 119Bcf per week to reach the trough level achieved last March 2004.

This week's storage report completely shocked the gas market. No one was expecting a withdrawal level this large, this early in the withdrawal season. The high reported number has already caused wide speculation that it is likely an error from some east coast storage operator. While I view erroneous reporting of data as possible, I can also envision other possible factors contributing toward greater use of natural gas and thus early large withdrawals from storage. The number one probable cause of higher gas withdrawals is the substitution effect with heating oil. With heating oil currently trading at over $1.40/gal, natural gas would have to sell at $11-$12/MMBtu before energy users would be economically motivated to switch out of gas and into heating oil. Current low heating oil inventory levels are also likely causing some conservation of these supplies since we are just now entering the winter season. Another possible contributing factor for the large withdrawal is LinePak adjustments. If some pipelines and LDC's currently have too low of an operating pressure in their lines, then this may very well be a preparatory move ahead of an anticipated higher gas demand period when withdrawals reach physical limitations of the storage facilities. Since extreme cold weather hasn't really arrived across the country yet, I think this high withdrawal is a one time event which will be more fully explained in the weeks to come. If it isn't an explainable one time event for some currently unknown, but rational reason, then the gas market may be in for the ride of a lifetime once winter gas demand officially kicks in and begins pulling down gas storage in triple digit fashion.

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The Bowers Gas Report

Week ending: 11/12/04

Gas storage for the week ending 11/12/04 was 3321Bcf which was a decrease of 6Bcf from the prior week. This compares to the year ago level of 3155Bcf and the five year average of 3046Bcf, a difference of +166Bcf and +275Bcf, respectively. With 20 weeks remaining in the withdrawal season, we need to average 115Bcf per week to reach the trough level obtained in March 2004.

Okay, which is it? One week we don't have enough crude, heating oil, diesel, natural gas, and gasoline, and the next week we have too much! The hypersensitivity of the commodity markets to the slightest piece of news continues to move energy prices like a yo-yo. My interpretation of recent price volatility is pure and simple. With almost the entire energy complex in a supply/demand balanced situation, very subtle pressure on either the demand side or the supply side of energy commodities is enough to change the market clearing price for these goods. I'm convinced that this economic condition could only exist if OPEC, as the historical providers of excess oil capacity, has lost its ability to threaten market pricing with extra oil supplies, and if gas production in the U.S. is shrinking. As evidence, recent OPEC jawboning attempts to persuade the global oil refiners to increase their capacity to refine the sour grades of crude representing OPEC's current excess supplies. Since the global refining capacity of sour crude is already at maximum levels, this sour crude can only be sold with a significant discount to the sweeter grades of crude. What little excess supply that OPEC has, nobody wants. Refining limitations are also causing problems with supplies of heating oil and diesel. In the last twenty years, the world has never gone into winter with heating oil supplies as low as they are right now. A colder than normal winter this year in the U.S. would see massive price spikes for both heating oil and natural gas because of the substitution effects of both commodities, and without regard to record storage levels that we currently have in natural gas. The reason that record gas storage would have little impact on natural gas pricing is because gas storage only meets 20% of gas demand. The remaining 80% has to be provided by current gas production which I have mentioned countless number of times in past reports is falling at an alarming rate. In 2003, U.S. gas production fell by about 1%. In 2004, the projection is for U.S. gas production to fall by about 4%. Only through Canadian imports making up the difference over the last two years have we not seen major problems with natural gas supplies. However, Canada is rapidly losing its ability to export its gas to the U.S. as its own supply needs take priority. With an expected reduction in Canadian imports, should anyone be surprised that the LDC's decided to store record levels of gas as a contingency? If the speculators understood the truth about the tenuous nature of natural gas supply issues, I do not think we would see the on-going BTU discounts to crude that we've seen for many months now.

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The Bowers Gas Report

Week ending: 11/05/04

Gas storage for the week ending 11/5/04 was 3327Bcf which was an increase of 34Bcf over the prior week. This compares to the year ago level of 3187Bcf and the five year average of 3061Bcf, a difference of +140Bcf and +266Bcf, respectively. This is the last week of the injection season and gas storage is considered full. With cold weather across much of the Midwest and Northeast, we should see a slight withdrawal in next week's report which is the first week of the withdrawal season.

We've witnessed the price of oil dramatically rise to $55/Bbl recently only to see it pull back to about $47/Bbl. We've also seen natural gas soar to over $8/Mcf only to watch it pull back to around $6/Mcf on a cash basis. All of this energy price fluctuation is occurring even before winter really gets going. In light of this recent volatility, one has to wonder what is truly happening in the energy market. If I may, I'd like to put my two cents in as to what I think is causing the price swings. Before hurricane Ivan, I believe we had a significant amount of speculation betting that energy prices would be falling from their elevated levels. However, once the reality of Ivan's impact became apparent to practically everyone, the speculators were faced with being on the wrong side of their bets. To minimize their losses, the speculators were forced to repurchase their short energy positions in the open market. When these repurchases were conducted on a broad scale, the result through the end of October was pricing of oil in the mid $50's and gas in excess of $8. In light of near adequate oil inventories and the perception of sufficient supplies in gas storage ahead of cold weather's arrival, the price over-reaction to the upside caused by Ivan began swinging the other way based on fundamental near-term factors to bring us to where we are today. As I warned you several months ago, the volatility in the march toward a higher pricing platform would be very extreme as the market adjusted to the new reality of higher energy prices. Through all of this market movement nothing has really changed in the oil or gas supply picture to reach the level of current demand. As long as global energy demand continues to increase faster than the availability of new supplies, the longer term higher price trend for both oil and gas marches onward and upward.

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<u>The Bowers Gas Report</u>

Week ending: 10/29/04

Gas storage for the week ending 10/29/04 was 3293Bcf which was an increase of 44Bcf over the prior week. This compares to the year ago level of 3155Bcf and the five year average of 3054Bcf, a difference of +138Bcf and +239Bcf, respectively. With one week remaining in the injection season, gas storage is considered full. As if on cue, the first colder than normal weather is slipping into the Midwest and Northeast this week which should cause one last small injection in next week's report, the last report of the injection season.

With fears of insufficient heating oil for winter and implicit increased demand for its primary substitute, natural gas, the huge MMBtu discount of natural gas to crude oil has evaporated. Furthermore, expectations of a colder than normal winter this year has also caused natural gas pricing to rise dramatically from just one month ago. However, I learned a long time ago that in the financial markets it's really perception that matters in the short term and facts that matter in the long term. The current perception in the natural gas market is that gas storage is at on all time record level and since winter really hasn't shown itself yet, then we likely have adequate gas supplies for this winter. It is this current misperception which I believe will cause natural gas pricing to swing violently for the next month and will continue until the first really severe snowstorm hits sometime in December. We'll have to wait for the actual long term "facts" of this winter's impact on natural gas storage to assess where prices go in 2005. However, as I review the "facts" of declining U.S. gas production, slower than necessary drilling rig counts, and growing demand for a shrinking commodity, I'm encouraged that the longer term upward price trend is very much intact for natural gas.

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The Bowers Gas Report

Week ending: 10/22/04

Gas storage for the week ending 10/22/04 was 3249Bcf which is an increase of 26Bcf over the prior week. This compares to the year ago level of 3121Bcf and the five year average of 3039Bcf, a difference of +128 and +210Bcf, respectively. With two weeks remaining in the injection season, gas storage is now full. The end of injection season should now show peak storage of about 3300Bcf which would represent an all time high storage level.

Bottlenecks are beginning to demonstrate themselves through the entire energy industry. Let me explain through a series of examples. We're now seeing six month waits for supplies of steel casing, and don't even bother asking what the cost will be. The aging of energy professionals and the resulting personnel shortage are now being frequently discussed on Wall Street. Drilling rigs have lengthy wait lists. Oil field services such as fracs, work over rigs, and cementing services have to be scheduled many weeks in advance. However, oil field services are now steadily ratcheting up to eat away the oil and gas price margin received at the producer level. Utilities are having difficulty receiving sufficient coal deliveries due to transportation problems with the railroads. Oil tanker rates are commanding seven times their breakeven rate due to shortages of available ships. Heating oil supplies in the U.S. are at record lows going into winter while imports from Europe are expected to be non-existent due to refinery problems there. The U.S. refineries continue to be constrained in their ability to take on sour grades of crude, the only grade of global crude with excess capacity.

Is it any wonder to anybody that oil and gas prices have steadily increased this year in the face of these factors? I believe that the gut-wrenching volatility that we've seen in energy prices will continue for many years until prices reach a level that begin impacting energy demand from consumers, commercial, and industrial users. So far, relative to other costs, energy pricing has not had a significant and meaningful impact on energy users. Naturally, the higher energy costs are being recognized, but energy users have yet to radically change their energy consuming pattern. We could literally see a doubling in oil and natural gas pricing from current levels before this radical adjustment in energy consuming behavior takes place. This would imply oil reaching $100/Bbl and natural gas at $16/MMBtu before the demand side of the equation shifts downward. Without significant supply disruptions for either oil or gas, I believe we will move toward this higher price structure which represents the inflation adjusted trend line for both commodities by 2010. If significant supply disruptions occur, then we will reach these levels much sooner.

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The Bowers Gas Report

Week ending: 10/15/04

Gas storage for the week ending 10/15/04 was 3223Bcf which was an increase of 64Bcf over the prior week. This compares to the year ago level of 3066Bcf and the five year average of 3002Bcf, a difference of +157Bcf and +221Bcf, respectively. With three weeks remaining in the injection season, storage is now full when compared to previous years.

The energy market finally woke up this week and realized just how cheap natural gas prices had become. Relative to the price of oil, the price of natural gas had reached a 40% discount on an MMBtu basis just last week. Traders and speculators somehow decided that this amount of price discount was just too much to ignore for any longer and ramped up pricing to just a 15% discount relative to oil. A couple of other key factors helped in pushing up prices as well. Continued shut-ins of gas production in the Gulf of Mexico as a result of Hurricane Ivan have raised supply concerns in the near term. In addition, reports of declining U.S. heating oil inventories and subsequent increases in heating oil prices has pulled natural gas along for the ride. To shift the economics in favor of heating oil, natural gas would have to be higher than $9/MMBtu. If industrial and commercial users of heating oil are supply constrained due to high residential demand for winter heating purposes and they have the capability of switching fuels, these users may resort to increasing their use of natural gas. Any increased winter demand for natural gas would place further strains on an already tight natural gas supply market. Because of price support from heating oil and other factors discussed previously, I look for continued strong natural gas pricing in the $8 to $10/MMBtu range for the entire winter season. The severity level of this year's winter event, mild, or extreme, will tell us whether natural gas prices in 2005 will be $6/MMBtu or greater than $10/MMBtu. We'll just have to keep tabs with our local weather man to find out.

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The Bowers Gas Report

Week ending: 10/08/04

Gas storage for the week ending 10/8/04 was 3159Bcf which was an increase of 67Bcf over the prior week. This compares to the year ago level of 2981Bcf and the five year average of 2948Bcf, a difference of +178Bcf and +211Bcf, respectively. With four remaining in the injection season, we need to average 10Bcf per week to reach full storage by early November 2004. We should technically reach full storage with next week's report. However, we will likely end this injection season with about 3250Bcf in storage before the first withdrawals.

This newsflash just in! China's demand for oil is going down. Their demand for oil imports in 2005 is expected to now only grow 20% to an additional 400,000 Bbls per day. This number is down from the previously reported import growth of 40%. I don't know about you, but to me 20% import growth is still a big number. Considering that current global oil demand is in line with global oil supply, this extra demand of 400, 000 Bbls per day represents the marginal barrel of oil to which I have made reference over the past several weeks. If global oil supply isn't increasing and China needs an extra 400,000 Bbls per day, what do you suppose will happen to the marginal price of oil and who in the world will be giving up their allocation so that the Chinese can have it? In 2004, the estimated global production is about 80 million barrels per day. On the demand side of the equation, global oil demand is estimated to also be about 80 million Bbls per day, but is on trend to grow about 2% annually. At the present level, this means that an extra 1.6 million Bbls per day will be needed to meet demand in 2005 of which China's 400, 000 Bbls per day would represent 25% of the increase. Unless some oil company or oil producing country can magically start increasing oil production to meet this growth in demand, somebody somewhere will be hard pressed to fulfill their demand needs. Maybe the Saudi's will cut the Chinese a deal to take some of their sour crude which nobody wants at the moment. Desperate buyers will be willing to do desperate things if the need is great enough. This increase in oil demand will continue putting pressure on oil prices even after the strong winter demand period is over and bodes well for future oil prices at the $50+ per Bbl level.

With just a few weeks left in October, you need to take one last, long hard look at natural gas prices with a 5 in front of the decimal point. If my predictions about price levels are on target, it may be several years before we see five dollar natural gas again. My belief has been and continues to be that with declining U.S. natural gas production, increasing demand on that same constrained supply, and with price support from the oil side, natural gas prices would be on an upward path into unchartered territory. Well, we're certainly getting price support from oil, and U.S. gas production is estimated to be down 4.5% in 2004. The only real uncertain factor is whether gas demand will continue to increase or not. If we just assume that gas demand remains constant, I think that natural gas pricing below $6/MMBtu is history. That is, until some external source can provide gas supply to offset the declining U.S. gas production in the likely form of LNG. With this nation's historical record of delaying much needed infrastructure projects under the guise of environmental safety, I anticipate that many of the planned LNG facilities will face years of scrutiny and hearings to protect the public good and avoid placing these "ticking time-bombs" in people's backyards. While projections show sufficient LNG facilities in place by 2008 to deliver 7.5% of U.S. gas supply which would be up from 2.5% existing currently, I believe that this number will prove to be very optimistic. The NIMBY crowd will find ways to delay these projects for several more years beyond 2008. If we're lucky, these facilities will be in place by 2015 to deliver this same 7.5% of gas supply. All of this implies natural gas prices at significantly higher levels and will be indicative of the "Golden Era of Natural Gas".

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The Bowers Gas Report

Week ending: 10/01/04

Gas storage for the week ending 10/01/04 was 3092Bcf which was an increase of 81Bcf over the prior week. This compares to the year ago level of 2904Bcf and the five year average of 2892Bcf, a difference of +188Bcf and +200Bcf, respectively. With five weeks remaining in the injection season, we need to average 22Bcf per week to reach full storage by early November, 2004.

To hear Wall Street talk about oil, you would think that oil prices were poised to collapse at any moment. Most of these pundits that speak along these lines are simply following what has happened time and again with energy prices over the last twenty years. The market would witness prices going up for awhile and then, as if on queue, prices would go back down. Wall Street has seen this same cycle take place countless number of times for a generation of traders and investors. It is no surprise to me that the vast majority of Wall Street misunderstands the key factors which make this cycle different from the rest. With past oil spikes being event-driven, primarily by wars, the market would rely on the excess productive capacity of OPEC to eventually bring prices back to reality. The key difference this time is that global oil demand has grown to the point where OPEC's excess productive capacity has been almost completely absorbed and therefore OPEC's ability to control prices has been eliminated. It has been a very long time, if ever; that the energy markets have witnessed a supply-driven price move to the upside, so naturally they are uncertain as to what to believe. The truth is that the oil market is now subject to and must obey the economic laws of classic supply and demand, without artificially being controlled by producers who have the ability to manipulate the market. Unless something significant happens to either oil demand or supply, henceforth, oil prices will be determined by whatever the marginal buyer of oil is willing to pay for the marginally produced barrel of oil. Today, the marginal buyer of oil is telling the market that a barrel of oil will cost you over $53 U.S. dollars. Whoever said that economics was boring stuff?

A report just put out by Lehman has U.S. gas production for the 3rd quarter of this year down 3.8% compared to the 3rd quarter last year and projects that gas production for 2004 will be down an estimated 4.5% from 2003 levels. This report comprises data from producers making up about 75% of the U.S. gas market, so I believe there's sufficient information to be very accurately with this forecast. The difference between U.S. production and the amount of gas consumed is made up from Canadian imports and LNG supplies. However, LNG supplies are currently capacity constrained to no more than about 2% of gas demand and Canadian supplies are soon expected to be reduced. The net effect at present is that current gas demand is just even with available gas supply to the U.S. market with absolutely no room for error. This fact demonstrates itself from the gas price response from shut-in production caused by Hurricane Ivan. With this fine balance between gas supply and demand, the impact from changes in winter weather could be quite dramatic. Severe weather could cause gas price spikes way north of $10/MMBtu this winter. Because of this tight supply condition, I currently expect that gas prices for December through February will range between $8 and $10/MMBtu with unbelievable surprises to the upside.

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The Bowers Gas Report

Week ending: 9/24/04

Gas storage for the week ending 9/24/04 was 3011Bcf which was an increase of 69Bcf over the prior week. This compares to the year ago level of 2820Bcf and the five year average of 2828Bcf, a difference of +191Bcf and +183Bcf, respectively. With six weeks remaining in the injection season, we need to average 32Bcf per week to reach full storage by early November, 2004.

The catastrophic winds and water of Hurricane Ivan have brought more than widespread property damage to Florida and Alabama. The damage to offshore Gulf of Mexico energy production and infrastructure and its resulting economic impact continue to this day. As much as 25% of the offshore gas production was down for almost two weeks and it will be several months before full production can be fully restored. An estimated 2Bcf per day of gas production was lost which is definitely showing itself in the storage reports for last week and this week. The tightness in the U.S. natural gas market can clearly be seen in the demonstrated price response since Ivan hit just three weeks ago. Cash prices for natural gas have jumped almost 30% in the last three weeks while the price response for longer dated natural gas futures has been even more. Although some of the price move can be attributed to concerns over supplies, rumor has it that some major hedge funds found themselves on the wrong side of the price move and have subsequently been forced to close their short natural gas positions by buying back highly priced contracts in the futures pits, causing a classic short squeeze. Somebody somewhere lost a ton of money in the last few weeks. If they had asked this consultant about the wisdom of making such a bet, I would have advised against it. Maybe they'll ask next time. Since October is still a shoulder month, I expect gas prices to pull back moderately, but winter is just around the corner. I continue to expect $8/MMbtu by the end of the year.

I first mentioned oil above $50/Bbl back in early March of this year. At the time I said that world oil pricing was adjusting to a new reality where oil prices would move higher with only a temporary stop at $40/Bbl on its way to a typical range of $50-$60/Bbl. I think this assessment is still basically correct for the next couple of years. However, this will be only the first of several upward adjustments in oil prices as the gap closes toward the inflation-adjusted trend-line price. If the gap were closed today, we would already be at $80/Bbl. However, markets take time to adjust to reality so I think we'll see a range of $70-$80/Bbl by 2007 and then a range of $90-$100/Bbl by 2010. The global consequences of these price adjustments will be highly damaging to the financial markets for stocks and bonds. This notion represents what I believe is the shift from the investment of choice being financial assets toward real assets in a cycle which will last another ten years

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The Bowers Gas Report

Week ending: 9/17/04

Gas storage for the week ending 9/17/04 was 2942Bcf which was an increase of 68Bcf over the prior week. This compares to the year ago level of 2719Bcf and the five year average of 2754Bcf, a difference of +223Bcf and +188Bcf, respectively. With seven weeks remaining in the injection season, we need to average 37Bcf per week to reach full storage by early November, 2004. The impact of Hurricane Ivan is showing up in this week's storage report and will also have some carryover impact into next week's report as well.

Natural gas is now poised to test the $8.00/MMBtu mark by the end of this year and continue on into the early part of 2005 at record price levels. I base this supposition on a number of critical and key factors which appear to be lining up like the sun, the moon, and the stars. Not that I am a big believer in astrology, mind you, but when such events present themselves in unison, they deserve special acclaim and are worthy of additional commentary. I've also mentioned some of these items in the past but wanted to list them anyway since they are still noteworthy factors as price determinants for natural gas. At the top of the heap of factors implying higher gas prices is declining U.S. gas production. Current projections are for gas supplies to shrink by at least 3% for 2004 with the rate of decline accelerating into 2005. Gas production in 2005 could decline by as much as 5% from 2004 levels. Associated with declining production is the low rate of growth in drilling activity in the U.S. With the number of rigs drilling for oil and gas essentially unchanged from three months ago, operators either do not have qualified prospects to drill or they remain unconvinced of the sustainability of commodity prices. Another aspect to this is the reluctance of land-based drillers to add to their existing drilling fleet. The drillers continue to experience personnel problems to the point where they would rather operate toward higher rig utilization than take a chance on capacity additions, thus representing a limiting factor on the number of wells which could be physically drilled at the present. I've previously stated that at least 1400 rigs would be needed simply to maintain constant production of gas supplies. The more recent factors that I wanted to mention fall into the category of creating substitution demand for natural gas which should also imply higher prices. Chief among these factors is price support from global crude oil. With prices currently above $48/Bbl and with the seasonally strong demand period of the 4th quarter in front of us, those energy users who have the ability to switch to cheaper sources of fuel are highly motivated to do so. Further pushing users of energy toward natural gas is unusually low supplies of heating oil, coal, and uranium in the U.S. Whether you're in need of heat or electricity this winter, the providers of heat and electricity may be unable to obtain adequate supplies of those commodities and may be forced to substitute natural gas as their primary fuel instead. This assumes, of course, that winter conditions remain rather normal so as to not constrain natural gas supplies as well. Coincidental and potentially offsetting factors to this are predictions from the Farmer's Almanac for a colder than normal winter and the historical trend of cooler than normal summers, like we had this year, being followed by cooler than normal winters. A final factor creating substitution demand for natural gas at present is the scheduled maintenance shutdowns of coal and nuclear plants which normally take place at this time of year. Many of these plants had foregone previously scheduled shutdowns in the spring due to the high cost use of natural gas earlier in the year. Individually, each of the above factors might not impact natural gas prices to any great extent, but collectively imply a distinct and clear direction for pricing in the near future. The real surprise to the energy market in 2005 will be the reluctant acceptance of $8 gas and its sustainability as the new price floor for the next several years.

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The Bowers Gas Report

Week ending: 9/10/04

Gas storage for the week ending 9/10/04 was 2874Bcf which was an increase over the prior week of 99Bcf. This compares to the year ago level of 2619Bcf and the five year average of 2673Bcf, a difference of +255Bcf and +201Bcf, respectively. With eight weeks remaining in the injection season, we need to average 41Bcf per week to reach full storage by early November 2004. While the historical injection rate over the past nine years for the last eight weeks of the injection season has averaged 46Bcf per week, we could reasonably estimate that the end of the injection season will find storage at about the 3250Bcf level.

The pricing discount between natural gas and oil has reached 35%. At the same time, prices for competitive energy sources of fuel such as uranium used in nuclear power and coal are going through the roof. Tight supplies of each of these two commodities is making their viability as the marginal fuel of choice less of a threat to the use of natural gas for power generation. This would naturally imply that fuel switching back to natural gas could be widespread in the weeks ahead, especially as many nuclear and coal-fired plants shut down for long overdo maintenance. Many of these plants have been operating full bore, defined as 95%+ capacity, for almost a year as utilities generated electricity from these lower cost fuel sources. The nature of these plants, however, requires routine maintenance which prevents them from running for too long past their scheduled outage period. Natural gas pricing should benefit as demand shifts toward more usage for electricity generation.

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The Bowers Gas Report

Week ending: 9/3/04

Gas storage for the week ending 9/3/04 was 2775Bcf which was an increase of 80Bcf over the prior week. This compares to the year ago level of 2518Bcf and the five year average of 2592Bcf, a difference of +257Bcf and +183Bcf, respectively. With nine weeks remaining in the injection season, we need to average 47Bcf per week to reach full storage by early November, 2004. The comparables to last year become a little easier as we averaged 97Bcf per week injections over the next six week period at this time last year. Assuming we average 85Bcf injections over the next six weeks, we would close the gap compared to last year by 72Bcf.

I believe the current weakness in natural gas pricing can be explained as one of those "self-fulfilling prophesy" items. As more gas market participants watch storage levels as a gauge to assess near-term gas demand, they are led to believe that storage levels approaching full status must indicate, incorrectly I must add, that current gas demand is weakening, and therefore pricing for near-term delivery should head lower. However, as near-term pricing heads lower, the storage buyers attempt to arbitrage the large difference between near-term pricing and December or January pricing by increasing their injection levels to maximize their profit opportunity. As the near-term injections appear larger than normal, the gas market participants watching storage levels as a gauge for gas demand are spooked by this development and in turn push near-term pricing even lower. The gas storage buyers in like step become even more motivated to arbitrage the pricing differential by buying more gas for storage. This pattern continues until storage is full as physically and economically possible. Winter demand and withdrawals will ultimately close the pricing gap, but until then we witness these highly unusual gas pricing moves. Thank goodness the withdrawal season is only nine weeks away!

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The Bowers Gas Report

Week ending: 8/27/04

Gas storage for the week ending 8/27/04 was 2695Bcf which is an increase of 81Bcf over the prior week. This compares to the year ago level of 2419BCf and the five year average of 2511Bcf, a difference of +276Bcf and +184Bcf, respectively. With ten weeks remaining in the injection season, we need to average 51Bcf per week to reach full storage by early November, 2004.

I would not have thought it possible, but the natural gas discount to oil continues to expand, now at about the 35% level. While the world's attention seems to be squarely focused on every piece of oil related news, scant little attention seems to be paid to what's happening closer to home regarding natural gas supplies. I mentioned a few weeks ago the "Peak Oil" theorists and recently came across some interesting information from one of these guys who just so happened to apply the theory to U.S. natural gas supply. His results have U.S. natural gas production declining from its present level of 22Tcf per year to about 6TCf per year by 2015. This would represent a fairly dramatic shock compared to what expectations are currently for U.S. gas production over this time frame. However, we already know and have witnessed the early stages of declining production with the rate of decline expected to increase with time. While this theorist's results may seem extreme at the moment, it is definitely not beyond the realm of possibility. If gas demand remained at 22Tcf over the next ten years, a 16Tcf shortfall could not possibly be met by LNG imports by 2015 given the long lead time needed for licensing and construction of these facilities. Present expectations are for LNG to supply roughly 10% of U.S. gas demand by 2010, or about 2.5Tcf of gas if demand in 2010 is 25Tcf. This number is considerably different from 16Tcf and implies that a vastly greater number of LNG terminals and associated infrastructure would be required. Conversely to this wide level of expectations, consensus thinking in the U.S. financial markets believe that gas supplies will always be there when needed, and its only a matter of drilling more wells to meet the need. When it comes to energy issues, natural gas remains the Rodney Daingerfield of the energy sector.

And now for a public service announcement……This is an open call for all speculators, gamblers, and hedge fund managers to come to the aid of the beleaguered U.S. natural gas producers who for too long now has suffered at the hands of the Wall Street analysts. Let's all come together and do your part to end the gas producer's agony by investing against the consensus by betting on higher natural gas prices. Who knows? With the natural gas discount at extreme levels, you might be doing both the natural gas producers and yourself a big favor. Your wallet will be glad you did! This message has been brought to you by Concerned Citizens for Natural Gas Producers Everywhere…….And now we return you to our normally scheduled programming.

OPEC is calling on the world's oil producing countries to step in and increase oil production wherever possible. It seems that OPEC has finally begun to realize that the world is already discounting their recent rhetoric to talk down oil prices by promising to deliver more oil supply. I am seeing more information, confirming what I mentioned back in May, that the only surplus OPEC oil production is in the form of sour grades of crude which cannot be used by current global refining capability. It will take several years to modify refineries with enough coking capacity to utilize this sour crude supply. In the meantime, global oil demand will continue rising at about 2% annually putting even more pressure on global oil supplies.

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The Bowers Gas Report

Week ending: 8/20/04

Gas storage for the week ending 8/20/04 was 2614Bcf which was an increase of 84Bcf over the prior week. This compares to the year ago level of 2352Bcf and the five year average of 2449Bcf, a difference of +262Bcf and +165Bcf, respectively. With 11 weeks left in the injection season, we need to average 53Bcf per week to reach full storage by early November, 2004.

With the perception in the market that gas storage is comfortably in a position to adequately meet the needs of coming winter demand; natural gas pricing has reacted by hitting the skids over the past few weeks. When compared to oil pricing, natural gas is trading at nearly a 30% discount despite the high volatility seen with oil of late. In my mind, the gas market has overly reacted to the gas storage figures and is incorrectly assuming adequate future gas supply. As I've stated many times, the gas storers are mandated to bring storage levels to adequate levels for winter demand, regardless of cost, or else face the wrath of the public and draw unwanted government scrutiny. An unseasonably cool summer over much of the U.S. has allowed this year's storage injections to occur at a higher than normal rate and therefore given the perception that everything is all peachy and rosy with gas supply. Nothing could be further from the truth. The energy sector continues to drill at a level too low to overcome naturally occurring depletion of existing gas fields. This fact is evidenced by current gas production continuing its decline on a year over year basis even while the rig count climbs ever so slowly. Gas production in 2004 is expected to be at least 3% less than gas production in 2003 with the further expectation that the decline rate will be increasing going forward. On the demand side of the equation, a growing U.S. economy and industrial sector has been applying pressure to supplies of all fuel types including coal, fuel oil, distillates, as well as natural gas. For those focused on winter gas storage levels as their gauge for overall gas supply, I believe they are missing the bigger issue completely. Let me explain what I mean with a very basic example. For the past several years the winter demand for natural gas has been roughly 12.5Tcf of which 20% or 2.5Tcf comes from storage with the remainder coming from current production, about 10.0Tcf. With maximum storage capacity at 3.2Tcf, this leaves a cushion of 0.7Tcf at the end of each withdrawal season. Let's suppose through economic growth and winter weather conditions that winter demand climbs only 10% to 13.8Tcf. We already know that current production can be no more than 10.0Tcf, so that implies that gas demand on storage would be 3.8Tcf. With this figure added to the 0.7Tcf cushion, the necessary winter storage requirement becomes 4.5Tcf which is an amount greatly in excess of current storage capacity. As gas production declines each year, the burden on gas storage will only increase with time. In the face of shrinking gas supplies, we will have to either be resigned to less gas availability and an implied lower economic growth or find new supplies from drilling efforts or through the importation of LNG. Either situation implies higher pricing for existing natural gas supplies until gas demand is met.

The oil picture is taking on new dimensions. A recent report showed that the movement of oil from Saudi storage facilities doubled in the month of June versus normal outflows. In June, the oil shipments to U.S. refiners jumped to 380,000 Bbls/day versus 190,000 Bbls/day on a normal basis. This represents a 200,000 Bbls/day increase in supply on the U.S. market, but not from current production. I have to wonder if similar oil movements are taking place with other buyers of Saudi crude! I mentioned this as a possibility in the middle of July and further stated that once the world caught on to this practice that oil pricing would be going up. The recent pull back to $43/Bbl form $49/Bbl only a week ago is likely the oil market catching its breath and taking an opportunity to shake out some of the weak hand speculators before advancing higher.

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The Bowers Gas Report

Week ending: 8/13/04

Gas storage for the week ending 8/13/04 was 2530Bcf which was an increase of 78Bcf over the prior week. This compares to the year ago level of 2299Bcf and the five year average of 2394Bcf, a difference of +231Bcf and +136Bcf, respectively. With 12 remaining in the injection season, we need to average 56Bcf per week to reach full storage by early November 2004.

This focus on global oil supply problems is beginning to raise the awareness level that maybe something is wrong with our country's ability to deliver energy resources, of any fuel type, to meet the insatiable energy demand of a growing U.S. economy. Along these lines, one very interesting body of work that studies global oil production is labeled "Peak Oil". The "Peak Oil" theorists believe that the day of maximum global oil production is coming soon, after which the world's supply of oil will be in a state of continual decline. These theorists currently expect that the global peak could be reached as early as 2008, but certainly by 2015. Their models incorporate similar methods which previously were used to accurately predict peak oil production in the U.S. These guys have simply taken the same concepts and applied them to the entire world. While the "Peak Oil" theory is highly debatable, it is one possibility which could explain global oil producer's sudden inability to increase oil supply to match the rise in oil demand. At least on the part of oil, global production continues to rise, albeit at a rate insufficiently slower than the projected increase in global oil demand.

When it comes to natural gas, I could strongly argue that the state of "Peak Gas" has already been reached in the U.S. as evidenced by two years of declining U.S. natural gas production. So far, the gravity of this possibility has yet to be understood by very many in the energy industry, much less the mainstream media. Natural gas simply continues to be the red-headed stepchild of the energy sector with the majority of everyone's attention, including the media, squarely on rising oil prices. However, the potential economic impact on the U.S. from insufficient natural gas supply is enormous because the problem is facing us now, not five to ten years from now as in the case with declining oil supplies. The U.S. is woefully unprepared to deal with this issue. I'll admit that attempts are being made to build numerous LNG terminals to import gas supplies to make up the difference in declining gas production, but the NIMBY crowd (Not In My Back Yard) are lining up to delay and stall these very necessary construction efforts while the rest of the world locks up the very gas supply upon which the LNG terminals depend. Only through a series of favorable weather conditions has gas supply problems not revealed themselves over the last two years. As the U.S. economy continues its growth and natural gas demand continues its commensurate growth, the likelihood of fortunate weather conditions bailing us out diminishes greatly. If you're a gas producer, the next several years will represent a time of great reward. Unfortunately, that reward will be paid by the U.S. natural gas consuming public who with each passing day steps gradually forward in a very vulnerable position with pants down around the ankles. The time to wake up about the natural gas problem is upon us.

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The Bowers Gas Report

Week ending: 8/06/04

Gas storage for the week ending 8/6/04 was 2452Bcf which is an increase of 72Bcf over the prior week. This compares to the year ago level of 2222Bcf and the five year average of 2335Bcf, a difference of +230Bcf and +117Bcf, respectively. With 13 weeks remaining in the injection season, we need to average 58Bcf per week to reach full storage by early November 2004.

It takes a big man to admit when he's wrong and so far this summer, I've been wrong in my prediction for natural gas prices. In retrospect, I have missed the boat in two critical areas. The first of which is that I have relied too heavily on the BTU equivalent between gas and oil being maintained at a 6:1 ratio. When gas was in abundance several years ago, I distinctly recall the ratio constantly hovering around 10:1. Recent history has even moved the ratio as low as 5.5:1. My rationale for thinking that 6:1 was a reasonable ratio was based upon the belief that a commodity in a shrinking supply situation as we are witnessing in natural gas is very defensible. However, that does not appear to be the case, at least this week. As of this writing with today's closing commodity prices, the ratio is at 8.4:1 and represents a 28% discount from my expected 6:1 ratio. The second area which significantly impacted my incorrect prediction was the weather. Milder than normal weather across much of the U.S. in July and August has allowed refilling of gas storage at a higher than normal rate with full storage easily within reach this injection season. With winter storage perceived as adequate, the speculators and gas buyers are reducing their purchase prices as current gas supply is temporarily in excess of current gas demand. I take some comfort in my errant prediction by knowing that each of the contributing factors is temporary. A recent Raymond James natural gas report indicated that year over year gas production in the U.S. for the 2nd Quarter 2004 was down 3.8% as represented by producers comprising 60% of the market. The remaining 40% of the market consists of smaller producers who likely lack the financial ability to change the results of the producing majority. Each successive quarter of inadequate drilling levels simply exasperates the gas problem and increases the likelihood of higher gas pricing in the future. With some time on my side, I'll continue to stick with my earlier prediction of $8/MMBtu gas pricing before yearend. In the meantime, near-term natural gas prices are very cheap when compared to other energy choices.

I really couldn't believe my ears last week when I heard OPEC officials publicly announce that they were producing as much oil as they could! **This news is huge for the oil market**. A key factor in my assessment of the oil market this year was the belief that over twenty years of underinvestment would finally catch up to the energy sector. With global oil demand increasing dramatically from the likes of China, India, as well as the U.S., eventually global oil supply would be strained as excess oil production is absorbed. This announcement confirms the statement I made in May that OPEC was at maximum capacity and therefore had lost its ability to control oil prices. As I have mentioned previously, under these conditions, oil pricing will be determined by what a buyer is willing to pay for each marginal barrel of oil. In a tight oil supply market, the likely buyer of each marginal barrel of oil will be whoever has the most cash and can afford to pay the market price of oil. The current buyer who can afford whatever it takes is China. The Chinese' desire to grow their economy can only be achieved through higher levels of energy consumption. As they willingly pay more for greater oil supplies, oil prices will rise steadily higher until new oil supplies are brought to the market. Because of the lack of any new oil supplies being available through years of underinvestment, I believe the world will face several years of steadily climbing oil prices toward the current trend-line inflation-adjusted price of $80/Bbl. At 4% inflation, we could expect normal oil pricing at $100/Bbl by 2010. This higher level of oil pricing will have little impact on the Chinese economy, but will have a significant impact on the U.S. economy. This announcement is simply one more piece of evidence confirming my belief in the shift away from financial assets and the move toward real assets.

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The Bowers Gas Report

Week ending: 7/23/04

(There will not be a report next Thursday, August 5 as I will once again be on vacation. I promise this will be the last vacation for several months! I will resume with the next report on Thursday, August 12.)

Gas storage for the week ending 7/23/04 was 2297Bcf which was an increase of 70Bcf over the prior week. This compares to the year ago level of 2062Bcf and the five year average of 2228Bcf, a difference of +235Bcf and +69Bcf, respectively. With 15 weeks remaining in the injection season, we need to average 60Bcf per week to reach full storage by early November 2004.

With gas storage levels showing all the signs of being sufficient and adequate for winter '04/'05, the natural gas market seems to have relaxed in the belief that everything's just fine with gas supplies. The reality is something quite different though. This perception of gas normalcy has only been achieved by the willingness of the gas storers to fulfill their organizational duty to their customers by paying substantially more for natural gas than they did in prior injection seasons. By way of comparison, the gas storers in 2003 were paying an average cost of $5.25/MMBtu versus about $6.00/MMBtu so far in this injection season, representing a jump of about 15% on a year over year basis. One could argue that without the increased competition for gas supplies from the industrial sector that pricing would have been lower. However, I believe that we're witnessing very fundamental market forces at work which have permanently shifted the price structure for U.S. natural gas. I further believe that the current price structure will remain until outside influences such as LNG or Alaska gas, both of which are a decade away from having any meaningful impact, have an opportunity to change the price structure. The price structure that I'm referring to basically establishes a floor price of $5.00/MMBtu for current U.S. natural gas supply with a normal expected range of $5.50/MMBtu to $7.50/MMBtu. Depending on factors such as hot or cold weather, mild summers or winters, Gulf of Mexico hurricanes, or rig count levels, gas prices should fluctuate within this range. Extreme factors such as harsh winters or oil supply disruptions could easily cause natural gas spiking above $10/MMBtu. I'm already on record regarding my prediction for oil pricing moving through $50/Bbl on its way to $60/Bbl over the next few years. If I'm correct in this regard, then you can simply add $2.00/MMBtu to the above range to compensate for substitution effects from the oil market. As the new price structure for natural gas becomes more accepted, capital will seek out the energy sector and increase the valuation level of all energy assets.

In the oil markets, we likely witnessed the first step in the re-nationalization of Russian energy assets with the heavy taxation of Yukos. As the Russian government exerts influence over other energy firms through various means at their disposal, they will become a less attractive destination for foreign energy capital. However, the Russians likely do not care about foreign capital as long as oil prices remain strong. Higher oil prices would allow them all the capital they need to maintain their energy production without having to share with foreigners or shareholders. I recognize that my position on this is somewhat extreme, but I expect very few positives from a country which ignores the rule of law, where contractual rights have no meaning, and where property rights are nonexistent. We need to continue watching events over there very carefully, only because so much capital of U.S. energy companies has been invested in recent years.

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The Bowers Gas Report

Week ending: 7/16/04

Gas storage for the week ending 7/16/04 was 2227Bcf which was an increase of 72Bcf over the prior week. This compares to the year ago level of 1981Bcf and the five year average of 2170Bcf, a difference of +246Bcf and +57Bcf, respectively. With 16 weeks left in the injection season, we need to average 61Bcf per week to reach full storage by early November 2004.

Do you know how to tell who's in control over prices in the natural gas market? Simply look at the futures price changes the last two weeks when the EIA reported injections into storage of +109Bcf and +108Bcf. Natural gas pricing subsequently fell below $6/MMBtu over that time period although these level of injections are relatively normal for this time of year. With today's report showing an injection of +72Bcf which is also a normal injection amount, pricing almost immediately jumped a quarter. This continual, volatile price reaction to each week's slight wiggle in reported news tells me that the hedge funds and speculators are in firm control and active in the natural gas market. During recent weeks however, the speculators have failed to recognize the BTU linkage to oil pricing and have now significantly discounted natural gas to oil, therefore making natural gas the low cost fuel of choice. This certainly improves the desirability and demand for natural gas versus other fuel choices at least in the near term.

Speaking of factors which should improve the demand for natural gas, anyone whose livelihood or fortune is in any way reliant upon natural gas needs to immediately send Eliot Spitzer, attorney general for the State of New York, a big bouquet of flowers or at least a thank you note for his recent lawsuit against several big utilities. He is accusing these utilities of excess carbon dioxide (CO_2) emissions from their power plants and their contributory effect on global warming, health risks to people, etc. While he's not asking for monetary damages, he wants these utilities to reduce their emissions through various means. The highly obvious way to reduce CO_2 emissions is for these utilities to use more natural gas rather than oil or coal. While Mr. Spitzer is obviously grandstanding for some future political aspiration, any resulting actions or settlement for the utilities should only increase the future demand for natural gas.

On the oil front, some OPEC officials have come out this week with public statements to change the price band from the current range of $22-$28 to a new range of $28-$32 per barrel. I predicted this past January that I thought OPEC would change the price band to a new range of $28-$36. They will likely settle this matter at their next meeting in September. OPEC was originally scheduled to meet in late July, but for some reason cancelled the meeting. Given that OPEC officials dearly love to have meetings, the cancellation raises a red flag that all is not well at the Vienna headquarters. I believe that OPEC is running out of ideas on how to verbally manipulate the market in the face of global oil demand outstripping global oil supply. Anecdotal evidence further suggests that the recently announced supply increases from the Saudis is simply being pulled from storage facilities around the world. The Saudis could not possibly rely on delivering oil from storage for a sustained period of time; therefore because of seasonal increases in oil demand during the fourth quarter, I think we will know without a doubt by the end of this year the true state of the oil market. If the Saudis are delivering oil out of storage rather than through increased production, the world will immediately recognize the inherent problem and push oil prices significantly higher from current levels. My bet, given that the global economy continues to grow and expand, is that we have a problem. Hold onto your shorts!

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The Bowers Gas Report

Week ending: 7/09/04

Since Danny is on vacation:

Starting to get hot, hopefully it is not too late….

Storage Highlights:

Working gas in storage was 2,155 Bcf as of Friday, July 09, 2004, according to EIA estimates. This represents a net increase of 108 Bcf from the previous week. Stocks were 251 Bcf higher than last year at this time and 54 Bcf above the 5-year average of 2,101 Bcf. In the East Region, stocks equaled the 5-year average following net injections of 69 Bcf. Stocks in the Producing Region were 44 Bcf above the 5-year average of 648 Bcf after a net injection of 26 Bcf. Stocks in the West Region were 10 Bcf above the 5-year average after a net addition of 13 Bcf. At 2,155 Bcf, total working gas is within the 5-year historical range.

Thanks to Brian M. Hickman for providing the above information in Danny's absence.

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The Bowers Gas Report

Week ending: 7/02/04

(There will not be a report next Thursday, July 15 as I will be on vacation. I will resume with the next report on Thursday, July 22.)

Gas storage for the week ending 7/2/04 was 2047 which was an increase of 109Bcf over the prior week. This compares to the year ago level of 1809Bcf and the five year average of 2023Bcf, a difference of +238Bcf and +24Bcf, respectively. With 18 weeks remaining in the injection season, we need to average 64Bcf per week to reach full storage by early November 2004.

The gap between this year's storage level and last year continues to steadily close. All of this has occurred without the benefit of hot summer temps or our first hurricane showing up just yet and has allowed normal injections to storage over the past six weeks. This year over year gap should reduce further over the next six weeks as hot temperatures finally arrive over much of the U.S. The gap should be completely erased by the end of the injection season. While everything appears all hunky dory for gas storage at present, there are underlying conditions which cause me significant concern. Although the rig count hit the 1200 level last week, we remain woefully short on drilling activity to reach a balanced supply/demand condition. U.S. gas production remains on track to decline roughly 3% compared to last year. This declining production is slowly eating away at the rate of 3Bcf per day the nation's ability to send gas to storage. We may not see any apparent problems for gas deliverability going into this winter, primarily because of our starting point at this spring's trough, but the day of reckoning from insufficient drilling activity will be seen in spades if a colder than normal winter event hits this year or most definitely by the summer of 2005.

More people, both in and out of the energy industry, are beginning to understand our gas supply problem. For this reason, natural gas pricing will remain over the $6/MMBtu level for the foreseeable future. Gas price support from the oil side also remains strong as global concerns push oil toward $40/Bbl again. I look for gas prices to test the $7-$8 per MMBtu level this summer if above average temperatures hit the U.S. or if we have supply disruptions from Gulf of Mexico hurricane activity. We are that close to the razor's edge.

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The Bowers Gas Report

Week ending: 6/25/04

Gas storage for the week ending 6/25/04 was 1938Bcf which was an increase of 93Bcf over the prior week. This compares to the year ago level of 1662Bcf and the five year average of 1928Bcf, a difference of +276Bcf and +10Bcf, respectively. With 19 weeks remaining in the injection season, we need to average 66bcf per week to reach full storage by early November 2004.

Concerns of summer heat this year has been temporarily replaced with a monsoon season! Much of the producing regions of Texas, Oklahoma, and Louisiana have simply been deluged with record levels of rainfall for the month of June. The unusually wet weather should only have temporary repercussions with the rig count over the next several weeks as the preparation of drilling pads experience short term delays. The industry can ill afford any delays at this time as year over year gas production declines require every available rig to be running full bore.

Speaking of rig counts, little notice has been made of the slowing growth in the rig count lately. While everyone knows that the count is up from a year ago, few realize that there are only 10% more rigs running today versus a year ago. A year ago there were 1074 rigs running. As of 6/25/04, there were 1176 rigs running, a difference of 104 rigs. Of which, the primary producing states of Texas, Oklahoma, and Louisiana accounted for 71% of the increase in rigs, or only 74 rigs. Since a year ago natural gas prices have consistently been over $5/MMBtu, so it makes little sense to say that there's no economic incentive to drill. The answer lies with the theme of some of my recent posts about the shortage of experienced and knowledgeable field hands. The lack of qualified personnel represents a huge bottleneck for the industry which cannot be changed overnight. Although people can be hired to do the job, which of you producers out there want a bunch of rookie hands drilling your wells? I certainly do not. Therefore, I remain firm in my convictions that we will have chronic problems with shrinking supplies of natural gas for many years to come.

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The Bowers Gas Report

Week ending: 6/18/04

Gas storage for the week ending 6/18/04 was 1845Bcf which is an increase of 85Bcf over the prior week. This compares to the year ago level of 1565Bcf and the five year average of 1846Bcf, a difference of +280Bcf and -1Bcf, respectively. With 20 weeks left in the injection season, we need to average 68Bcf per week to reach full storage by early November 2004.

Since I've been in the habit lately of rehashing topics which directly affect natural gas consumption and supply, I thought I would try another one. After a recent field visit, I picked up more anecdotal evidence that the oil service sector continues to have widespread personnel problems for drilling and completion rigs. There also appears to be very insufficient and competent personnel capable of handling the traditional pumper role. Lastly, the oil field professionals needed to locate and drill for reserves such as engineers and geologists are reaching retirement age in record numbers. If these personnel problems persist, I have to question the industry's ability to meet the future demand for gas supply. We already know through hard number reporting that gas production in the U.S. declined about 2% in 2003 compared to 2002. We also know that the trend continued for the 1st quarter of 2004 and appears to be accelerating. I've seen estimates that gas production in 2004 may decline as much as 5% compared to 2003. Although there are 10% more rigs currently operating in the U.S. versus a year ago, it still isn't enough to change the trend of declining production. This is also in the face of rising oil and gas pricing compared to last year. I've previously predicted the need for a rig count of around 1400 to have balance between supply and demand. With the persistent and ongoing personnel problems outlined above, we will have great difficulty even get close to that number of operating rigs. This is another example of the many bottlenecks developing for energy which will result in predictably higher pricing for natural gas.

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The Bowers Gas Report

Week ending: 6/11/04

Gas storage for the week ending 6/11/04 was 1760Bcf which was an increase of 94Bcf over the prior week. This compares to the year ago level of 1438Bcf and the five year average of 1751Bcf, a difference of +322Bcf and +9Bcf, respectively. With 21 weeks left in the injection season, we need to average 69Bcf per week to reach full storage by early November 2004.

As of today's futures trading close (6/17), the twelve month natural gas strip was about $6.63. I believe that number is an all time high since the beginning of recordkeeping on such things. While I normally take the contrary path when it comes to investing, I am firm in my belief that when it comes to energy investing, the proper course is to now follow the momentum crowd. They are beginning to catch up to my way of thinking as demonstrated in the strip. Futures traders and companies who use futures to hedge their production are starting to understand the magnitude of the gas problem and are thus reflecting it in gas pricing. As summer cooling demand increases, as more tropical storms turn into Gulf of Mexico hurricanes, as industrial demand increases from a growing economy, as coal and oil supplies continue to meet bottlenecks, as gas storers strain to have sufficient supply for the coming winter, the stage is set for the twelve month strip to blow right through $7.00 and continue its upward march.

Turning to thoughts about oil, the escalating events throughout much of the Middle East and Africa appear to me to be a highly coordinated effort by Al Qaeda or similar like-minded groups to systematically undermine the economies of the developed world, in particular the U.S, by attacking the oil producing capability of the region. Whether its pipeline bombings in Iraq, political strife in Algeria or Nigeria, or attacks on Westerners in Saudi Arabia, the results at this stage in the global economy will be significantly higher oil prices. These events if considered individually would not be much of an issue. However, with OPEC already believed to be producing at maximum capacity, the combined events and their nibbling away at oil deliverability prevents the demand for oil from being met at lower prices. There's currently a fine balance between global oil demand and global oil supply which has little to no excess capacity, and each day we walk the tightrope on whether future oil demand will be at met at current prices. Of particular concern to me is the escalation of attacks in Saudi Arabia. The Saudi Kingdom produces about 1/3 of OPEC's total production and over 10% of the world's daily production. They rely a great deal on western oil personnel and technology to maintain production in their aging oil fields. Anecdotal evidence suggests that recent attacks are starting to create a brain drain of the oil field knowledge personnel upon which the Saudis have so heavily depended. If this exodus is truly happening, then it's only a matter of time before Saudi oil production begins to fall. The next six months will be critical since seasonal oil demand rises in the third and fourth quarter of each year. I could also paint a conspiracy theory that these coordinated attacks are being conducted now as a way to push up oil prices in the face of the U.S. Presidential election, and possibly sway the election outcome to the detriment of George W. Bush. Al Qaeda, because of their train attacks, certainly was emboldened through their ability to change the recent Spanish elections. These twisted people likely know that direct attacks on the U.S. would not change the course of an election, but that higher oil prices which cause economic hardship on the voting public might be sufficient to change the outcome. As I previously mentioned in prior reports, with OPEC's ability to dictate oil prices gone through the elimination of their excess capacity, the future price of each marginal barrel of oil will depend wholly on the price that a willing buyer will pay a willing seller. With global oil demand rising in the face of stable oil supply, oil prices will continue to climb.

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The Bowers Gas Report

Week ending: 6/04/04

Gas storage for the week ending 6/04/04 was 1666Bcf which was an increase of 102Bcf over the prior week. This compares to the year ago level of 1324Bcf and the five year average of 1669Bcf, a difference of +342Bcf and -3Bcf, respectively. With 22 weeks left in the injection season, we need to average 70Bcf per week to reach full storage by early November 2004.

I think it's time to bring up a topic which I've mentioned in the past but now appears ripe for further discussion based upon current anecdotal field evidence. The topic for the week is producer's drillable locations, or lack thereof. I'm hearing tales of drill rigs at present having no where to relocate once their current locations are drilled. In addition, completion rigs are starting to stack up like cordwood. Now I have to ask myself how either of these events can possibly be happening when oil is over $36/Bbl and natural gas is over $6/MMBtu. Surely, there must be somewhere in the continental U.S. where a hole could be drilled to reach economical quantities of hydrocarbons. I'm jesting a little bit because I know the drilling companies try to allocate their rigs regionally based on local demand. However, I can only conclude that in various regions producers are running out of viable developmental drilling locations. The availability of completion rigs also tell me that all current wells including the strippers are in full production and that the pace of new well completions is holding at a steady rate. Another possible explanation could be the lack of casing required to complete wells. Although steel prices have come off their highs from a few months ago, casing prices continue to remain at elevated levels and availability appears to be an issue. I have long contended that over the past several years producers have been consuming the easy pickings with new activity primarily being step outs from existing fields. As the producers reach the edge of their fields, lower production and higher costs become the norm. Simply drilling the same number of wells as last year isn't good enough. With lower production from new well completions, the pace of drilling would have to accelerate quite rapidly from current levels just to remain even. With this type of result occurring nationwide, is it any wonder that domestic production of oil and gas is declining at an ever more rapid rate. Anadarko's election to sell off their U.S. production and shift resources to international activity is certainly further evidence that they likely foresaw similar results in their producing areas and determined that the company's long-term survival required doing business elsewhere.

If I'm correct regarding my drillable location theory, the impending direction for U.S. natural gas pricing is both certain and predictable. Assuming demand for natural gas remains constant, which would be incorrect in today's growing economy, and that gas supply is declining, then prices have to go up from the present $6/MMBtu level to displace the demand for a commodity in shortage condition. I contend that pricing will approach the $8/MMBtu level on a sustained basis before the energy industry responds by exploratory drilling for new U.S gas fields. Even renewed exploratory drilling may not deliver the desired results of increased gas production, but may simply encourage further step outs to existing gas fields creating the need to drill even faster to maintain production. Until pricing reaches much higher levels though, the oil service guys may find themselves with lower activity from producers who aren't willing to spend risk dollars just yet. For those producers with good viable drilling locations, they will be seeing lower service costs overall which translates into a much fatter bottom line for profitability. Let the good times roll!

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The Bowers Gas Report

Week ending: 5/28/04

Gas storage for the week ending 5/28/04 was 1564Bcf which was an increase of 87Bcf over the prior week. This compares to the year ago level of 1199Bcf and the five year average of 1572Bcf, a difference of +365Bcf and -8Bcf, respectively. With 23 weeks left in the injection season, we need to average 71Bcf per week to reach full storage by early November 2004.

While we are still three weeks away from the official start of summer, it has been hotter than blazes for much of the southern portion of the country. The June weather forecast looks for much of the same high temperatures to continue, but spreading into the Midwest and Northeast regions. These hotter than normal temperatures and the impact of the growing U.S. economy are beginning to show up in the gas storage figures compared to a year ago. The ability to inject more gas into storage has been hindered by higher electricity demand resulting from the growing economy. You may recall that about 20% of all U.S. electricity generation is originally fueled by natural gas. This extra electricity demand compared to a year ago accounts for around 2Bcf per day which otherwise would have gone into gas storage. This is a prime example of the tremendous competition between the electricity generators and the gas storers which I have mentioned many times in recent months. While the users of gas for electricity generating purposes have been willing to pay when gas is above $6/MMBtu, it seems that the gas storers have deferred their purchases until later, likely hoping that prices will drop to some lower level before adding to storage. They're involved in a high stakes game of "weather chicken" that could bump pricing into the $7-$8 per MMBtu range that I've been expecting if the gas storers are wrong regarding their purchase timing.

Speaking of games! With the latest announcement from OPEC, I'm more and more convinced that it's game over for OPEC in their ability to dictate global oil pricing. In case you missed it, OPEC boldly announced that they would raise their production quota two million barrels per day by July 1, and then an additional 500,000 barrels per day by August 1, if the world needed the oil. The announced changes would raise their current quota of 23.5 million barrels per day to 25.5 million barrels on July 1. The additional 500,000 barrels per day would then boost the quota to 26.0 million barrels per day on August 1. The major fact which OPEC failed to announce was that actual oil production from all cartel members is 26.0 million barrels per day right now! The quota adjustment simply legitimizes their vast overproduction and "quota cheating" that they knew had already taken place. What we need to keep in mind is that OPEC's extra production occurred during the second quarter of the year which is historically the year's weakest demand period. Global oil demand typically increases sharply during the third and fourth quarter each year. So while they may be attempting to sooth over the numerous calls by developed countries for more oil, the reality is that OPEC will be falling further behind in their ability to meet oil demand. You also have the last remaining OPEC members with extra production capacity, Saudi Arabia and the UAE, committing to place an extra one million barrels per day on the market right away. Due to tanker constraints, this extra oil will not even reach its destinations until mid-July at the earliest, just in time to offset only a portion of the growing seasonal demand. The Saudis also say they can produce another 1.5 million barrels per day, if needed by the market. What they fail to say is this possible oil production is in the form of sour grades of crude which is faced with refining constraints and limitations, and therefore will not be needed by the market. Like so many things, it's a matter of not listening to what OPEC says, but watching what they do that will be important in future oil pricing. With current global oil demand at 80 million barrels per day and growing about 2% per year, this implies a yearly demand increase of 1.6 million barrels per day. In order to meet this growing global demand, the OPEC producers would need to immediately spend hundreds of billions of dollars on a collective basis to increase their overall productive capacity. Doubting OPEC's ability to respond to market forces in this manner, I continue to stand by my previous belief that OPEC is already producing at maximum capacity and have lost their ability to control world oil prices.

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The Bowers Gas Report

Week ending: 5/21/04

Gas storage for the week ending 5/21/04 was 1477Bcf which is an increase of 89Bcf over the prior week. This compares to the year ago level of 1085Bcf and the five year average of 1479Bcf, a difference of +392Bcf and -2Bcf, respectively. With 24 weeks remaining in the injection season, we need to average 72Bcf per week to reach full storage by early November 2004. Over the next six weeks we will likely see a narrowing of the comparison to a year ago by at least 100Bcf due to the abnormally high injections experienced last year from cooler than normal weather.

I've got a question for everyone! Are you enjoying the wild ride being experienced in crude oil pricing? It seems like there are more up and downs than on the Texas Cyclone at Astroworld! For the uninformed, the Texas Cyclone is an old-style wooden roller coaster with lots of twists and turns, hills and valleys, and really clatters and creaks as she traverses rapidly over her course, not all that different from recent price movement in oil. Volatility in oil pricing is what happens when we have such uncertainty as to the future availability of supply. On one hand you have the side which believes that prices have topped because OPEC can simply turn on a spigot and BINGO, you get more oil which will lead to lower prices. On the other hand you have the group which believes that global oil supplies have reached the limits of their deliverability and are faced with greater demands for the limited amount of supply. If you've read my previous reports, you already know that I fall in the latter camp. Last fall I began speculating that OPEC would at some point adjust their price band for oil on the premise that higher pricing was necessary to offset the purchasing power effects from a weakening dollar. We now hear OPEC members discussing openly this very issue. In addition, with global demand for oil rapidly increasing as the world rebounded from its slump, excess oil capacity has been absorbed over the past year with very little, if any, capacity remaining. From this point forward, each marginal barrel of oil will be priced based upon demand. If a buyer needs oil and is willing to pay more than someone else, oil prices will go up and vice versa. The future rapid growth of developing countries like China and India will place even more pricing pressure on oil as these countries compete headlong with the U.S. for each marginal barrel. Oil price volatility will continue until users of energy realize that the days of cheap oil are over. I find it rather amusing to hear various OPEC members posturing back and forth about the appropriate quota level for themselves in an attempt to maintain credibility. The reality is every available barrel of oil that OPEC can produce is needed now. One day soon the world will wake up and realize that OPEC has lost control of the price mechanism, their reason for existence is no longer needed, that oil prices are subject to the economic laws of supply and demand, and that OPEC has just become marginalized themselves.

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The Bowers Gas Report

Week ending: 5/14/04

Gas storage for the week ending 5/14/04 was 1388Bcf which was an increase of 85Bcf over the prior week. This compares to the year ago level of 990Bcf and the five year average of 1403Bcf, a difference of +398Bcf and -15Bcf, respectively. With 25 weeks left in the injection season, we need to average 72Bcf per week to reach full storage by early November 2004.

Three months ago I made a forecast that by summertime we would see oil above $40/Bbl and natural gas in the $7-$8/MMBtu range. Admittedly the oil forecast came in a little early as we are already over $41/Bbl. However, with only a month to go before summer officially starts in late June, natural gas pricing is only 10% from my original forecast. While the investment pundits and talking heads on CNBC for the most part want us to believe that energy prices are near a top, more of the fringe element who believe in continued strengthening energy prices like I do are beginning to attract more media attention. With 2004 as an election year, I become more than a little suspicious that the media has latched onto energy as an election issue. I do not for a minute believe that the media is concerned about addressing the real issue of solving our country's energy problems. They simply view energy as an easy issue to rouse consumers from their slumber and remind them that we are in an election year. They continually try to remind us that the current administration isn't doing enough to fix high energy costs and that we might be better served by electing someone else. The media hype concerning $2.00 gasoline prices and the economic pain for consumers is beginning to be very nauseating. What I want to know is where the media was when oil was $10/Bbl and natural gas was $1/MMBtu and why weren't they concerned about the pain being inflicted on the U.S. energy producers? As always, the media shows their true colors and biasness with no further discussion necessary.

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The Bowers Gas Report

Week ending: 5/7/04

Gas storage for the week ending 5/07/04 was 1303Bcf which was an increase of 76Bcf over the prior week. This compares to the year ago level of 900Bcf and the five year average of 1324Bcf, a difference of +403Bcf and -21Bcf, respectively. With 26 weeks remaining in the injection season, we need to average 73Bcf per week to reach full storage by early November.

Well, isn't this a find kettle of fish! The Commodity Futures Trading Commission (CFTC) has announced that the owners of gas storage facilities are being subpoenaed for their storage records this past winter. While the CFTC did say they were looking into the causes of large natural gas price movements beginning last fall, maybe they're also reviewing whether those facilities were accurately reporting storage levels to the Energy Information Administration (EIA)! If certain companies misrepresented pricing of natural gas sales used to develop natural gas price indices, surely they wouldn't have double-dipped by low-balling the amount of physical gas going into storage! As everyone knows, these storage figures are greatly scrutinized by the futures market in assessing adequacy levels in meeting winter gas demand. Is there some concern on the part of the CFTC that storage should have been higher than reported therefore justifying lower natural gas prices? Or maybe they're wondering how on earth storage was able to be refilled from absurdly low levels prior to the big government/corporate Confab last spring to a full storage condition by last November! Surely, the CFTC must be thinking, there must be extra gas stashed somewhere that hasn't been accounted for and is being intentionally held off the market and therefore driving up natural gas prices currently! Maybe they're wondering to themselves that it simply doesn't make sense that prices during the shoulder months are higher than this past winter, so someone somewhere has to be doing something wrong which needs to be investigated! (Excuse me one moment while I ever so quickly remove my tongue so deeply implanted in my cheek!)

Once the witch hunts are completed and the scapegoats revealed, maybe real solutions can be discussed and then implemented. So let's drop the finger pointing! If the CFTC wants to know why natural gas prices are going up, all they have to do is ask me. I'll tell them straight out. It's really fairly simple, basic, and consistent with the same story that I've been harping on for the last two years. Gas demand from all users is growing faster than the gas supply. In fact, gas supply is shrinking due to drilling levels being too low to overcome the ever increasing depletion rates of existing gas fields. The capital to find new gas fields has not been spent because natural gas pricing simply has not justified the vast cost of exploration risk. Who knows? Maybe even if the money was spent, we still would not make sufficient new discoveries to replace existing gas production. At some point, everyone needs to recognize that the U.S. is a very mature producing basin. If the energy industry decides to hunt further domestically, the technology envelope will have to be pushed further, taking us either deeper or into previously unknown territory. But to take this next step in exploration, the risk takers will need greater certainty of reward that only higher natural gas prices can provide. The majors have already decided that the better use of capital is to develop the LNG infrastructure to deliver known, foreign sources of captive gas supplies, and therefore have left the risk taking to the independents and less well-financed mom and pop producers. The delay in recognizing the gas supply problem has brought us to where we are today, a majority of the gas consuming populace faced with unexpected rising prices and then demanding that their elected officials find out who's trying to get the better of them. So if the CFTC bothers to ask me, I'll tell them we need to stop the finger pointing, allow market forces to adjust natural gas pricing which will allow the risk takers to find the gas demanded by the market. Simple as that!

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The Bowers Gas Report

Week ending: 4/30/04

Gas storage for the week ending 4/30/04 was 1227Bcf which was an increase of 72Bcf over the prior week. This compares to the year ago level of 836Bcf and the five year average of 1254Bcf, a difference of +392Bcf and -27Bcf, respectively. With 27 weeks remaining in the injection season, we need to average 73Bcf per week to reach full storage by early November.

On the day I write this report, oil ever so briefly traded at $40/Bbl and then quickly backed away for fear of treading into forbidden territory. Through a combination of fears including attacks on U.S. workers in Saudi Arabia, gasoline supply concerns for this summer, and continued turmoil in Iraq, the energy markets have moved so very close to a decision point. Does the market react on the belief that energy prices can't possibly stay at these all-time high levels based on past history and then move prices lower, or does the market finally wake up to the fact that global energy consumption has risen to a level where excess oil supply is simply unavailable at lower prices and that the market clearing price for oil is somewhere higher? It has been over 14 years since oil prices were at this same price level. If inflation were considered, oil would have to reach about $58/Bbl to cost the same as in 1990. Until now, the message that the market sent to oil producers, through the price mechanism, is that they were adequately compensated for their efforts by being paid on a constant dollar basis for almost two decades. Is it any wonder that the energy industry, more or less any industry, could not maintain itself under such stringent conditions? As a strong believer in reversion to the mean for many aspects of economic activity, I believe we have reached the point where we will be reverting to the mean and thus closing the gap to where oil prices should have been. This implies oil prices moving through $40, past $50, and toward $60/Bbl over the course of the next few years.

The price support from oil will also prove beneficial to natural gas pricing. Whereas gas producers were resigned to be compensated for their product in a range of $1 to $3 per Mcf for what has seemed like forever, the new pricing order will be moving through $6, past $8, and toward $10/Mcf over the next few years. These price changes for oil and gas are what happen when you've under-invested in the industry for almost twenty years. There's nothing magical going on. We're simply reverting to the mean of where prices should have been moving anyway. We'll also be witnessing capital investment catch-up over the next several years as massive quantities of money are invested in LNG infrastructure to deliver natural gas to the U.S., caused by a realization that domestic supply is not infinite. As a result of what I believe will be happening with oil and gas prices, all economies around the world will go through gut-wrenching changes as they adjust to the new reality of higher energy costs.

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The Bowers Gas Report

Week ending: 4/23/04

Gas storage for the week ending 4/23/04 was 1155Bcf which was an increase of 78Bcf over the prior week. This compares to the year ago level of 754Bcf and the five year average of 1189Bcf, a difference of +401Bcf and -34Bcf, respectively. With 28 weeks left in the injection season, we need to average 73Bcf per week to reach full storage by early November.

With the market starting to believe the long-term issues regarding natural gas supply and demand, the level of deal making in the oil patch is starting to heat up like a Texas summer. Anecdotal evidence from the patch is beginning to show the rough edges which usually occur whenever we've been in the early stages of a new boom time. Let me explain myself. With all evidence pointing toward historically high oil and gas pricing, the corrupt and nefarious promoters which have so frequently tainted the energy industry for investors are starting to appear again. With their promises of easy money and get rich quick schemes, these characters take advantage of people's desire to follow the latest, hot investment trend. With the financial markets recently demonstrating to be a difficult or uncertain arena to invest due to historically low interest rates, investors are searching for alternatives to grow their money faster. The conditions are ripe for the slick promoter to find a plethora of easy marks.

The promoter's game is legendary. He simply acquires raw acreage that can be had on a low cost per acre, creates the illusion that based on a producing well 10 miles away; there is high likelihood a new field is just waiting to be found under his acreage. His next step is to prepare his drilling program with cost estimates way higher than anyone could ever imagine, justified by high leasehold costs and extra frac work necessary to get the difficult geology to relinquish their precious hydrocarbons. Critical to the promoter's success is the use of a boiler room operation to line up the marks (investors). With the promise of new field discoveries and rapid payback from high oil and gas prices, the pitch becomes an easy sell to the unknowledgeable investor. The promoter then lines up a legitimate drilling contractor who will indeed drill him a hole wherever he wants one. Of course, the promoter's plan is to always say a well is worthy of completion since his cost estimates include such costs. However, to make even more money for himself, the promoter cuts corners on everything necessary to actually complete the well. Substandard or inferior casing is frequently set, too small of frac jobs are used, and no use of actual log work are the typical corners cut. Invariably, hole problems develop for each of the wells, but not until several wells in the program have been attempted. All along, the helpless investors are strung out, constantly asked for more money with the promise of success right down the road. In the end, the investors' dreams and hopes of energy-induced riches are shattered. I'm convinced the saying "throwing your money down a hole" had to originate from bad experiences in the oil patch.

My point in this is simply to remind investors of the Latin phrase: Caveat emptor or buyers beware. The energy industry is indeed running out of economically viable PUD locations. However, what may be being held out as a PUD may not actually be a PUD at all. PUD means Proven UnDeveloped, which implies good adjacent closure to an existing producing well bore. As the boom continues, we all need to be aware of the siren call of the promoter selling his poison and try our best to reveal his game in the bright light of day. The energy industry will be much better off without these guys.

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The Bowers Gas Report

Week ending: 4/16/04

Gas storage for the week ending 4/16/04 was 1077Bcf which was an increase of 28Bcf over the prior week. This compares to the year ago level of 702Bcf and the five year average of 1143Bcf, a difference of +375Bcf and -66Bcf, respectively. The level of injections should steadily climb for the next six weeks until hitting the triple digit injection level in early June. With 29 weeks left in the injection season, we need to have an average injection of 73Bcf/week to reach full storage, defined as 3200Bcf, in early November, 2004.

The U.S. manufacturing sector continues to rebound strongly as indicated by March, 2004 durable orders increasing by 3.4%. What this basically means is that demands for long life goods such as airplanes and machinery is growing very rapidly and that the plants which make these goods will likely increase their production to accommodate the demand. The owners of businesses are gaining confidence in the direction of the economic environment and are thus willing to make the long-term capital investment decisions necessary to grow their business. Up until now, we have experienced over three years of declining business capital investment. This news may very well represent the turning point in the direction of that capital investment.

As all manufacturing processes require significant and sustained energy sources to make their goods, the implication for the energy sector from this news is enormous. With natural gas currently representing about 20% of all energy sources in the U.S., the rebound in manufacturing is bound to increase the demand pressure on an already limited supply of gas. The industrial demand for natural gas had fallen off over the last few years in line with the decline of the manufacturing sector. However, we now have confirmation that industrial demand for natural gas will definitely be growing despite higher price levels. Manufacturers furthermore have limited ability to switch to other fuel sources as inventories for coal and oil are at historically low levels. When you factor in the other growing gas demand components of electricity generation for commercial and residential users and storage demand for winter heating purposes by local distribution companies, the decline in U.S. natural gas production implies greater competition and pricing for a resource in shortage condition.

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The Bowers Gas Report

Week ending: 4/09/04

Gas storage for the week ending 4/09/04 was 1049Bcf which was an increase of 15Bcf over the prior week. This compares to the year ago level of 642Bcf and the five year average of 1106Bcf, a difference of +407Bcf and -57Bcf, respectively. This week's report officially begins the start of the injection season. With this week's cool front across much of the Central U.S., we may see one more small injection in the next report before the levels of injection begin to climb.

The hot news recently has been the announced mergers between Kerr-McGee and Westport Resources and then EnCana and Tom Brown. Why, all of a sudden, are companies buying up other companies when prices for oil and gas are at historically high levels? The answer is relatively easy, drilling locations and PUD value. The larger independent E&P companies like Kerr-McGee and EnCana have a constant need to replenish depleted reserves and book new reserves to satisfy Wall Street investors who constantly are scrubbing the balance sheets of publicly traded energy companies. These investors like to see company growth, whether by finding new prospects or acquiring another company's assets. The last thing they want to see is a company which appears to be shrinking, which for energy companies occurs when sales revenues deplete the asset base of the company. Up until now, Wall Street has been long expecting energy prices to fall back significantly which translate into oil at under $30/Bbl and gas below $4/MMBtu. They have been very reluctant to accept the new price structure because of the implied consequences for the rest of the financial markets. Higher energy prices infer more inflationary pressures and more inflation is historically damaging to fixed assets like bonds and sector-specific damaging to various parts of the stock market.

The more important part of the merger story is the implication for energy asset valuations, in particular natural gas reserves. I have for several years now been in the camp which believes that the U.S. energy industry has been rapidly running out of economically viable drillable locations. We have steadily drilled out the easy reserves which were profitable at $2/MMBtu, then $3/MMBtu, and now $4/MMBtu. Is it any wonder then that companies running out of drilling locations would go after companies that had them? The value of reserves in the ground will also continue to climb as recent commodity pricing becomes accepted as the norm. The EnCana/Tom Brown deal states a value of $1.95/Mcf for reserves in the ground. I think we will see more deals that also approach the $2/Mcf level. If a company can develop the certainty of selling gas for $6/Mcf, they won't mind paying $2/Mcf for the in-place reserves. Those companies looking to acquire reserves in the future will need to accept paying the rightful value of those assets in the ground or else be content to let their company shrink.

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The Bowers Gas Report

Week ending: 4/02/04

Gas storage for the week ending 4/02/04 was 1034Bcf which was an increase of 20Bcf over the prior week. This compares to the year ago level of 688Bcf and the five year average of 1097Bcf, a difference of +346Bcf and -63Bcf, respectively. The peak to trough withdrawal for this season was 2173Bcf which is about the expected withdrawal for an average winter like we had this year.

As we enter the injection season, buyers are already starting the refill process, but at $0.50/MMBtu higher than in 2003. With the U.S. industrial sector starting to rebound from the last recession, the resulting return of industrial demand for gas will bring even more pricing pressure onto an already tight supply condition. You may remember that industrial gas usage was the first to fall as prices went from $3/MMBtu on its way to $5/MMBtu. Industrial users simply could no longer afford to keep their manufacturing and processing facilities profitable as the price of natural gas continued its climb. With the U.S. economy strengthening and prices soaring for commodities like steel and fertilizer, the industrial users can now afford to fire up their gas furnaces to make their steel ingots or use gas as a feedstock. But now, the industrial user has to compete against rising demand from the commercial and residential users, the utilities using gas to generate electricity and the LDC's storing gas for next winter. There are simply way too many mouths to feed!

From the supply side of the equation, a confluence of many events has brought us to this point. Let's just start naming them off the top of our head. 1) 20+ years of underinvestment in exploration, production, transportation, and refining in the energy sector 2) Development drilling of all our inexpensive reserves 3) Enhanced technological techniques which more rapidly deplete existing production 4) Not replacing the oilfield professionals who are rapidly retiring and taking their vast knowledge with them and finally 5) a lack of any U.S. Energy Policy. I'm sure I forgot many important others, but you get the idea. I believe we can expect continued price volatility as the recognition of higher natural gas prices settles into reality. With the 12 month NYMEX strip already at $6/MMBtu, I think the march toward spot gas pricing at $7 will happen this summer with an $8 target by year's end. Keep in mind that the trend is your friend!

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The Bowers Gas Report

Week ending: 3/26/04

Gas storage for the week ending 3/26/04 was 1014Bcf which was a withdrawal of 18Bcf from the prior week. This compares to the year ago level of 696Bcf and the five year average of 1098Bcf, a difference of +318Bcf and -84Bcf, respectively. While technically there's one week left in the withdrawal season, I believe this week's report will be the trough in storage this year. The only factor to change this would be a freak, early spring cold front which is not likely at this stage. The next few weeks of reports are historically choppy as we transition from the withdrawal season to the injection season. Some gas owners will continue to withdraw gas for awhile since the stored gas is less expensive than current spot priced gas.

Is anybody else wondering why gas futures prices for the shoulder months of April and May is currently higher than average gas prices for the winter months of January, February, and March? Or, have you picked up on the fact that the current twelve month gas futures strip is nearly $6/MMBtu? I believe the market is beginning to understand the gravity of the gas problem. With domestic gas supply shrinking, casing supplies running short, and competition heating up between the industrial users of gas and the LDC's needing to begin the process of storing supply for next winter, the market is sensing that not every mouth is going to be fed under these conditions at last year's prices. That great arbiter of balancing supply with demand called the price mechanism is alive and well and living on the New York Mercantile Exchange.

Crude oil prices are bouncing around like a Superball over the past week as everyone wonders about the impact of OPEC's decision to do what they already decided two month's ago. The reality is that OPEC is jawboning with agreements to cut production when they will not actually be reducing production at all. They do not need to cut production in the face of increasing global oil demand. Over the next few years, as global demand continues rising, <u>all</u> of OPEC's excess production capacity will have been absorbed anyway. The cut agreement is their subtle way to raise oil prices into a higher price level now without announcing what the new price band will be, all of which is a preparatory move to get the world use to higher oil pricing. Just as we no longer have $3 natural gas, we will soon no longer have oil below $30 either.

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The Bowers Gas Report

Week ending: 3/19/04

As nothing of significance happened last week in the gas market while I was out of town during my daughter's spring break, I elected to skip the gas report for the week ending 3/12/04 and will catch up with this week's report.

Gas storage for the week ending 3/19/04 was 1032Bcf which was a withdrawal of 65Bcf from the prior week. This compares to the year ago level of 660Bcf and the five year average of 1124Bcf, a difference of +372Bcf and -92Bcf, respectively. With only two weeks left in the withdrawal season, the trough going into the injection season will be about 1000Bcf. Since recent gas prices are above the cost of gas currently in storage, we may actually see a few more weeks of greater than expected withdrawals as the owners of stored gas utilize the cheaper cost gas to add to this quarter's profits.

Following up on my discussion a month ago regarding "bottlenecks", I want to talk about something which absolutely no one at the beginning of 2004 ever contemplated or even remotely considered as a possibility. What happens to domestic rig count and subsequently domestic natural gas production if those desiring to drill prospects cannot find supplies of casing, regardless of cost, to complete their wells? At present, a mad scramble is going on to lock down casing supplies for this year's drilling programs. Anecdotal evidence suggests that suppliers have little to no casing inventory currently and cannot guarantee delivery for the next two months. Casing suppliers will, however, guarantee delivery later this summer if you pay in advance, but they cannot tell if you will receive your entire order or how much it will cost. Does this sound like a recipe for fewer wells being drilled this year or what? A lot of the scarcity has to do with the escalating cost of steel scrap, iron ore, and coke used to make steel and competition for these limited resources from China. While no one can say for sure how long this scarcity of casing persists, I will go out on a limb and give you my guess as to its eventual impact.

For the past six months, the rig count has danced around the 1100 level. Higher oil and gas prices during that time frame do not seem to be much of a motivational force to push the rig count any higher. At the same time, domestic natural gas production at the end of 2003 is estimated to have declined about 2-3% from the previous year. As you can see, we're not drilling fast enough as it is to maintain gas production. By my estimate, we need about 1400 rigs running simply to remain even. I think by the end of April we will see the rig count start slipping as the casing issue comes to a head and causes producers to delay the drilling of this year's prospects. Even one quarter's slippage in drilling activity will accelerate the decline in year over year gas production toward the 5% level. Eventually, casing supply will return to normal availability, albeit at predictably higher price levels, and drilling plans can resume. This drilling slowdown, however, will place even more strain on already tight natural gas supplies and prices will go higher. I would expect prices to comfortably move over $6/Mcf. Natural gas prices may even de-link from oil pricing given the need to replenish gas storage in time for next winter. During this time, service providers may experience lower activity levels as drilling plans are shelved. If you're a producer with adequate casing supplies, a rising commodity environment and stable to lower services cost will seem the best of all possible worlds.

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The Bowers Gas Report

Week ending: 3/05/04

Gas storage for the week ending 3/5/04 was 1143Bcf which was a withdrawal from the prior week of 28Bcf. This compares to the year ago level of 736Bcf and the five year average of 1246Bcf, a difference of +407Bcf and -103Bcf, respectively. With four weeks left in the withdrawal season, we would need to average a withdrawal of 125Bcf per week to reach the trough level of 2003. Next week's report should show a withdrawal of about 50Bcf as moderately colder weather returned to portions of the Midwest. As we approach the withdrawal trough for this season, we will likely bottom out around 1000Bcf as the impact on storage levels from any possible cold weather diminishes rather quickly. I believe the seasonal competition for gas supplies started this week as market reaction to a low withdrawal was to push natural gas prices up.

Between the gas competition and price support from oil, natural gas pricing through May will remain north of $5/MMBtu and most likely in the $5.50 to $6.00 range. As OPEC oil production cuts take hold over the next few months, oil will be poised to test $40 which will provide further price support to gas enabling us to see greater than $6.00/MMBtu gas. Political rhetoric about tapping the Strategic Petroleum Reserve to bring down gasoline prices will certainly play well in an election year. However, the politicians that count in the Bush Administration know that no long term solution to rising U.S. energy demand can be met by sacrificing our emergency supply. Besides, with the Federal Reserve pumping liquidity into the market which will ultimately raise prices of all goods and services through higher inflationary pressure, oil at $40/Bbl and $2/Gal gasoline prices will seem like a good deal compared to everything else. The reality is and has been that on an inflation adjusted basis, oil pricing should be closer to $80/Bbl. Only through the economic subsidy of the world by the OPEC producing countries have oil prices remained as low as they have been. We are entering an economically difficult period where that global subsidy ends and world oil pricing adjusts to a new reality. In high probability, this adjustment process will only take a temporary stop at $40/Bbl on its way to a new "typical" range of $50-$60/Bbl. For natural gas, this will imply $8-$10/MMBtu. As I have mentioned before, I believe we are in the beginning stages of a shift in investment preference toward real assets instead of financial assets. The holders of financial assets, such as stocks and bonds, will be faced with continual losses and declining asset values as the market slowly and meticulously re-prices their securities because new potential investors will command a greater return on their capital and will expect financial assets as riskier to hold. This entire process will be extremely gut-wrenching on people's retirement plans and investment portfolios. The sooner these investors adjust their thinking to the new reality, the less a shock they will incur. If I am correct in assessing this shift, the primary beneficiaries will be commodity-based investments in mining, oil & gas, timber, and real estate

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The Bowers Gas Report

Week ending: 2/27/04

Gas storage for the week ending 2/27/04 was 1171Bcf which was a withdrawal of 96Bcf from the prior week. This compares to the year ago level of 838Bcf and the five year average of 1320Bcf, a difference of +333Bcf and -149Bcf, respectively. With five weeks left in the withdrawal season, we would need to average 106Bcf per week to reach the trough storage level of 2003. Because of warmer than normal conditions across the country, next week's report will show a low withdrawal in the 20 to 40Bcf range.

The hot topic this week appears to be the escalating cost of steel casing. It seems that the price for various grades of casing, both new and used, has shot up over 50% in the last three weeks alone and that current supplies are at low levels. In economic terms, what we see happening with steel casing is a materials "bottleneck". A bottleneck occurs whenever demand for goods exceeds available supply and the provision of future supply is constrained because of a shortage of a needed ingredient in the manufacturing process or in the ability for the manufacturer to deliver their goods. As for steel casing, several bottlenecks have occurred to create the problem. The leading cause of many recent raw material bottlenecks has been the rapid development and growth of China. The Chinese are attempting to maintain their rapid growth through the development of their industrial base and become the low-cost provider of goods to the world. To increase their industrial base, you need more factories. To build factories, you need steel and other building materials. This increased demand for raw building materials has in turn absorbed the world's supply of most raw commodities, but primarily demonstrated in base metals such as lead, iron, copper, and zinc. Demand in excess of supply has driven prices up for everyone around the world. Because China has increased its demand for raw material, the ability to ship goods has also been impacted. Transportation rates for cargo ships have soared as ship availability is diverted to deliver China's purchases. We are now seeing the effects of rising costs for goods being passing down the line to the end user. The price level of some primary ingredients in steel, iron ore and coke is now being passed down the manufacturing chain to finished goods such as steel casing. If the casing comes from one of several foreign manufacturers in China, India, Brazil, or Russia, there's also cost added for the rising shipping charges. Although the world has plenty of manufacturing capacity to build whatever is needed, the shift in material demand has caused havoc with prices which will take awhile to smooth out.

Bringing this situation closer to home, I believe we will see more bottlenecks occurring in the energy sector. A very apparent bottleneck and frequently discussed topic is the professional personnel needed to find, develop, and deliver hydrocarbons. These people are quickly approaching retirement with an insufficient number of qualified replacements coming behind them. As already inferred, if insufficient supplies of casing hinder the ability to drill natural gas wells, the already shrinking domestic supply of gas will fall even faster. No one has yet considered what a shortage of steel would do to the construction and cost of the vast fleet of LNG vessels necessary to deliver foreign gas supplies to the U.S. You think maybe the breakeven price point between U.S versus foreign gas might go up considerably because of this single issue? We had better get use to these problems caused by bottlenecks. Shortages in the supply of natural gas or other energy sources could very well be the bottleneck which changes the costs of goods to the U.S. consumer.

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The Bowers Gas Report

Week ending: 2/20/04

Gas storage for the week ending 2/20/04 was 1267Bcf which was a withdrawal of 164Bcf from the previous week. This compares to the year ago level of 1014Bcf and the five year average of 1430Bcf, a difference of +253Bcf and -163Bcf, respectively. With six weeks left in the withdrawal season, we would need to average 104Bcf per week to reach the trough level of 2003. The expected withdrawal for next week's report should be about 100Bcf.

We will likely finish the gas withdrawal season with about 900Bcf in storage. At that level we would have withdrawn about 2300Bcf from the time of peak storage in November 2003 which is about the expected withdrawal amount for a normal winter season. Once again, we will have escaped deliverability problems by the luck of the draw. However, my sense is that we are rapidly running out of long straws and will be soon holding a fist full of short straws. Just this week, I saw an industry gas production survey which showed that the quantity of gas produced for 2003 was 2% less than the quantity of gas produced for 2002. The sampling represented about 60% of the U.S. producers and was adjusted for mergers and acquisitions. The remainder of the sampling not included was primarily small "mom and pop" producers. Simple logic would tell you that while this group likely increased their cash flow from higher commodity pricing, they lack the necessary access to financial capital to expand beyond their area of local expertise. While the extra cash flow generated for this group allows them to more quickly develop their field, as a collective group their increased production will ultimately be insufficient for the country as they too become prospect poor. I am lead to only one conclusion from this information. At a price level of $5/MMBtu, there are insufficient prospects and/or capital to maintain, not to mention increase, U.S. domestic gas supply. Maybe when the normal price for gas is $6 or $7/MMBtu there will economic prospects to go after. But I'm afraid that by the time we reach those price levels, we will already be on the "hamster wheel" through increased drilling efforts, needing to drill faster and faster, simply to stay even with gas production. The end game in my scenario involves gas prices rising ever higher until LNG infrastructure is in place to meet the marginal demand through the import of cheaper foreign supply. With the bureaucratic way in which these projects get approved, let's hope the country can hang on that long!

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The Bowers Gas Report

Week ending: 2/13/04

Gas storage for the week ending 2/13/04 was 1431Bcf which was a withdrawal of 172Bcf over the prior week. This compares to the year ago level of 1168Bcf and the five year average of 1526Bcf, a difference of +263Bcf and -95Bcf, respectively. With seven weeks left to go in the withdrawal season, we would need to average 113Bcf per week to reach the trough level of 2003. The expected withdrawal for next week's report should be above 150Bcf.

Even with a cold March we are destined to have ample gas supply to make it through the winter of '03-'04, but at what cost to future deliverability? How long can the energy industry expect to scrape by on mild summer and winter weather? The fundamental belief still exists that regardless of where we are at the end of any winter, ample gas supply will still be available for injection purposes in time for the next winter need. I can already estimate that the range of gas supply needed for injection into storage by November 1, 2004 will be 2300-2500Bcf which is about the same range needed over the last few years. One key economic difference exists now that hasn't been around in the last few years, that being an improving and growing U.S. economy.

In just two months time, the battle for constrained gas supply will be waged between the gas storers who will be preparing for next winter and the gas users who will be feeding the increasing energy demand from an economic rebound. Even during a soft economy, this battle for shrinking gas supply has eliminated the price dips we use to experience during the shoulder months of April and May. I pose the simple question of what happens now that the demand side of the equation is increasing while the gas supply continues to decrease. To get our answer, we look no further than our old Econ 101 books at those confusing supply/demand curves. For a fairly elastic commodity like natural gas, if demand is static and supply decreases, then the equilibrium price of gas goes up. If supply is static and demand increases, then the equilibrium price of gas also goes up. With both demand increasing and supply decreasing, the equilibrium price level goes up even more. Over the last few years as supply moved from increasing levels to decreasing levels, we've seen the price trend move from $4/Mcf to over $5/Mcf. The energy industry's response to higher prices was an attempt to raise supply as demonstrated in the climbing rig count from around the 900 level to the present 1100 level. The result has been abysmal as depletion of fields accelerates, developmental prospects are used up, and the experienced industry personnel needed to make it all happen age and retire. By my presumption, it will be the increase in demand for gas which will drive pricing to the next equilibrium point above $6/Mcf on its way to $7/Mcf. Only under the conditions of a weakening economy with resulting reduced gas demand would prices stay at present levels. A weakening economic condition could easily be induced by the Federal Reserve at some point, but as I previously discussed, I think the Fed will err on the side of inflating our way out of problems as the least painful path for the country. With the prospects for domestic supply increases constrained by personnel issues, gas supplies will only be increased through the future delivery of LNG. Arguably, the supply side of the equation will not see a material increase for at least another five years. When it comes to the matter of significantly higher gas pricing, it's not a matter of if, but just when.

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The Bowers Gas Report

Week ending: 2/06/04

Gas storage for the week ending 2/06/04 was 1603Bcf which was a withdrawal of 224Bcf from the previous week. This compares to the year ago level of 1371Bcf and the five year average of 1641Bcf, a difference of +232Bcf and -38Bcf, respectively. With 8 weeks left in the withdrawal season, we would need to average 120Bcf per week to reach the trough level of 2003. Of significance this week is the fact that we've now fallen under the five year average to a magnitude that we haven't seen since early last October. This would indicate that we are rapidly consuming much of the extra gas injected into storage from the mild summer last year. With next week's withdrawal expected to be near 200Bcf and more arctic fronts on the way, we are very likely to finish February with only 1000Bcf in storage and five withdrawal weeks left. Only normal weather in March will cause us to reach the lower end of my expected trough range of 800-1000Bcf. If colder than normal weather takes hold in March, then we will easily surpass last year's trough level.

Sometimes in forecasting, or as I like to call it wild-a-- prognostication, you get lucky and hit the nail on the head. In last week's report I expected OPEC to announce a production cut of 1 to 2 million Bbls per day either this month or by the March meeting. The actual announcement this week has the OPEC producers reducing 1.5 million Bbls per day of "cheating" production immediately and an additional 1.0 million Bbls per day below official quotas by April 1. While OPEC as a collective body has been highly disciplined in the last few years, various members like to and will cheat to the extent that they have extra production capability. I expect only the 1.5 million Bbls per day will be removed from the market which will bring production back to the current "official" quota of 24.5 million Bbls per day. All of this is simply posturing by the OPEC producers to hold oil prices over $30 as additional compensation for lost purchasing power because of a declining U.S. dollar. However, with a rebounding U.S. economy, low inventories across much of the energy complex, and very tight global shipping capability for all commodities, we could be witnessing the early stages of a springboard effect which takes oil prices above $40 on a long-term sustained basis.

With the rig count still hovering around 1100, declining U.S. natural gas production, and economical development prospects running short, I'm predicting that by summertime natural gas pricing will be in the $7-$8 per MMBtu range and will remain there for a sustained period. This forecast (read as wild-a-- prognostication) is based upon strong support from the oil side as well as the need to replenish storage in time for winter '04-'05. I firmly believe that sustained higher gas pricing is necessary to establish the next stage of exploratory drilling in the U.S. While many available prospects are uneconomic at $4-$5 pricing, they suddenly become very economic at $7-$8. However, these risk dollars will not begin to show up until the energy industry also believes in the sustainability of higher pricing. Given the normal budgeting cycle, I would look for a drilling boom to emerge in early 2005 as everyone and his brother decides they need a gas well. Drilling for oil & gas will no longer be risky, but fashionable! Does anyone remember the Western Company's advertising on television in the 70's saying "If you don't have an oil well, get one!"? As a youngster growing up in Fort Worth, Texas, this commercial was very impressionable and certainly made me want to have an oil well. This time it will be "If you don't have a gas well, get one!" Where's Eddie Chiles when you need him. I also look for the Federal Reserve to begin raising interest rates after the Presidential election which will put downward pressure on most sectors of the stock market as well as the bond market. Wall Street's attention will be shifting favorably toward energy as higher pricing encourages those with money to move it where they think it has a chance to make more money. As an energy-dependent country realizes it has a major problem on its hands, capital will already be responding and a decade-long focus on energy will have begun.

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The Bowers Gas Report

Week ending: 1/30/04

Gas storage for the week ending 1/30/03 was 1827Bcf which was a withdrawal of 236Bcf from the prior week. This compares to the year ago level of 1521Bcf and the five year average of 1767Bcf, a difference of +306Bcf and +60Bcf, respectively. With nine weeks remaining in the withdrawal season, we would need to average a withdrawal of 132Bcf per week to reach the trough in 2003's gas storage.

Gas pricing after this week's EIA storage report took an interesting turn which speaks volumes about the insane world in which gas traders live. Market expectations for storage this week were for a withdrawal of about 210Bcf. After finding out that actual withdrawal was significantly greater than expected, gas traders on the NYMEX decided that gas prices should be $0.25 per MMBtu **lower** because "this would likely be the worst withdrawal number that we would see this season". I want someone to explain to me where this justification for lower prices makes any rational sense. Of course, I'm baiting myself because everyone firmly realizes that gas traders like most of their breed of speculators have no use for rational behavior. Suffice it to say, another deep freeze arctic event similar to a few weeks ago that settles this time on top of Chicago will change their tune on a dime. Nine weeks of winter feasibly has potential for many large withdrawal events before finally reaching a trough in early April. By my expectations, only average winter weather conditions here on out will prevent us from incurring a deliverability problem before spring.

In the oil market, all eyes are on OPEC regarding will they or will they not cut production at their next meeting. As I have mentioned many weeks ago now, I think the OPEC surprise factor will be justification for a higher price band, I'm guessing $28-$36, than currently adopted. OPEC producers want and desire the higher price band to offset the lower purchasing power experienced from U.S. dollar weakness. They can accomplish the higher price band in several ways. 1) They could simply announce a new price band. 2) They could start selling oil in a stronger currency such as the Euro. Or, 3) They can remove oil from the market. 1) & 2) would be difficult to accomplish politically, so naturally they will lean toward 3). Statement posturing has already occurred about excess supply in the market later in the year. I will not be surprised to see an announcement either at this meeting or in March to remove 1to 2 million barrels per day of OPEC supply from the market. Continued U.S. dollar weakness throughout the year will only exert more pressure on the OPEC producers to deliver a response.

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The Bowers Gas Report

Week ending: 1/23/04

Gas storage for the week ending 1/23/04 was 2063Bcf which was a withdrawal from storage of 195Bcf. This compares to the year ago level of 1729Bcf and the five year average of 1900Bcf, a difference of +334Bcf and +163Bcf, respectively. With ten weeks left in the withdrawal season, we would have to average a withdrawal of 142Bcf per week to reach 2003's trough in gas storage.

The market is currently anticipating sufficient gas in storage to finish out the winter without any deliverability issues. Gas pricing would likely be significantly weaker if not for the ties to oil pricing. We should all hope that this tie to oil continues. With U.S. crude supplies at 30 year lows, any true growth in the U.S. economy will be pushing crude prices toward $40/Bbl and will be dragging gas prices along for the ride. Premium pricing for gas from short supply would imply an $8.00 price level. This price level will be necessary to offset rapidly rising service and material cost increases being experienced in the field. Anybody priced casing lately?

Due to rapid growth in the Chinese economy, the appetite for commodities to sustain their industrial growth is proving to be insatiable. This Chinese demand for iron ore, coke, copper, etc. is putting pressure on price levels of all commodities not to mention energy supplies. In the history of mankind, no economy has been able to achieve industrial status without access to energy supply. The Chinese will be no different. By the end of this year, the price increases from worldwide demand for commodities will be rolling through the cost of everything. We haven't seen the inflationary effects so far because of excess capacity in many sectors of the U.S. economy and the inability of manufacturers to make the price increases stick. A growing U.S. economy will quickly absorb excess capacity and enable companies to pass through price increases. This course of events has not been by accident.

After the last recession, the Federal Reserve concluded that the U.S. economy could not grow normally due to "debt strangulation" effects from record high debt loads on the part of consumers, businesses, and government. Economies experiencing "debt strangulation" have to either pay down the debt, have their lenders write off the debt, or monetize the debt. I believe the Fed decided that to pay down the debt or have the debt written off would have been too painful for our economy to bear. Under either of these scenarios, the economy would have had to liquidate assets of all types to reach normalized levels. Such asset liquidation would have pummeled the stock, bond, real estate, and commodity markets. Believe me when I say that under either scenario it would not have been a pretty sight. The least painful choice for the Fed was to allow the debt to be monetized. This simply means that they were going to allow higher levels of inflation to ease the pain of repaying the debt. They accomplish this by allowing monetary growth through maintaining low interest rates. Very low short rates have already been in place for a year with very little economic benefit showing up. This speaks to some of the side effects of an economy under "debt strangulation" where things do not work economically as normally expected. However, by keeping the money spigot wide open, the Fed will ultimately achieve the higher inflation which it seeks. One has to now wonder what all of this gobbledygook mumble jumble talk about economics has to do with oil and gas. I am of the belief that all of this is creating a shift for investors where "real assets" will be the investing area of choice compared with "financial assets". For over twenty something years, investors benefitted more from investments in financial assets such as stocks and bonds rather than "real assets" such as commodities or real estate. If I am correct in assessing this shift, then more investor focus, and more importantly their money, will move toward the oil and gas sector with higher valuations as a result. The length of time were "real assets" are in favor could last well over a decade.

Danny J. Bowers, Jr. is currently President of Bowers Investment Group, LLC, a Houston based investment consulting firm offering services to institutional investors and high-net worth individuals. He has had over fifteen years of diversified investment and asset management experience. His interest in the energy market extends back to 1988 when he first became a working interest owner of properties in East Texas.

Mr. Bowers was previously the Chief Investment Officer for the Houston Firefighters' Relief and Retirement Fund, a public fund in Houston, Texas. Prior to his ten years with the Firefighters', Mr. Bowers also obtained ten years of broad experience in engineering, finance, and pension management with TXU Corporation, a public utility in Dallas, Texas.

Mr. Bowers received his Bachelor of Science degree in Engineering from Texas A&M University and his Master of Business Administration from Southern Methodist University.

The Bowers Gas Report

Week ending: 1/16/04

Gas storage for the week ending 1/16/04 was 2258Bcf which was a reduction from the prior week of 156Bcf. This compares to the prior year ago level of 1976Bcf and the five year average of 2065Bcf, a difference of +282Bcf and +193Bcf, respectively. With eleven weeks left in the withdrawal season, gas in storage appears to be sufficient to meet demand for the winter of '03/'04.

However, some quirky effects are showing up in the latest storage numbers. The heating degree days for the last two weeks justify greater levels of withdrawal than showed up in the numbers. This can only be explained by greater levels of domestic gas production than recently experienced, which doesn't fit with industry information. This aberration in the storage numbers could possibly be explained by the EIA's modeling of storage levels which would incorporate reported storage levels and adjustments from expected growth in gas production for 2004. If the EIA is missing the boat by incorrectly anticipating higher 2004 gas production and rolling the adjustment into storage levels, then this causes lower confidence in the reported gas storage figures in my mind. My theory would be completely blown out of the water if indeed domestic gas production has turned the corner and is now increasing relative to demand. Time will tell.

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