

## The Bowers Gas Report

Week ending: 12/30/05

Gas storage for the week ending 12/30/05 was 2641Bcf which was an **INJECTION** of 1Bcf over the prior week. This compares to the year ago level of 2720Bcf and the five year average of 2473Bcf, a difference of -79Bcf and +168Bcf, respectively. With 13 weeks remaining in the withdrawal season, we need to withdraw less than 146Bcf per week to remain above the danger zone. Another follow-on week of mild temperatures should cause next week's report to show a minimal withdrawal of about 30Bcf.

For the first time since gas storage was reported from the Energy Information Administration (EIA) we have seen an injection into storage rather than a withdrawal during the last week of December. While there's some speculation that this could be another erroneously reported number from the EIA, it is likely to be correct. Didn't anyone else notice how extremely warm everywhere was right after Christmas? Just like early November when they thought winter would never start, thus causing natural gas prices to plunge, the energy markets are thinking that winter must surely be over, as reflected in another precipitous price fall in natural gas since mid-December. However, after next week's weak withdrawal, there will still be 12 weeks remaining in the traditional winter withdrawal season with plenty of time for multiple Arctic fronts to increase consumption levels. I'm confident that winter will eventually show itself and would bet accordingly that natural gas will once again rise. Anyway, these gyrations are making me dizzy! I did see some anecdotal evidence that some hedge funds were taking advantage of the price drop and available space in gas storage facilities. They essentially were buying cheap December gas, injecting into storage (thus the likely cause of this week's net injection), with the expectation of selling at higher prices sometime in February or March. Is it a wonder to anyone that price volatility would increase if gas purchases and sells have shifted from the hands of the traditional players, being the utilities and LDC's, and toward the financial speculators? If much more of this type of activity continues, I'll offer up the following prediction. At some point the speculators will get their head handed to them on a silver platter and natural gas prices become even more volatile for a period of time until more rational purchasing behavior exerts itself.

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## The Bowers Gas Report

Week ending: 12/23/05

Gas storage for the week ending 12/23/05 was 2640Bcf which was a withdrawal of 162Bcf over the prior week. This compares to the year ago level of 2874Bcf and the five year average of 2607Bcf, a difference of -234Bcf and +33Bcf, respectively. With 14 weeks remaining in the withdrawal season, we need to withdraw less than 136Bcf per week to remain above the danger zone. As near record warm temperatures were experienced across much of the country over the past week, the withdrawal amount next week should be no more than 30Bcf as the need to withdraw gas from storage was minimal.

What a year we saw in the energy market! For all of 2005, we saw crude oil prices climb about 40% from the end of 2004 and most spectacularly, we saw natural gas prices climb almost 80% for the year. With such significant commodity price movement occurring in one year's time, most analysts are expecting lower prices for 2006, something like \$50/Bbl oil and \$8/MMBtu natural gas. I will strongly contend, however, that these are the same analysts who have been expecting lower energy prices for three years now and who have yet to comprehend the change in energy market dynamics currently in place. They have failed to recognize that U.S. natural gas production has declined for a fourth consecutive year. They fail to understand that the GOM which provides 1/4<sup>th</sup> of the nation's gas supply, currently has 1/4<sup>th</sup> fewer rigs drilling in the basin than a year ago, and depletes at a rate of 30% will pose a major gas deliverability problem for years to come. They continue to misunderstand that higher energy prices have yet to cause widespread demand destruction in the U.S. and the rest of the world. They fail to grasp that quite the opposite is happening with emerging market countries increasing their demand for energy as they attempt to grow their economies. Most importantly, these analysts lean on the misguided belief that energy supplies will materialize out of thin air while the energy industry re-invests at a below necessary rate to replace consumed reserves. For these reasons, I contend that these analysts are dead wrong and that the trend for higher energy prices is very much intact as we begin a new year. I look for oil to hit \$80/Bbl sometime in 2006 with natural gas reaching a level of \$16/MMBtu. This forecast would represent spike levels with the averages for the year likely to be \$70/Bbl and \$14/MMBtu. While slightly higher than my 2006 forecast made about a month ago, my convictions tell me that the trend is my friend and that I shouldn't overtly knock back my numbers because of the naysayers who couldn't recognize a trend if it bit them in the nether regions.

While my passion is the energy market, as an investment consultant, I also look at all other investments. I continue to believe that we are early in the "real asset" cycle which places preference on things such as precious metals, selective real property, and energy assets over financial assets such as stocks and bonds. Historically, when these cycles have crossed over, they tend to last for several years with the latest crossover occurring in 2000 and likely to remain in favor through 2015. Another belief of mine is that non-US assets will perform better than US assets for the next several years as the probability of US dollar weakness occurring during this time frame is very high. Non-US assets tend to appreciate during times of dollar weakness as it takes more dollars to purchase foreign assets than it previously did. I also think that the US economy will be faced with higher interest rates and higher inflation as the Federal Reserve attempts to use one to contain the other.

With the start of a new year, those of you with retirement assets heavily weighted toward financial assets may want to take the opportunity to reassess your strategies. To remain with the strategies that performed so very well in the 90's could prove hazardous to your wealth.

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## The Bowers Gas Report

Week ending: 12/16/05

Gas storage for the week ending 12/16/05 was 2802Bcf which was a withdrawal of 162Bcf over the prior week. This compares to the year ago level of 3045Bcf and the five year average of 2738Bcf, a difference of -243Bcf and +64Bcf, respectively. Over the remaining fifteen weeks, I will provide you a gauge of the withdrawal rate as it moves toward an end of withdrawal season trough. In last week's report I suggested that a normal winter event this year should take us to 740Bcf by the end of March, so this is the benchmark which I have chosen for the trough. Anything below this level, which I will call the "danger zone", puts the storage system at serious risk of insufficient gas supplies for portions of the country. For example, with 15 weeks remaining in the withdrawal season, we need to withdraw less than 137Bcf per week to remain above the danger zone. The withdrawal amount next week should again be about 150Bcf as the prior arctic blast carried over into the early part of the reporting week.

If everyone hasn't noticed, we are experiencing extreme price volatility for natural gas in both the futures and the cash delivery markets over the past month. This is to be expected for a commodity delivered on a just-in-time basis. During the winter months, when it's cold the market will pay more for spot market natural gas because of its ability to provide heat where demand is highest. Conversely, when things warm up during the winter, then demand for spot market natural gas softens with a commensurate lowering of pricing. However, for natural gas, there is a presumption that gas supplies will always be there, if and when needed. This could very well be a faulty assumption given the scarcity nature of natural gas supplies. Of course, the purpose of gas storage is to assist in providing gas supplies during high demand periods. As the demands on storage increase over time, however, this may not be a completely fail safe mechanism to prevent deliverability problems from occurring. Another factor coming into play with natural gas price volatility is the Law of Large Numbers. A 10% price move when natural gas is \$10/MMBtu represents a full \$1.00/MMBtu; however, the same percentage move when natural gas was \$3.00/MMBtu is only 30 cents/MMBtu. As the numbers grow larger, the price volatility seems more significant because changes represent larger amounts. We'll just have to get use to this one because I do not see us moving back to small price numbers for natural gas ever!

I've seen estimates for global oil demand in 2006 that are about 85 million barrels/day which I think is reasonably accurate. However, current global oil production is only about 84 million barrels/day, at best. This trend can only last for so long before oil in storage is depleted to minimum required levels from covering the production shortfall. The oil market has failed to recognize this conundrum thus far and seems to expect new supplies to make up the difference. Based upon this information, we will again be walking the razor's edge in 2006 when it comes to adequate oil supplies. I see two areas which I believe will be the cause of higher oil pricing next year. The first is China. We've already seen the price impact over the past two years caused by greater Chinese oil demand. This trend will continue all the way through 2008, commensurate with the Beijing Olympic Games, only because the Chinese will see to it that the world observes a highly modern and industrial China when it hits center stage during the Games. To accomplish this feat requires continued, greater oil consumption. The other area which I believe will drive oil prices higher in 2006 is Venezuela. The oil production capability of Venezuela is rapidly declining as Chavez cannibalizes existing oil fields in a scramble to maintain production revenues to keep the country afloat. Inadequately trained oil field personnel cannot possibly keep the ship upright at the current pace. In fact, Chavez may be permanently damaging his oil reservoirs by pumping too hard on the existing wells. I think we are seeing a signal of the Venezuelan government's desperation as recent information is leaked out that new production taxes on foreign-owned reserves may be increased from 30% currently to a new rate of 50%. This new level of taxation will ultimately cause foreign oil investors to seek opportunities elsewhere as these investor's properties are slowly, but steadily nationalized through the taxation process.

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## The Bowers Gas Report

Week ending: 12/09/05

Gas storage for the week ending 12/09/05 was 2964Bcf which was a withdrawal of 202Bcf over the prior week. This compares to the year ago level of 3159Bcf and the five year average of 2857Bcf, a difference of -195Bcf and +107Bcf, respectively. As of this writing, we still have about 3Bcf/day of shut-in gas from the GOM and onshore Louisiana, combined. Losses to-date from Hurricanes Katrina and Rita total almost 102 million barrels of oil and 526Bcf of natural gas. Next week's withdrawal will be close to 150Bcf as the arctic blast which started last week continues to put the Midwest and Northeast portions of the country in the deep freeze.

After next week's storage report, we will have exactly fifteen weeks of withdrawals remaining until the start of the next injection season. While we had a slow start to withdrawals in November because of record warm days across most of the country, the signs are pointing to a colder than normal winter now. At this stage of winter, I can begin forecasting end of withdrawal season gas storage levels based upon gas consumption patterns which vary by the severity of the weather. My starting point is next week's storage report which will be about 2800Bcf remaining in storage. Under mild winter conditions the next fifteen weeks would consume an additional 1400Bcf of gas. A normal winter would consume 1850Bcf of gas over the same time period, while a severe winter would command an additional 2300Bcf. However, this winter we have to consider the additional demand on storage from the shut-in gas in the GOM and on-shore Louisiana. Assuming an average of 2Bcf/day will continue to be shut-in over the next fifteen weeks, I can estimate that the extra demand on storage equates to 210Bcf. My estimates show that a mild winter should leave about 1190Bcf in storage at the end of March. A normal winter would leave 740Bcf remaining and a severe winter would leave 290Bcf at the end of the injection season. Anything worse than a normal winter by my estimates will be severely testing the storage system and will cause extreme price volatility as winter's end nears. Regardless, the significant pull on storage levels, regardless of which type of winter unfolds holds very well for strong double digit natural gas prices in 2006.

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## The Bowers Gas Report

Week ending: 12/02/05

Gas storage for the week ending 12/02/05 was 3166Bcf which was a withdrawal of 59Bcf over the prior week. This compares to the year ago level of 3224Bcf and the five year average of 2961Bcf, a difference of -58Bcf and +205Bcf, respectively. As of this writing, we still have about 3Bcf/day of shut-in gas from the GOM plus another 1Bcf/day located onshore Louisiana. Losses to-date from Hurricanes Katrina and Rita total almost 100 million barrels of oil and 500Bcf of natural gas. I expect withdrawals to accelerate as severe cold weather grips the Midwest over the next two weeks. In fact, next week's withdrawal will be close to 200Bcf as the arctic front sweeps across most of the country and provides us a hint as to the impact on gas storage from an extended period of shut-in GOM gas production.

First of all, my apologies to my readers for having gone an extended number of weeks without providing my comments on the energy market. Sometimes I find myself having to prioritize between personal activities and business responsibilities. Other times I struggle to provide you an interesting commentary which doesn't seem to repeat itself week to week. The point is that while I always attempt to report on a weekly basis, sometimes it's simply not possible and until a gun is pointed at my head to do so, I'll keep writing as my abilities dictate. I do find it very beneficial though to pause, sit back, and observe the gyrations of the energy market through the passage of time which tends to eliminate a vast amount of market noise and provide a clearer picture in my mind as to the direction that I believe we are heading.

All year long I've been hanging my hat on a prediction of \$10/MMBtu gas and now the market is trying to push through \$15. The realities of a winter with insufficient supplies of gas in storage are showing its true colors as those in need of gas supplies are forced to pay up. I would agree that there's an element of speculation in current pricing. However, whenever considering the facts of declining U.S. gas production, continued shut-in of hurricane affected supplies, delayed LNG infrastructure, insufficient drilling rates, and inability to switch to alternative fuel sources, should we not be wondering if natural gas could go higher? At some point higher energy pricing will slow the U.S. economy and reduce the demand pressure on gas. Many analysts have expected reduced demand to show up from current pricing, but it still hasn't happened. The simple reason for demand not reducing is because of the ability of end users to absorb the higher costs, whether they're consumers or businesses. Businesses, particularly, are discovering the ability to pass through the higher cost of energy in their final costs. This is a leading reason for the rise in inflation over the last few years. With continued support from crude oil, I believe double digit gas will be with us for many years. I further expect because of scarcity reasons that natural gas will also trade at a BTU premium to crude oil at a ratio of less than 6 to 1 over the same time frame. My forecast for gas pricing in 2006 is for a range of \$10 to \$15/MMBtu and an average price of \$12/MMBtu.

It has been awhile since I mentioned anything about crude oil. That is because it has been surprisingly quiet other than OPEC stating that they see no reason to cut production in the 4<sup>th</sup> quarter. That's a mighty bold statement given that the quarter is nearly over. I think the oil suppliers have decided that the best way to contain pricing is by remaining silent, keeping their fingers crossed hoping that the world makes it through this winter with current oil production, and that somehow oil demand goes down before everyone discovers the inadequacy of global supplies. However, here comes another year in the form of 2006 and another increase in global oil demand by about 1.5 million Bbls/day. This year I predicted that we crossed the point where oil demand exceeded oil supply. This new increase will cause demand to exceed supply by roughly 2 million Bbls/day for all of 2006. Any minor disruptions in 2006 will see price spikes toward \$80/Bbl, but I think the range will more likely be \$60 to \$70/Bbl and an average price level of \$65/Bbl.

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## The Bowers Gas Report

Week ending: 11/11/05

Gas storage for the week ending 11/11/05 was 3282Bcf which was an injection of 53Bcf over the prior week. This compares to the year ago level of 3322Bcf and the five year average of 3103Bcf, a difference of -40Bcf and +179Bcf, respectively. This week's injection represents the peak of the gas storage level for this injection season. We actually injected gas into storage for one week more than expected due to unseasonably warm weather across much of the country. With the nation's first cold spell upon us this week and an Arctic front coming next week, I expect the rate of withdrawals from storage to pick up substantially as about 5Bcf/day of gas continues to be shut-in from onshore Louisiana and the GOM.

While many observers and pundits of the energy market want to believe that the price weakness experienced in crude oil and natural gas over the last several weeks is due to falling demand for these commodities, I feel an urgent need to set the record straight. With almost ninety million barrels of crude oil production and 450Bcf of natural gas production lost due to Hurricanes Katrina and Rita to date, our country's energy needs have only been met through significant releases of crude oil from the Strategic Petroleum Reserve and the emergency importation of refined products from foreign stockpiles. These two events have already caused energy prices to drop to pre-hurricane levels and have simply addressed short-term energy supply problems without dealing with our longer-term fundamental energy supply need. Most certainly, this effort has assisted in providing repair time to the damaged refineries along the Gulf of Mexico, but more importantly, when SPR releases are halted and European shipments of gasoline and diesel are discontinued, we will face the same set of circumstances that we faced previously. To make matters worse, while the high energy product prices in the post-hurricane period would have started to reduce demand for energy, the artificial energy supply efforts resulting in reduced prices have likely re-stimulated demand for these products to an even higher level than before. We haven't avoided the inevitability of higher oil prices, but have simply delayed it.

As for natural gas, infrastructure bottlenecks along the Gulf Coast have prevented the free flow of gas during the recent abnormal warm period. High levels of gas in storage combined with these bottlenecks have caused a huge price disparity between the price of natural gas on the futures exchange and the price of physically delivered gas along the Gulf Coast. The price spread has reached almost \$4/MMBtu and will certainly represent the cause of much consternation between gas producers, gas marketers, and pipelines if not resolved soon. The delay in winter weather has not helped the situation, but help may be on the way shortly as the first true Arctic blast of the season comes screaming through the Midwest this coming week. The irony to this discrepancy in pricing is that nothing has been done to artificially reduce prices like in the case of oil and refined products. In fact, my projections from the current shut-in data show that the production problems in the GOM and onshore Louisiana are being resolved at a substantially slower pace than I projected a month ago. When the last amount of shut-in production finally comes back on-line, the total lost production could be as much as 150 million barrels of oil and 900Bcf of natural gas. So far, I haven't seen anyone else's projections this high, but then again no one else is projecting the time to recover pre-hurricane production levels all the way into 2007. My current forecast bodes very well for double digit natural gas prices for all of 2006.

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## The Bowers Gas Report

Week ending: 10/28/05

Gas storage for the week ending 10/28/05 was 3168Bcf which was an injection of 29Bcf over the prior week. This compares to the year ago level of 3287Bcf and the five year average of 3089Bcf, a difference of -119Bcf and +79Bcf, respectively. With 1 week remaining in the injection season, we need to average an injection rate of 232Bcf per week to reach full storage levels by November 4, 2005. As for next week's report, the expected last week of the injection season, the injection should again be no more than about 30Bcf as gas storers are about to start reversing the process with withdrawals.

Interesting things happen in the natural gas market whenever we reach the transition period between injections and withdrawals. During this brief time interval, every trader becomes hypersensitive to the weather forecasts and keeps a keen eye on the storage levels. However, a funny thing about traders is their propensity to interpret information in the same way that they've always done things. My case in point is the trader's reaction and the subsequent change in futures prices over the past week. Traders have basically looked at the ten day weather forecast across the U.S. and have concluded that winter is delayed. They take this bit of information and combine it with an expected full storage level of 3200Bcf at the end of the injection season and extrapolate a line of thinking that says "since gas storage is full, this warm weather will mean less gas consumption, therefore the market needs less gas, so we're going to sell gas down by \$2/MMbtu." I look at the same information and see two big problems that shoot holes in their line of reasoning. First of all, since when has anyone known a weather forecast to be completely accurate for one day out, not to mention for ten days? Secondly, I'm of the belief and conviction that full gas storage for the U.S. is currently about 3400Bcf and not the formerly stated amount of 3200Bcf. The 3200Bcf level is the historical storage number and does not take into consideration newly constructed storage facilities completed over the past few years. In addition, with increased U.S. gas demand the storage level necessary to meet the ongoing seasonal needs is also increased. Therefore, my conclusion is that we're actually 200Bcf short at the end of the injection season, and while I'm no weatherman, I firmly believe that it's eventually going to get cold whenever winter decides to make its arrival. If I take my information of being short gas in storage, and combine it with the well known fact of shut-in gas amounting to 6Bcf/day currently, 5Bcf/day in GOM and 1Bcf/day from onshore Louisiana, that is unable to contribute toward existing gas consumption, and finally add in the bit about winter being here soon, I believe I'd be a little more worried about natural gas prices not blowing through the teens and into the \$20/MMBtu plus level sometime this winter. Stay tuned! It's going to be very interesting from now until the end of the withdrawal season.

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## The Bowers Gas Report

Week ending: 10/21/05

Gas storage for the week ending 10/21/05 was 3139Bcf which was an injection of 77Bcf over the prior week. This compares to the year ago level of 3245Bcf and the five year average of 3054Bcf, a difference of -106Bcf and +85Bcf, respectively. With 2 weeks remaining in the injection season, we need to average an injection rate of 131Bcf per week to reach full storage levels by November 4, 2005. As for next week's report, cooler weather in parts of the country will cause gas storage to increase by no more than 30Bcf.

As I mentioned at the beginning of the injection season, I have defined full gas storage at a level of 3400Bcf due to increases in the amount of recently constructed storage space as well as recognition of greater demands on gas in storage. Many in the energy industry have failed to recognize these changes and continue to rely upon a historic level of 3200Bcf as a perception of full gas storage. This misperception of what constitutes full gas storage could be severely tested this winter as current GOM shut-ins will undoubtedly cause weekly withdrawals to be greater than past comparable periods. While this week's storage injection may seem higher than normal, it is simply because the local distribution companies, by attempting to fulfill their role of providing adequate gas supplies, have become the marginal buyer of gas, squeezing out other industrial customers, and are currently scrambling to meet storage goals ahead of the first required withdrawal, a mere two weeks away.

The projected lost gas production from Hurricanes Katrina and Rita through the end of October is about 380Bcf. The lost oil production through October amounts to about 75 million Bbls. Together, at current energy pricing, this lost oil and gas represents over \$8 billion in lost revenue for the companies impacted. A similar amount of lost production and revenue can be expected for these companies over the next five months as repairs take much longer than expected. Someone would naturally think that an industry faced with such significant losses caused by forces beyond their control would receive sympathy and maybe even a tax break from government officials wanting to help these companies in some way. How wrong that someone would be to assume such nonsense! Instead, as I first mentioned two months ago, our government leaders in Congress are practically stampeding to file bills calling for higher taxes on these energy companies through variations of a windfall profits tax. They also want to hold investigations and hearings with oil executives to explain why oil and gas prices are so high. The one I personally find amusing is the call for energy companies to give back a portion of their profit to consumers, because "consumers cannot afford these high prices". Can anyone imagine what Bill Gates would say if the government asked Microsoft to return a portion of their profits because consumers couldn't afford their software? If these government officials truly wanted energy companies to go about the business of providing adequate energy supplies, they would immediately stop their political pandering to the voting populace, and allow free market forces to deliver energy at whatever the prevailing global price level may be. Of course, I recognize that this would only happen when pigs fly!

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## **The Bowers Gas Report**

Week ending: 10/14/05

Gas storage for the week ending 10/14/05 was 3062Bcf which was an injection of 75Bcf over the prior week. This compares to the year ago level of 3214Bcf and the five year average of 3009Bcf, a difference of -152Bcf and +53Bcf, respectively. With 3 weeks remaining in the injection season, we need to average an injection rate of 113Bcf per week to reach full storage levels by November 4, 2005. Very obviously, we will finish the injection season with less than a full gas storage situation.

As of this writing, 65% of the GOM oil production, representing almost 1 million Bbls per day, and 53% of the GOM gas production, representing over 5Bcf per day, is still shut-in from Hurricanes Katrina and Rita. So far, almost 65 million barrels of oil and 325Bcf of gas have not been produced due to these events. With repairs taking much longer than anyone expected, total lost production for the entire winter will be on the order of 100 million barrels of oil and 700Bcf of gas. While Rita hit just four weeks ago and Katrina almost two months ago now, the resulting damage has been far worse than even I expected and will have lasting impact on the energy market for the remainder of this year and all of 2006. The market seems highly intent on carrying a continual debate on whether we have consumer demand destruction due to higher energy prices or not. Once again the market is missing the much bigger picture from the supply destruction standpoint. The lost energy supply will not easily be recovered for at least a year with the resulting impact being higher energy prices for a much more sustained period of time. I am particularly concerned about this winter's heating needs. With a less than full storage level, shut-in GOM still over 5Bcf per day, and no ability to alleviate increased demand through increased imports, the U.S. gas consumer is between a rock and a hard place. It appears to me that at this stage of the injection season, even a mild winter may cause gas storage levels to be drawn down to unprecedented levels. You better hang on to your shorts!

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## The Bowers Gas Report

Week ending: 9/30/05

Gas storage for the week ending 9/30/05 was 2929Bcf which was an injection of 44Bcf over the prior week. This compares to the year ago level of 3080Bcf and the five year average of 2889Bcf, a difference of -151Bcf and +40Bcf, respectively. With 5 weeks remaining in the injection season, we need to average an injection rate of 94Bcf per week to reach full storage levels by November 4, 2005. Due to continued shut-in GOM gas, next week's report will show an injection of no more than about 50Bcf.

There is no doubt in my mind that we have a huge energy problem in the making. The sheer volume of winter energy price forewarnings by government agencies, energy analysts, and energy company officials is unprecedented over the past week. I interpret these actions as a clear signal that no alternatives exist to alleviate much higher energy pricing in the near-term. While we have over 80% of the GOM oil production and over 60% on the GOM gas production still shut-in after two weeks since Hurricane Rita made landfall, the total lost production since Katrina amounts to 50 million barrels of oil and 240Bcf of gas in the last six weeks. We will easily have additional lost gas production of 100Bcf between now and the start of the winter drawdown season. This lost gas production can never be produced to help with this winter's heating demand, and more importantly, shut-in gas production places greater demands on whatever gas supplies are in storage. The energy industry is being pressed from every angle to fix the infrastructure as rapidly as possible, but little can be done when you simply lack the gas processing equipment and compressors to replace those damaged by the hurricanes. Six month backlogs are the current timeframe for such specialized equipment with the number needed in the hundreds. The ability to manufacture these compressors will simply take time.

With regards to oil, this week the energy market severely misinterpreted a piece of data released by the Department of Energy which caused significant volatility with futures and energy stocks. The DOE stated that gasoline demand, **as measured by refinery output**, over the last four weeks was down 2.6% when compared to the same period a year ago. The energy market viewed this as an indication that high prices are finally causing consumers to curtail their demand for gasoline and that this must be in some way a start of a permanent trend. I do not know how more wrong the market could be!!!!!! As I've noted with bolding and underlining, this measure is determined from gauging refinery output. Has anything happened over the last four weeks which might have caused refinery output to be less than normal? I think the knucklehead traders and speculators must be suffering from massive and collective short-term memory loss. As my nine-year old daughter would say in this situation, "Snap!" knowing that with almost 20% of the U.S. refining capacity shutdown for a month because of two hurricanes we're bound to lose some gasoline output compared to a year ago. The moronic behavior in the markets never ceases to amaze me. As a result, I believe we will see price escalation over the next month for all energy products as calmer and certainly more intelligent heads discount this piece of reported news.

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## The Bowers Gas Report

Week ending: 9/23/05

Gas storage for the week ending 9/23/05 was 2885Bcf which was an injection of 53Bcf over the prior week. This compares to the year ago level of 3001Bcf and the five year average of 2817Bcf, a difference of -116Bcf and +68Bcf, respectively. With 6 weeks remaining in the injection season, we need to average an injection rate of 86Bcf per week to reach full storage levels by November 4, 2005. Due to continued shut-in GOM gas, next week's report will show an injection of no more than about 30Bcf. With continued infrastructure problems as a result of Hurricanes Katrina and Rita, gas storage at the end of the injection season will be lucky to reach the 3200Bcf level.

I was unable to issue a report last week due to becoming an evacuee victim of Hurricane Rita, along with 2 million of my closest friends in the greater Houston area. While categorically slightly weaker than her predecessor Katrina, Rita will likely prove to be even more damaging to the GOM gas producing region. In both cases, substantial sub-sea pipeline damage occurred along with drilling rig damage. Katrina dealt greater onshore gas processing damage which will take at least six months to recover, while the damage to gas processing facilities from Rita should be operational in a few months. The difference for Rita appears to be the much greater number of platform losses than from Katrina. This would imply that we will eventually see more permanently lost gas production as a result of Rita than from Katrina. When taken together, I'm estimating that about 2Bcf/day of GOM gas production, representing 20% of early August, pre-hurricanes levels and about 5% of total U.S. gas production could be permanently lost as the producers elect not to restore uneconomic platforms. There is even some discussion amongst various producers to abandon development plans in the GOM altogether as the future hurricane risk is perceived to be too great to justify the large capital expenditures necessary to maintain GOM production. Regardless, I believe it will take at least a year to rebuild or repair all damaged infrastructure, re-establish gas production from the remaining platforms, and drill new wells simply to bring gas production levels back to where we were before Katrina.

These permanent losses come at a time when the remaining onshore U.S. gas producing regions continue to face declining production levels. In addition, the permanent loss of 5% of U.S. gas supplies will put ever increasing pressure on gas storage to meet the needs for winter heating purposes. As we see every year, the demand on storage is a function of the winter's severity. However, with this year having roughly 5% less gas supply, anything other than a mild winter is going to severely strain the ability of the energy industry to provide adequate gas supplies. Already, the majority of weather forecasts for this winter call for it to be colder than normal. Since we currently have natural gas pricing in the \$13-14/MMBtu range as a result of Katrina and Rita, and because the GOM production problems for the most part will not be resolved for another six months, no one should be surprised to see ongoing non-spiking natural gas pricing in the \$15-\$20/MMBtu range beginning in November and lasting through February or March. I would expect prices to moderate somewhat after March, in the \$10-\$14/MMBtu range, as more damaged-induced supply comes back to market sometime next year.

As for oil and refined products, Katrina knocked out 5% of U.S. refining capacity for an estimated six months and Rita has disrupted about 12% of refining capacity for the next month until power supplies can be re-established to those refiners. The most visual impact from these events which I expect to see very soon will be the temporary return of gas lines like we saw in the 70's as nationwide gasoline supplies begin to run low. The actual gas line event will be short-lived for now as the down refiners bring their production back online. However, I believe this will foreshadow ongoing gas lines in a few years as the world faces a shortfall in global refining capacity.

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## The Bowers Gas Report

Week ending: 9/09/05

Gas storage for the week ending 9/9/05 was 2758Bcf which was an injection of 89Bcf over the prior week. This compares to the year ago level of 2860Bcf and the five year average of 2660Bcf, a difference of -102Bcf and +98Bcf, respectively. With 8 weeks remaining in the injection season, we need to average an injection rate of 80Bcf per week to reach full storage levels by November 4, 2005. This week's abnormally large injection in the face of gas delivery problems from the GOM was caused by several factors including reduced industrial demand from the hurricane-impacted areas, reduced demands because of cooler weather in various parts of the country, and lastly, probable reductions in linepack pressures throughout the area surrounding the Katrina-hit zone with subsequent diversion of the gas into storage. There is some speculation that another error may have found its way into the reported figures. If so, we will know over the next few weeks. The next storage report will reflect the continued loss of large quantities of shut-in gas from the GOM and should show an injection of about 60Bcf.

The impact on our nation's energy supply from Hurricane Katrina has been and will continue to be very significant. As of this writing, over 50% of the GOM oil supply, representing 800,000Bbls/day, and over 30% of the GOM gas supply, representing 3.4Bcf/day remains shut-in. The lead causes of the shut-in energy supply are damaged gas processing facilities located onshore Louisiana, damaged or missing platforms offshore, and unknown sub-sea pipeline damage. The time frame to repair the gas processing facilities appears to be about three months due primarily to severe flooding problems in these locales around southern Louisiana. The damaged and/or missing platforms will take anywhere from six months to a year to fully restore energy production, likewise with any sub-sea pipeline problems. The biggest unknown lies with the pipelines as the ability to properly inspect them has been hampered by insufficient personnel, specifically divers, and equipment, specifically boats, which are addressing higher priority items like regaining control of lost drilling rigs adrift in the GOM and assessment of offshore well bores with missing platforms. While I had previously estimated permanent loss of 200,000Bbl/day of oil and 2Bcf/day of gas, I now think the actual losses will be about one-half these levels, 100,000Bbl/day of oil and 1Bcf/day of gas. These figures would represent 7% of current GOM oil production and 10% of current GOM gas production. However, the time to recover the salvageable energy production may very well take longer than I anticipated as the magnitude and severity of infrastructure damage becomes better known. In preparing for this winter's gas storage we've already lost the ability to inject 100Bcf over the last 20 days since Katrina hit. For the remainder of the injection season further losses will likely be at least another 150Bcf for a total injection loss of 250Bcf. I estimate that peak gas storage will be no more than 3200Bcf which wouldn't be too bad if we didn't also have ongoing gas losses beyond the injection season. As I've mentioned before, the demands on gas storage will be greater because of these ongoing losses. With a slower ramp up toward recovery of GOM production, the increased demand on gas storage will be more like 400Bcf rather than my previous 300Bcf estimate. As a result, depending on the severity of the winter, the end of the draw down season will likely see gas storage in a range of 300 to 900Bcf. This intense pressure to provide adequate gas supplies over the next six months will deliver double digit natural gas prices from now until the end of 2006 as low levels of storage at the end of winter will have to be replenished in the next injection cycle.

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## The Bowers Gas Report

Week ending: 8/26/05

Gas storage for the week ending 8/26/05 was 2633Bcf which was an injection of 58Bcf over the prior week. This compares to the year ago level of 2683Bcf and the five year average of 2503Bcf, a difference of -50Bcf and +130Bcf, respectively. With 10 weeks remaining in the injection season, we need to average an injection rate of 77Bcf per week to reach full storage levels by November 4, 2005. The next storage report will begin to reflect the tremendous and overwhelming impact of Hurricane Katrina on our nation's gas storage as no more than about 30Bcf will be injected. Subsequent weeks' reports will bring validation to my belief that an already stressed natural gas supply problem has now been thrown headlong into a major gas supply crisis as I will discuss in the paragraphs below. What began as a minor CAT 1 hurricane crossing over the tip of Florida and by Friday, August 26, was being completely dismissed by energy market traders as inconsequential to the Gulf of Mexico oil and gas production area, quickly developed into CAT 4/5 Hurricane Katrina and eventually wrought damage the likes of which our country has never known. Although the tragic aspects of this event cannot be overlooked and I am in no way trying to diminish the vast losses of human life and property, I will focus exclusively on my expectations of the resulting impact from Katrina on the energy market.

Over the last several years of providing my thoughts and concerns on issues driving the oil, and in particular, the natural gas market, I have leaned heavily on my observation that growing demand for oil and gas was running headlong into tightening conditions for both commodities. I have attempted to discuss my expectations each week by focusing on various factors which support my belief that rising oil and gas prices will be with us for at least the next five to ten years. By landing us in the middle of a full blown energy crisis, Katrina has significantly altered the energy landscape and has accelerated price increases which will be with us for many years. By knocking out 10% of U.S. refining capacity and 20% of all U.S. oil and gas production, a finely balanced global energy system has been tossed into complete chaos. Much of the lost refining capacity will be re-established over the next year, but will certainly not meet growing demands for refined products. Most of the lost oil and gas production will be re-established as well, but will take at least a year or more because of damaged support facilities such as platforms, sub-sea pipelines, compressors, and gas processing equipment. I have heard various reports which suggest that sub-sea pipeline damage alone could be ten times worse than that incurred by Hurricane Ivan a year ago which took six months of recovery. Without a doubt, some offshore oil and gas production will be lost forever as it will be deemed uneconomic to incur the expense of fixing production platforms and associated facilities. This lost production will likely be around 10% of current offshore oil and gas production which equates to about 200,000Bbl/day of oil plus 2Bcf/day of natural gas.

We recently witnessed the oil price impact of losing 200,000Bbl/day in today's energy market when Ecuador halted exports because of civil unrest. Oil prices immediately jumped \$5/Bbl in its move from \$60/Bbl to \$65/Bbl. Although Katrina has already moved oil prices to \$69/Bbl, I believe we will see continued upward price moves as we enter the 4<sup>th</sup> quarter where higher oil demand for the coming winter is the norm. No one should be surprised if we move toward \$75/Bbl or higher in the near future. While releases from the SPR dampen the oil price move, these releases will be temporary as government officials recognize the necessity of maintaining these reserves for military purposes and oil production disruptions, and not necessarily to provide Americans with cheaper gasoline.

I believe our bigger energy problem lies with natural gas supply. Throughout this year's hot summer, we have witnessed increased gas demand which has dramatically reduced gas storage injections needed for winter heating purposes. Prior to Katrina, we were on track to have sufficient gas in storage, albeit at a higher price level, with an expected storage of 3200-3400Bcf. Subsequently after Katrina, we have 8Bcf/day of gas currently shut-in of which I'm projecting that we'll permanently lose 2Bcf/day for being uneconomic to repair. The remaining 6Bcf/day will not automatically come back into production all at once as various repairs will delay the re-start of some production. I'm guessing that one-half of the remaining 6Bcf/day, or 3Bcf/day, will be out for at least 60 days. When combined with the lost uneconomic production of 2Bcf/day, we will have at least 5Bcf/day which will be lost for at least 60 days. This translates into 300Bcf of total gas production which cannot be consumed or go into storage during this time period. With this lower production level, gas storage at the end of the injection season would likely be in a range of 2800-3100Bcf. Furthermore, the lost 2Bcf/day will be placing greater demands on whatever storage is available on a permanent basis. A mild winter event will now take 2200Bcf out of storage; a normal winter event will take 2500Bcf out, while a severe winter will now consume 2800Bcf. As you can tell from my projections, a severe winter event will leave us from zero to 300Bcf at the end of winter. Even a mild winter will begin the next injection season with only 600-900Bcf in storage. While there is uncertainty about the timing to re-gain shut-in production, one thing is extremely certain and undeniable. There is an even more significant need for new natural gas supply to replenish permanently lost production. As we were already having difficulty drilling fast enough before Katrina, this fact is further compounded by the loss of several

## **The Bowers Gas Report**

Week ending: 8/26/05

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drilling rigs in the Gulf which were being used to find new gas supplies. As we have now seen the Btu discount between natural gas and crude oil completely disappear, this new supply problem should cause natural gas to trade at a Btu premium for a sustained period of time. I expect natural gas from now through winter will see a range of \$12-\$15/MMBtu with spikes toward \$20/MMBtu if things get really cold. The average for 2006 will be around \$14/MMBtu as there are no sufficient new supplies to make much of a difference.

This hurricane named Katrina was a resounding wake-up call for the United States of America. My sense is that she will have awakened us from our energy lethargy and will move all of us toward higher energy consciousness. This awakening will still take several years, as there are no quick fixes, but I believe we will now move much more rapidly toward more conservation, consideration of more alternative fuels, quicker construction of LNG facilities, and nuclear power for electricity generation. You will soon likely hear many political calls for price controls or a windfall profits tax on energy companies to alleviate the economic damage on our citizenry from the higher energy costs to come. Either of these moves would be wrong-headed and would only discourage the energy industry from accomplishing the task at hand. These mechanisms did not work in the '70's and they will not work now. The best fix for all is to let the free markets work themselves out, let capital flow to the energy challenge, change our nation's dependency on hydrocarbon-based fuels, and prepare us for a new and different energy future.

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## **The Bowers Gas Report**

Week ending: 8/19/05

Gas storage for the week ending 8/19/05 was 2575Bcf which was an injection of 60Bcf over the prior week. This compares to the year ago level of 2602Bcf and the five year average of 2439Bcf, a difference of -27Bcf and +136Bcf, respectively. With 11 weeks remaining in the injection season, we need to average an injection rate of 75Bcf per week to reach full storage levels by November 4, 2005. The next storage report will likely show an injection of about 50Bcf as higher temperatures across the country increase gas demand.

The Btu discount between natural gas and crude oil has closed to 13% as the energy market begins to comprehend the gravity of increased demands from coal-burning utilities, gas storers, and higher than normal summer temperatures all culminating at once. While my gas price forecast of \$10/MMBtu by yearend looks very certain at this point, albeit about 4 months early, I have to admit that I'm not surprised. When all of the gas market facts, not speculations, are laid bare, in my mind there has been only one direction that gas pricing could go. It has simply been a matter of when these events would occur to deliver an expected result. When I consider the facts as they present themselves now, I believe that the time period between now and 2008 will be the most volatile natural gas pricing ever seen. Consider the following supply and demand issues in no particular order: 1) declining imports from Canada, 2) continued declining U.S. gas production because of several of these factors, 3) insufficient LNG infrastructure, 4) too few drilling rigs, 5) too few O&G professionals, 6) dwindling geologic prospects in the U.S., 7) rapidly depleting Gulf of Mexico reserves, 8) increased demand for home heating and cooling, 9) increased industrial demand, and lastly 10) constrained power plant usage of other fuels such as coal or nuclear. We happen to have significant problems on both sides of the economic equation of supply and demand which cannot possibly be fixed in the next two years, outside of U.S. economic collapse which would obviously reduce gas demand. If I also factor in strong price support from oil, we easily have a recipe for double digit natural gas prices until at least 2008.

Oil prices are about to receive another level of support from the Chinese. Plans are now in place for the Chinese to begin filling, as of September 1, their own Strategic Petroleum Reserve which would be similar to that of the U.S., but only 100 million barrels. Given that there is no global excess capacity of crude oil supplies, what do you think will happen to oil prices as the Chinese begin buying oil for storage? Unless they are willing to fill their reserve exclusively with Saudi heavy crude, oil prices will continue moving higher with this added demand on oil supplies. I mentioned many times in the past that the Chinese have the financial capacity above all others to be the marginal buyer of oil and pay whatever it takes for an incremental barrel of oil and that they will be setting the global price. I think we are about to witness what it means to hold such power over a global commodity as everyone else will either have to meet or beat the price established by this energy hungry country.

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## The Bowers Gas Report

Week ending: 8/12/05

Gas storage for the week ending 8/12/05 was 2515Bcf which was an injection of 52Bcf over the prior week. This compares to the year ago level of 2519Bcf and the five year average of 2375Bcf, a difference of -4Bcf and +140Bcf, respectively. With 12 weeks remaining in the injection season, we need to average an injection rate of 74Bcf per week to reach full storage levels by November 4, 2005. The next storage report will likely show an injection of about 60Bcf as slightly cooler temperatures across the country moderate gas demand.

With this report, we've now eliminated the perceived excess gas in storage compared with a year ago and are steadily chewing away at the five year average comparison. While I place little value on the use of these comparisons as an indication of gas supply sufficiency, the energy market still places significant weight on them, erroneously in my opinion. I predict that over the next several weeks that the gas market will show concern with 1) too little gas in storage to meet this winter's demand, 2) too much hurricane season left to contend with, and lastly 3) too much gas being consumed by coal-burning utilities. This last item will likely set the stage for higher gas pricing throughout the remainder of 2005 as coal inventories are now exceptionally low and these utilities have been forced to generate electricity with more costly gas supplies. This comes, of course, when gas demand has been at its greatest due to record high temperatures and as gas storers are attempting to provide sufficient gas supplies for winter. There are simply too many demands on a continually shrinking U.S. gas supply. Every freshman college student learns in Economics 101 that this scenario is a recipe for higher natural gas prices. My \$10/MMBtu prediction by the end of '05 may again prove to be highly conservative.

On the oil front, the pressures of 3<sup>rd</sup> quarter oil demand are showing themselves as well as supply disruptions from Ecuador, which provides the U.S. with 200,000 Bbls per day are driving us back up to the \$66/Bbl level. This amount of supply from Ecuador is almost rounding error compared with the daily oil consumption in the U.S. However, this gives us a prime example of the tightness in the current oil supply market. Can anyone imagine what a significant disruption would do to global oil prices? As a not so far fetched example, what happens if Chavez decides tomorrow that his countries' oil supply will no longer be destined for what he calls "the imperialist U.S."? The amount of oil coming from Venezuela is currently about 1.5-2 Million Bbls per day and could only be replaced from Saudi heavy crude supplies. The trip for Saudi oil takes six weeks compared to ten days for supplies from Venezuela. Although this scenario doesn't increase global oil demand at all, the time disruption alone to obtain the replacement oil would send oil prices over \$80/Bbl. Incidentally, Venezuela recently opened an office in China to make it easier to sell their oil. The opportunities for oil supply disruptions in today's world are almost countless with very little in the way of countervailing supply enhancements. All the while, oil demand will be increasing at about 1-2% annually which requires an additional 1.5 Million Bbl/day of new production to stay even. This does not account for any additional oil demand necessary to overcome geologic depletion of currently producing and rapidly aging global oilfields. It is on this basis that I believe we will be closing the gap between current oil pricing and the historic inflation-adjusted trend line price of \$95/Bbl over the next few years, with spikes way above this level in the case of a significant supply disruption.

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## The Bowers Gas Report

Week ending: 8/05/05

Gas storage for the week ending 8/5/05 was 2463Bcf which was an injection of 43Bcf over the prior week. This compares to the year ago level of 2442Bcf and the five year average of 2314Bcf, a difference of +21Bcf and +149Bcf, respectively. With 13 weeks remaining in the injection season, we need to average an injection rate of 72Bcf per week to reach full storage levels by November 4, 2005. Continued impact from a nationwide heat wave will show up in next week's EIA storage report which will show another weak injection of about 50Bcf, further reducing the comparisons to prior periods.

I think I should take vacations more often! I leave for a week and suddenly all heck breaks loose in the energy markets. As of this writing, I'm staring at spot crude oil pricing over \$66/Bbl and natural gas above \$9/MMBtu and reaching for \$10/MMBtu, in the September futures contracts of all places. It's all about supply, or in this case, the lack thereof in both commodities! Continued increases in global crude oil demand are currently absorbing **all** available crude supplies, with the exception of some Saudi heavy crude. Demand for more crude oil supply only increases at this time of year as users prepare for the peak usage during the winter months. We will not see a reduction in demand growth until sometime in the 1<sup>st</sup> quarter of next year as winter usage slows down. However, any oil price weakness will only be temporary as overall global demand in 2006 will be increasing 1-2% over 2005 demand. This small increase in 2006 oil demand implies an additional supply requirement of 1.5 million barrels per day of new oil at a time when current supplies are at maximum capacity. I seriously need someone, anyone to tell me where this new supply will be coming from.

The strengthening oil price will continue to support higher natural gas pricing as well since the demand picture for natural gas supplies is not all that different from crude oil. With low levels of U.S. coal inventories at utilities which burn coal to generate electricity, increased demand on natural gas as a substitute for coal is also occurring simultaneously with gas storers attempting to inject supplies into storage. We are now running a risk of having insufficient gas supplies in storage for winter heating demand as declining U.S. gas production from the Gulf of Mexico begins to hit home. Further strains on gas supplies are developing as U.S. producers attempt to increase their drilling efforts in areas outside of Texas, Oklahoma, and Louisiana. However, many of these efforts are in lower production regions or more rapidly depleting unconventional gas horizons. The infamous Btu discount between crude oil and natural gas, to which I have so frequently mentioned, has now declined to about 15% as the pressures of increased demand from multiple sources has clearly improved the price outlook for natural gas. My previous forecast of \$10/MMbtu by year-end may now prove to be way too conservative. The only possible redeeming supply response to save us this winter may again be coming from Canada as drilling in that country has exploded on a year over year basis. However, much of this Canadian drilling may very well be tar sand delineation drilling as many of these projects ramp up over the next several years, and may not be targeting gas production at all.

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## The Bowers Gas Report

Week ending: 7/22/05

Gas storage for the week ending 7/22/05 was 2381Bcf which was an injection of 42Bcf over the prior week. This compares to the year ago level of 2287Bcf and the five year average of 2184Bcf, a difference of +94Bcf and +197Bcf, respectively. With 15 weeks remaining in the injection season, we need to average an injection rate of 68Bcf per week to reach full storage levels by November 4, 2005. The impact of a nationwide heat wave will show up as next week's EIA storage report will show another weak injection of about 40Bcf which will further reduce the comparisons to prior periods. As I will be on vacation next week, I will not be sending out another gas report until around August 11.

As I have predicted, we are steadily chewing away at the perceived excess gas storages levels over the past one and five year periods. I've mentioned many times in prior reports that the energy market incorrectly relies on gas storage levels as a gauge of gas supply adequacy. As the U.S. economy continues to grow, it has simultaneously increased the overall demand on gas supplies. Because stored gas represents about 20% of the gas consumed for winter heating purposes, the growth in the economy implies that the trend in gas storage levels needs to grow as well simply to provide a comparable level of gas supply adequacy. If storage levels remained the same on a year over year basis, while gas demand continues growing, then we would end up with a smaller percentage of stored gas as a contingency for severe winter events and would be more dependent on current gas production to meet ongoing demand. So, the bottom line is that in a growing economy, higher comparisons to prior periods are an indication of similar contingency levels, while similar comparisons actually are indicating a tightening of gas supply.

The Btu discount of natural gas to crude oil remains at the 22% level with spot futures gas trading at \$7.89/MMBtu and spot futures oil trading at \$60.57/Bbl. Looking at some of my gas reports from earlier this year, I mentioned that the surprise of '05 would be \$60/Bbl oil. Now that \$60/Bbl is a reality, where do we go from here and will natural gas finally start participating on an undiscounted basis? As we are still early into the third quarter of '05, I believe that the remainder of '05 will see increasing price pressure on crude oil as global demand significantly outstrips global supply. With the oil supply shortfall in the 4<sup>th</sup> quarter projected at around 3 million barrels per day, oil price levels in the near term can easily climb to \$70/Bbl or beyond. 2006 should see oil prices in the \$60-\$80/Bbl range. Longer term, I believe we are inexplicably moving toward the current historical inflation-adjusted trend line price level of \$95/Bbl, but will take a few more years for the market to climb to this mark, likely by 2008. Unfortunately for natural gas, I think its stepchild status compared to oil will remain for awhile longer with Btu discounts persisting until the level of Canadian gas exports to the U.S. begin to decline. I do not mean to imply that natural gas prices go down from here! Continually declining U.S. gas production will still be pushing natural gas prices higher. I look for \$10/MMBtu to be with us by this coming winter and the price range for 2006 to be \$9-\$11/MMBtu. Longer term, natural gas prices in the \$12-\$15/MMBtu range is my expectation for 2007 and beyond. Higher energy costs over the next several years will be the penalty for a U.S. economy so heavily dependent on foreign sources of oil and LNG to meet its energy needs. With no other viable, economic alternatives available, the U.S. economy will have to adjust to running at these ever increasing energy price levels.

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## **The Bowers Gas Report**

Week ending: 7/08/05

Gas storage for the week ending 7/08/05 was 2280Bcf which was an injection of 94Bcf over the prior week. This compares to the year ago level of 2140Bcf and the five year average of 2042Bcf, a difference of +140Bcf and +238Bcf, respectively. With 17 weeks remaining in the injection season, we need to average an injection rate of 66Bcf per week to reach full storage levels by November 4, 2005. Next week's report will show the impact of Hurricane Dennis as shut-in Gulf of Mexico gas production prevented gas storers from injecting into storage for a few days with a likely resulting injection level of 60Bcf for the week. As of this writing, Hurricane Emily is taking aim for the southern Texas coast. Any slight northerly turn for this one will squarely hit offshore gas producing zones and cause an additional reduction of gas injection into storage.

The Btu discount of natural gas to crude oil has closed slightly to only 19%. While still a long way from a 10% discount or even a premium, I sense that the market is becoming more than a little concerned about the preponderance of hurricane activity thus far this season. With five named storms so far this year, much earlier than anyone alive can remember, I can certainly understand the market's anxiety. However, despite the hurricanes, the normal summer weather has been steadily chewing away the excess gas compared to last year and the five year average. As I've mentioned in previous reports, this perceived excess should be completely erased by the end of September and just in time for much higher oil pricing to begin showing up in the fourth quarter of this year. While we have already closed above my \$60/Bbl forecast for oil several times, we have yet to close above \$8/MMBtu for natural gas, although we are sneaking up on it very quickly. Hurricane Emily might just be the psychological event to finally put us over the magic mark, and then we'll be off to \$10. Hold on to your shorts!

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## **The Bowers Gas Report**

Week ending: 7/01/05

Gas storage for the week ending 7/01/05 was 2186Bcf which was an injection of 63Bcf over the prior week. This compares to the year ago level of 2031Bcf and the five year average of 1944Bcf, a difference of +155Bcf and +242Bcf, respectively. With 18 weeks remaining in the injection season, we need to average an injection rate of 67Bcf per week to reach full storage levels by November 4, 2005. With the approaching Hurricane Dennis taking dead aim for the gas-producing region of the Gulf of Mexico, I look for the storage injection reporting week after next to be significantly lower as producers shut in gas production.

The Btu discount of natural gas to crude oil is currently about 25% and has remained consistently elevated for too long now. The combination of normal summer weather which causes increased residential gas demand, an above average hurricane and tropical storm season, and continued too low drilling rates are steadily chewing away at the perceived excess storage cushion. These events will soon reveal the many problems confronting the U.S. natural gas producing sector. As the year progresses, I believe that the closing of the Btu gap with crude oil is inevitable as the veil of excess storage finally falls and can no longer hide the inherent problems with gas deliverability. As full knowledge about the problems with gas deliverability become known, natural gas will be re-priced by the market at the more appropriate 6:1 ratio or less. With support coming from crude oil demand in the 4<sup>th</sup> quarter, which is expected to be 3 million Bbls/day greater than supply, and because of winter gas demand, I am now expecting \$10/MMBtu for natural gas by the end of 2005. This price level should not be a shocker to anyone who has studied and fully comprehends the dynamics taking place in today's energy market.

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## **The Bowers Gas Report**

Week ending: 6/17/05

Gas storage for the week ending 6/17/05 was 2031Bcf which was an injection of 75Bcf over the prior week. This compares to the year ago level of 1833Bcf and the five year average of 1760Bcf, a difference of +198Bcf and +271Bcf, respectively. With 20 weeks remaining in the injection season, we need to average an injection rate of 68Bcf per week to reach full storage levels by November 4, 2005. Continued forecasts of high temperatures across the country will be reducing the injections over the next several weeks.

The natural gas market got scared this week, scared to follow in the footsteps of its counterpart, crude oil. While traders in the crude oil market have finally come to grips with an oil market facing greater demand than supply, the same cannot be said for natural gas. Although U.S. natural gas production is in its third year of declining production, imported gas from Canada and fluctuations in stored gas have prevented the realization that the same predicament exists in the natural gas market as with oil. With the Btu discount for natural gas to crude now at 26%, I believe the stage is set for a substantial jump in natural gas pricing. My rationale for this price jump comes from continued upward support from oil over the next several months, the elimination of perceived gas surplus in storage compared to previous years due to warmer than normal summer weather, and lastly, depletion effects from low drilling activity in the Gulf of Mexico over the past few years. Too little, new Gulf of Mexico drilling will soon be recognized as the primary reason for gas storers inability to replenish storage at the desired rate to suppress natural gas prices on an ongoing basis. Once this "cat" of Gulf of Mexico depletion is out of the bag, the natural gas market will steadily close the Btu discount to only the 10-15% level. Simply closing the gap to 10-15% allows for \$9 gas, however, with gas being the red-headed stepchild that it is, we'll likely see a range of \$8.25 - \$8.75/MMBtu. Look for the jump to occur at the first hint of the next Gulf of Mexico hurricane.

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## The Bowers Gas Report

Week ending: 6/10/05

Gas storage for the week ending 6/10/05 was 1963Bcf which was an injection of 73Bcf over the prior week. This compares to the year ago level of 1747Bcf and the five year average of 1669Bcf, a difference of +216Bcf and +294Bcf, respectively. With 21 weeks remaining in the injection season, we need to average an injection rate of 68Bcf per week to reach full storage levels by November 4, 2005. Continued high temperatures across the country will be reducing the injections over the next several weeks.

The Btu discount of natural gas to crude oil narrowed slightly again this week to 21%. However, the big story of the week was the future's and stock market's realization that we may indeed be experiencing energy deliverability problems before the end of the year. With today's near month gas futures at \$7.69 and the 12 month gas strip at \$8.18 and the near month oil futures at \$58.47 and the 12 month oil strip at \$59.86, the market now firmly believes in the energy story as reflected by strong contango in both commodities. In fact, six of the 12 months in the oil strip is now greater than \$60/Bbl. The issue going forward is how high natural gas and oil prices go now that OPEC jawboning no longer works and global economic growth continues in the face of greater than \$50/Bbl oil. The running room in natural gas prices is quite wide as total closure of the Btu discount would take gas prices to about \$9.75/MMBtu. We're currently less than 5% away from my expected \$8/MMBtu price level before the end of '05, and I think we may very well see the \$8 mark by July or August. High temperatures, hurricane activity, and growing industrial use of natural gas will dictate how soon we close that Btu gap. In the meantime, the "golden age" of natural gas continues in fine form.

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## The Bowers Gas Report

Week ending: 6/03/05

Gas storage for the week ending 6/03/05 was 1890Bcf which was an injection of 112Bcf over the prior week. This compares to the year ago level of 1651Bcf and the five year average of 1573Bcf, a difference of +239Bcf and +317Bcf, respectively. With 22 weeks remaining in the injection season, we need to average an injection rate of 69Bcf per week to reach full storage levels by November 4, 2005. This week's report is the first greater than 100Bcf injection of the season. Forecasted high and above normal temperatures across much of the U.S. for the next several weeks will apply significant pressure on storer's ability to maintain a similar high injection rate in the weeks ahead.

The BTU discount of natural gas to crude oil has reduced further this week to about 22% as natural gas played catch-up to oil's run in the prior week. As those who have read my reports in the past know, one of my major themes in justifying my projections for higher trending oil and natural gas prices involves the issue of energy industry bottlenecks. Stated very simply, as more and more bottlenecks develop in the process of delivering these commodities from the ground to the end user of the various refined products, the harder it becomes to deliver sufficient quantities demanded by the final market. Only through the resulting higher pricing of these commodities will we eventually see delivery of the quantity demanded by the market. However, these bottlenecks do not tend to occur in a smooth pattern and usually will become cumulative over time. My current example of a bottleneck which has reappeared again and will significantly slow the ability of the energy industry to deliver natural gas involves the availability of frac sand. As many of today's tight gas formations require extensive fracture stimulation to adequately complete these wells, shortages and/or delivery problems involving frac sands will slow down producer's ability to deliver natural gas to the market. With U.S. natural gas production already declining on a year over year basis, the industry can ill afford to have further complications from well completion bottlenecks. If we also toss in the issues of rapid depletion from the Gulf of Mexico, insufficient drilling rates, poor prospect quality, and the loss of geologic professionals through retirements, the provision of adequate natural gas supply in the face of growing gas demand becomes problematic at the least and in crisis mode at the worst.

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## **The Bowers Gas Report**

Week ending: 5/27/05

Gas storage for the week ending 5/27/05 was 1778Bcf which was an injection of 86Bcf over the prior week. This compares to the year ago level of 1552Bcf and the five year average of 1474Bcf, a difference of +226Bcf and +304Bcf, respectively. With 23 weeks remaining in the injection season, we need to average an injection rate of 71Bcf per week to reach full storage levels by November 4, 2005.

The BTU discount of natural gas to crude oil reduced slightly to the still lofty level of 24% as gas outpaced the recent rise in crude this week. The energy market has begun climbing its "wall of worry" as concerns about oil deliverability in the second half of 2005 start dwelling on investors minds. The very real issue, of course, is global oil demand in excess of global oil supply. The difference between these two measures is considered to be negligible at the present, but will widen significantly as we march toward the high demand period in the fourth quarter. My premise has been and continues to be that OPEC decided a few months ago that the only way to avert oil price spikes later in the year was to convince the market that they had plenty of capacity to meet the market's needs. At the same time as OPEC was making these bold statements, the plan was to steadily use their excess production to artificially boost global oil inventories. This plan was successful in growing oil inventory for about ten consecutive weeks, but then the unthinkable happened. Instead of having a historically weak demand period occurring during the second quarter of this year which would allow inventories to build rapidly, oil demand has remained strong as the global economy continues growing and its thirst for oil supply continues unabated. Many economic analysts believed that the global economy would be slowing down by now as the impact of higher oil prices started working its way through the business cycle and reducing corporate profitability. My belief is that the world has simply begun adjusting to the new energy price environment and has continued its business as usual. These economic analysts will be right about oil prices slowing down the global economy, but not at current price levels. Not until we reach \$90/Bbl, the current inflation adjusted trend line price, will oil pricing begin creating a significant drag on global growth. In the meantime, \$60/Bbl oil by the end of '05 looks to be very much baked in the cake, in my not so humble opinion.

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## **The Bowers Gas Report**

Week ending: 5/20/05

Gas storage for the week ending 5/20/05 was 1692Bcf which was an injection of 93Bcf over the prior week. This compares to the year ago level of 1464Bcf and the five year average of 1389Bcf, a difference of +228Bcf and +303Bcf, respectively. With 24 weeks remaining in the injection season, we need to average an injection rate of 71Bcf per week to reach full storage levels by November 4, 2005.

The BTU discount of natural gas to crude oil has jumped this week to 26% as futures traders have sold down natural gas because of continued concerns about too much gas in storage relative to past historical periods. It is this “rearview mirror” approach of placing too much emphasis on historical reference points which I believe has prevented producers from making riskier bets in their drilling programs and finding sufficient gas supplies to replenish current gas consumption. Similarly, this lack of forward thinking when it comes to exploration will ultimately contribute to higher natural gas pricing as existing drilling efforts fall short of meeting the needs from growing gas demand. How else could anyone explain why U.S. gas production continues to decline with prices above \$6/MMBtu? Another possible explanation would be that \$6 gas does not justify risk taking endeavors. I’ve already stated countless times that it will take \$8 gas before the energy industry generates adequate capital to justify losing some by venturing into the riskier exploratory mode. But alas, therein lays the conundrum! As long as the energy market determines gas pricing based upon perception and sufficiency of gas storage levels, we will continue to see BTU discounting to crude oil which further prevents gas prices from reaching the \$8 mark. By continuing to ignore the obvious gas production problem, the energy industry runs the risk of future price spikes which tend to draw the attention of governmental regulators. We all know that when that happens, everything gets mucked up.

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## **The Bowers Gas Report**

Week ending: 5/13/05

Gas storage for the week ending 5/13/05 was 1599Bcf which was an injection of 90Bcf over the prior week. This compares to the year ago level of 1376Bcf and the five year average of 1308Bcf, a difference of +223Bcf and +291Bcf, respectively. With 25 weeks remaining in the injection season, we need to average an injection rate of 72Bcf per week to reach full storage levels by November 4, 2005.

The BTU discount between natural gas and crude oil has reduced slightly to 18%. I attribute much of the recent movement of crude oil pricing and energy stocks to hedge fund's unwinding of positions in the energy markets. Many of these funds will place combinations of trades in both the futures and equity markets in an attempt to arbitrage the oil price difference which exists between the future delivery of oil and the oil price at which an energy company's underlying assets are currently priced by analysts who follow those companies. For example, when oil prices were perceived to be high, a hedge fund may sell futures when oil prices are \$55/Bbl and reduce their risk exposure by simultaneously buying an E&P's stock whose assets analysts have determined are currently valued in the market at \$35/Bbl. As the actual oil price drops to say \$50/Bbl, the hedge fund will close its futures position by buying back futures and in turn selling the shares of the E&P company stock. The fund will make money on its futures position, but lose money on its stock position. The hedge fund game attempts to net out a gain regardless of whichever way the market is moving in both futures and stocks. This particular strategy only works until the energy analysts properly bring the value of every E&P Company's stock up to the current level of oil prices. The time to accomplish this task is a very subjective process and thus implies continued market volatility in these stocks and in futures as both markets move toward an equilibrium point.

As the weather begins heating up across the country, I expect significant demand pressure to be applied this summer on natural gas supplies. We should see a steady whittling away of the extra gas in storage when compared to last year and the five year average storage levels. By September the extra gas will likely be gone and the storage comparisons to previous periods will not look so out of line. The main contributors for the rapid adjustment in gas storage will be the simple fact that U.S. gas production continues to decline and also that depletion effects from Gulf of Mexico gas production begin displaying themselves. With offshore producers slowing their drilling activity in the Gulf over the last year, the impact of falling gas production from a rapidly depleting region which provides 25% of the country's gas supply will bring new deliverability concerns to the market very, very soon. As this problem becomes apparent in the gas market, the pervasive BTU discount to crude oil could soon be just a bad memory.

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## The Bowers Gas Report

Week ending: 5/6/05

Gas storage for the week ending 5/6/05 was 1509Bcf which was an injection of 54Bcf over the prior week. This compares to the year ago level of 1292Bcf and the five year average of 1234Bcf, a difference of +217Bcf and +275Bcf, respectively. For this injection season, I will be defining full storage at a level of 3400Bcf recognizing additional storage capacity constructed over the past few years and increased gas demands by the U.S. economy. With 26 weeks remaining in the injection season, we need to average an injection rate of 73Bcf per week to reach full storage levels by November 4, 2005.

The BTU discount between natural gas and crude oil has closed slightly to 20% as crude sharply corrected in price this week. Ever since the President had his big powwow with the Saudi Crown Prince a few weeks ago the market has been selling energy like crazy. This is truly the epitome of talking a market down! Naturally, I agree that growing crude inventories could also have something to do with softening prices, but I've never been able to walk away from a little conspiracy controversy. Anyway, in my opinion the energy market has overdone it to the downside again as concerns about growing crude inventories are mistaken for ample oil supplies. The market has taken a very short term focus by misunderstanding OPEC's motive for allowing full bore production at the present. The reality is that OPEC has to maintain full production during what is typically the weakest oil consumption time of the year, and to allow inventories to build above normal in order to avert a supply crisis later this year when demand will far exceed the daily supply. The only way OPEC can keep oil pricing from shooting through the roof later this year is to artificially oversupply the market now through the inventory building process. This extra inventory will be used later this year to make up the shortfall in daily production versus the daily demand. Since the market hasn't quite figured out what OPEC is attempting to do, they certainly haven't comprehended the longer term ramifications of this last ditch effort to maintain lower energy prices. As year-over-year global crude oil demand finally grows to the point where excess inventory can no longer make up the supply shortfall, oil prices will climb beyond the \$60/Bbl level. By my best guesstimation, the summer of 2006 will be the point where inventory games no longer work and the energy market moves oil prices to the next higher tier with prices ranging from \$70 to \$80/Bbl. This would imply natural gas prices in the \$8 to \$10/MMBtu range. You better hold on to your shorts, it's going to be a bumpy ride!

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## **The Bowers Gas Report**

Week ending: 4/29/05

Gas storage for the week ending 4/29/05 was 1455Bcf which was an injection of 39Bcf over the prior week. This compares to the year ago level of 1217Bcf and the five year average of 1162Bcf, a difference of +238Bcf and +293Bcf, respectively. For this injection season, I will be defining full storage at a level of 3400Bcf recognizing additional storage capacity constructed over the past few years and increased gas demands by the U.S. economy. With 27 weeks remaining in the injection season, we need to average an injection rate of 72Bcf per week to reach full storage levels by November 4, 2005.

The BTU discount between natural gas and crude oil remained at 22% this week while the twelve month strip discount was only 18%. Some of the natural gas contango has flattened out slightly relative to crude oil. I've noticed numerous articles lately which talk about the energy industry problems caused by shortages of professionals such as geologists and petroleum engineers. Many of you know that I've been beating this same drum for several years now. However, I've yet to see much concern though for insufficient numbers of qualified drilling hands for the rigs which ultimately provide gas production. While the number of rigs operating in the U.S. has climbed over the last year to a current level around 1325 rigs, the number of rigs running has remained stagnant for the last two months. I personally find this fascinating at a time when natural gas prices have consistently been in excess of \$6/MMBtu during this time frame. This information continues to indicate to me that the E&P companies simply lack the economical drilling locations which make sense at \$6 gas. All the while, we continue slipping in U.S. gas production because of inadequate drilling rig rates. Interest is even waning in the Gulf of Mexico where there are only 90% of the rigs running compared to a year ago. With the Gulf typically providing 25% of the nation's gas supply, reduced drilling rates out there are a sure sign of bigger deliverability problems ahead. Most current activity is attempting to boost gas production out of non-traditional areas such as coal seam gas or tight shale formations. While these areas certainly have captive gas which can and should be produced, these areas also face very rapid production declines which are insufficient to replace current gas consumption. In light of these facts, natural gas pricing will continue to trend higher over time.

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## The Bowers Gas Report

Week ending: 4/22/05

Gas storage for the week ending 4/22/05 was 1416Bcf which was an injection of 73Bcf over the prior week. This compares to the year ago level of 1144Bcf and the five year average of 1097Bcf, a difference of +272Bcf and +319Bcf, respectively. For this injection season, I will be defining full storage at a level of 3400Bcf recognizing additional storage capacity constructed over the past few years and increased gas demands by the U.S. economy. With 28 weeks remaining in the injection season, we need to average an injection rate of 71Bcf per week to reach full storage levels by November 4, 2005.

This week has seen some gut-wrenching price moves in the energy market. Between the Saudi Crown Prince's meeting with George W. in Crawford and a softer than expected 1<sup>st</sup> quarter GDP report, oil and natural gas prices didn't stand a chance. Regarding the President's meeting this week, I saw some very subtle indications that there are high level concerns about future energy supplies in this country. A case in point is George's energy speech covering every conceivable aspect of reducing our dependency on foreign energy supplies. However, each and every idea represented possible longer term solutions and provides absolutely no help over the next three to five years. Could it possibly be that these ideas are being presented now so that when the manure hits the fan in the near future that the administration can at least say that they haven't been sitting on their hands while a crisis developed on their watch? Even more interesting to me was what the Saudis did not say after the meeting. What wasn't said was that they will immediately be delivering more oil on the market. They continued with their familiar song and dance about providing however much oil that buyers wanted, implying that only buyers wanting heavy oil supplies need bother to show up for future deliveries because that's all the Saudis have available to sale. The Saudis know good and well that the market cannot absorb any more heavy oil because of global refining limitations.

As far as the economy goes, the 1<sup>st</sup> quarter GDP showed slightly over 3% growth. However, the entire market expected more and has interpreted the report as meaning the economy is about to slide into the ditch. The market has further extrapolated the report to indicate that a main reason for the weakness is higher energy prices. Nothing could be further from the truth. The reality is that a year of Federal Reserve interest rate increases is finally starting to have an impact on our growth rate. Given the highly levered state of the economy from every corner, including government, businesses, and individuals, no one should be at all surprised that higher interest rates have reduced economic activity. As rates move up, the servicing of the debt cost becomes much more problematic, especially with the economy having the greatest level of debt in the history of the U.S. So far, higher energy prices have not been a significant factor. In fact, gasoline demand continues to climb in the face of prices over the \$2/gal level. My belief is that energy will not be a factor in slowing the economy until oil reaches \$80/Bbl. It is this level on an inflation-adjusted basis which has to be reached before we have similar conditions as the last energy crisis. Until then, we can expect slower economic growth with higher, creeping levels of inflation as we revisit what used to be called "stagflation". In a stagflation environment, energy investments will be superior to everything else.

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## The Bowers Gas Report

Week ending: 4/15/05

Gas storage for the week ending 4/15/05 was 1343Bcf which was an injection of 50Bcf over the prior week. This compares to the year ago level of 1073Bcf and the five year average of 1046Bcf, a difference of +270Bcf and +297Bcf, respectively. For this injection season, I will be defining full storage at a level of 3400Bcf recognizing additional storage capacity constructed over the past few years and increased gas demands by the U.S. economy. With 29 weeks remaining in the injection season, we need to average an injection rate of 71Bcf per week to reach full storage levels by November 4, 2005.

The BTU discount of natural gas to crude remains stubbornly high this week at 22%. However, contango effects in the futures market for both oil and natural gas bring the 12 month strip discount to about 16%. This tells us that the price escalation for natural gas is expected to be greater than the price escalation for crude oil, at least over the next twelve months. The market for natural gas and crude is beginning to understand that supplies for both commodities may be constrained in the near term as reflected in the futures pits. The market expects oil supply to be challenged through September while seasonal effects for natural gas is causing futures prices to climb through February '06. Of course, natural gas price escalation is further impacted by the need to inject into storage for next winter's demand. The "contango effect" of rising futures pricing tells us that the market is somewhat concerned about deliverability for a fairly brief period of time. I think if the market fully understood the deliverability problems which I believe to exist in natural gas and oil, then we would see an implied permanent contango where each subsequent month would show a higher price level. With oil demand in the 4<sup>th</sup> quarter of 2005 expected to exceed supply by at least three million barrels per day, we will get a good indication of market concerns for future energy supplies as recognition of supply shortages become more widespread over the next several months.

I've recently ran across information which implies that Chavez is continuing his plans to divert Venezuela's oil to China and away from the U.S. A PDVSA-owned terminal in the Bahamas with the capability to load the largest of oil tankers is taking over from the current operators who have been leasing the facility. The implication would be that the Venezuelans will be short hauling to the Bahamian oil terminal and reloading the bigger tankers for transport to either Europe or the more likely destination of China. This maneuver along with the obvious sale of their U.S. refineries indicates that they're not planning to deliver oil supply to the U.S. over the longer term. This further indicates that the two million barrels per day going to the U.S. currently would need to be replaced by imports from somewhere else. The only possible supplier of this heavy crude would be Saudi Arabia, but the supply would be coming to the U.S. at a higher price because of the greater transportation distance. If the U.S. replaced the Venezuelan heavy crude with the Saudi heavy crude, then all available remaining excess OPEC oil capacity even mentioned would be absorbed with no supply cushion to dampen the oil market from any disruption event whatsoever. As I have mentioned previously, we are being warmed up with \$50/Bbl oil to more easily handle \$60+ per barrel in the future.

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## **The Bowers Gas Report**

Week ending: 4/8/05

Gas storage for the week ending 4/8/05 was 1293Bcf which was an injection of 44Bcf over the prior week. This compares to the year ago level of 1047Bcf and the five year average of 1024Bcf, a difference of +246Bcf and +269Bcf, respectively. For this injection season, I will be defining full storage at a level of 3400Bcf recognizing additional storage capacity constructed over the past few years and increased gas demands by the U.S. economy. With 30 weeks remaining in the injection season, we need to average an injection rate of 70Bcf per week to reach full storage levels by November 4, 2005.

Bottlenecks and more bottlenecks! The report from the field continues to confirm what I have been harping about for well over a year now. Shortages of all varieties for oil country supplies and services are slowing down our ability to drill and equip new wells, and adequately maintain existing well bores. One primary problem continues to be with an inadequate number of properly trained rig hands. Which operator in their right mind wants poorly trained hands drilling and completing their wells? The obvious result is fewer wells being drilled than needed to replenish current consumption of natural gas or existing wells remaining off production longer while waiting for an adequately trained completion rig crew. I've previously mentioned shortages in frac sand supplies. Frac sand along with steel tanks and dehydration units are now taking six months for delivery. I won't even talk today about the rapidly escalating costs of all services and supplies which is eroding the profitability of operators, but will save that topic for a future report. The bottom line from the field continues to reaffirm my belief that all energy industry bottlenecks are severely constraining the ability to meet future gas demand and will result in much higher gas pricing as gas shortages persist in the U.S.

The oil supply trash talk is flinging fast and furious now as every government agency, OPEC official, and energy industry monitor is repeating the mantra of having adequate oil supplies to meet demand in the 4<sup>th</sup> quarter of this year. Me thinks they doest protest too much! I find it very amusing that after extreme concern about supplies just two weeks ago, we are now hearing unified chatter about declining Chinese and U.S. oil demand, increased OPEC production, and slower global economic growth later this year. Was this chatter coincidental or did it have anything to do with oil prices pushing rapidly toward \$60/Bbl? I stand by my conviction that global oil supplies will prove severely inadequate by the 4<sup>th</sup> quarter and will set the stage for continued rising oil prices.

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## The Bowers Gas Report

Week ending: 4/1/05

Gas storage for the week ending 4/1/05 was 1249Bcf which was an injection of 10Bcf over the prior week. This compares to the year ago level of 1031Bcf and the five year average of 1022Bcf, a difference of +218Bcf and +227Bcf, respectively. This represents the first week in the injection season which runs from now until November 1, 2005. The trough for this past withdrawal season is reflected in last week's report with gas storage at 1239Bcf.

We've seen an extremely volatile week in the energy markets as the Saudis use their last bullet. With the announcement that the Saudis will provide as much oil as the market wants, they have effectively sent the message that they are now pumping full out. This maneuver is an attempt by the Saudis to utilize their last remaining excess capacity to build global oil inventories ahead of the greater demand which will appear by the 4<sup>th</sup> quarter of this year. While the oil market interpreted this as too much oil being available in the near term and pushing oil prices down over \$5/Bbl, the longer term ramifications are clear and explicable. By the end of 2005 global oil demand will officially and undeniably be greater than the available global oil supply and as global demand continues its growth over sequential periods the supply gap will grow ever larger. Demand in excess of supply will be the economic force which will steadily push oil prices higher over the next several years until the price pain becomes too much for the global market to handle. The end result will be a global economic recession which curtails demand temporarily until the markets adjust to the higher price levels for energy. I mentioned over a year ago that the typical range for oil would be in the \$50-\$60/Bbl range for a few years and would then climb toward the inflation-adjusted historical trend line price which is now around \$85-\$90/Bbl. We are now in the "typical" range which should last until 2006. Afterwards, I expect oil prices to continue closing the price gap toward the inflation-adjusted trend line which will occur over the following two to three years. With any event-driven supply disruption the price gap will close immediately. Unfortunately for Wall Street, the implication for stocks and bonds through this environment will continue to shift favor toward real assets and away from financial assets.

The BTU gap between natural gas and crude oil has now closed to 18% as the gas storers support prices through their increased demand. With just a little bit more gap closing we will reach my forecasted price level of \$8/MMBtu in the not to distant future. \$10/MMBtu by the end of 2005 is still achievable given the strong price support being shown from the oil side. With industrial demand expected to increase this year, we could see some interesting price movement for gas if hot summer temperatures also decide to make an appearance. The gas market has gotten very complacent about unseasonably mild summers and winters, and has started to expect them as normal seasonal conditions. A hot summer this year could severely test the ability to inject the additional 2100Bcf needed in storage by next winter.

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## The Bowers Gas Report

Week ending: 3/25/05

Gas storage for the week ending 3/25/05 was 1239Bcf which was a withdrawal of 51Bcf over the prior week. This compares to the year ago level of 1017Bcf and the five year average of 1033Bcf, a difference of +222Bcf and +206Bcf, respectively. With one week remaining in the withdrawal season, we would need to average a withdrawal rate of 225Bcf per week to reach the trough level achieved in March 2004. As warm weather spreads across the country this week, we have likely seen this withdrawal season's trough with this report.

Natural gas pricing closed the BTU gap with crude oil slightly this week to a 17% discount as the gas storers began the mad scramble for supplies. The overall market is also beginning to understand the gravity of the gas supply problem as reflected in the twelve month gas futures strip which on the last day of March stood at \$8.11/MMBtu. Gas continues to be supported by strong oil pricing which is demonstrated by the twelve month futures strip at \$56.43/Bbl on March 31.

The energy industry bottlenecks to which I have frequently referred continue to show themselves as primary contributors to higher energy pricing. Although more crude oil supplies are arriving on our shores at the present, the end products such as gasoline, heating oil, and other distillates continue to shrink in supply. The quantity of end products is simply limited by the refining capacity to produce such products. I suspect too that much of the extra crude arriving here is heavy crude which our refineries have long ago reached their limits and ability to process. It is well known that lesser quantities of end products are achievable from heavier grades of crude than the lighter grades thus it takes more barrels of heavy crude to make the same amount of end products. While some refining capacity is currently lost to scheduled maintenance at this time of year, the total refining capacity remains insufficient to meet the growing demand for crude's end products.

It seems that I have been shortchanging you on my energy price forecasting. While I have remained consistent in predicting higher pricing trends and talking about \$60/Bbl crude and \$10/MMBtu for natural gas by yearend, my forecasts seem to pale in comparison to the recent reports put about by the esteemed energy analysts at Goldman Sachs. That venerable firm's report this week speaks of possible \$105/Bbl oil and \$13/MMBtu gas prices. Granted, they do not expect to reach these levels until 2007. However, I am pleased that other more significantly respected organizations are falling into my camp. Goldman Sachs does make one major mistake in my opinion. They expect prices to fall off dramatically after 2007 because of increased oil supplies and competition from LNG. My belief is that regulatory issues will delay the LNG build-out in this country for several years beyond 2007 and will not reach meaningful capacity levels until 2015 at the earliest. Only after reaching about 10% of gas demand will LNG even come close to competing with domestically produced supply. Another factor which needs consideration is the cartel potential of the future gas suppliers to the U.S. Has anyone considered the possibility that once massive capital investment is made in LNG facilities that the suppliers into the system may desire pricing more closely aligned to what domestic producers are commanding? We've seen the same movie before with crude oil supplies and we already know how that one ends. In addition, Goldman's presumption of higher oil supplies after 2007 seem out of whack to me as well. I guess the increased global oil supply will come out of thin air since the long-term investment to find new supplies has yet to be made. We'll just have to wait a couple of years to see which one of us has the better forecast. Hang on to your shorts, its going to be a bumpy ride!

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# The Bowers Gas Report

Week ending: 3/18/05

Gas storage for the week ending 3/18/05 was 1290Bcf which was a withdrawal of 89Bcf over the prior week. This compares to the year ago level of 1041Bcf and the five year average of 1058Bcf, a difference of +249Bcf and +232Bcf, respectively. With 2 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 138Bcf per week to reach the trough level achieved in March 2004. Next week's report should show a draw down of around 50Bcf from storage.

The BTU discount for natural gas compared to crude oil still hugs the 23% level despite the fact that U.S. gas production continues to shrink from almost every possible measure. The latest Raymond James survey of publicly traded gas producers shows a 2.7% decline in gas production for the 4<sup>th</sup> quarter 2004 on a year over year basis. The same report indicates that for the full year 2004 that gas production shrank by 3.5%. While this particular report represents only 50% of the country's gas producers, I consider it a reasonable proxy for the trend in gas production for the entire sector. I can argue this from the standpoint that the remaining privately held producers likely have less financial capacity and access to drilling rigs to sustain or even grow their production sufficiently to offset the decline from their public brethren. At some point, the gas market will realize the non-sustainability of this trend and close the gap between gas and crude. I anticipate that the "closing of the BTU gap" will occur during either the shoulder season or the onslaught of above average summer heat conditions. Both events would be driven by the LDC's need to sufficiently inject gas into storage for next winter while competing against utility and industrial users, whose gas needs are also rising in the current economic environment. The competition for shrinking gas supplies will only intensify as other fuel choices, in the form of oil and coal, also become constrained because of increasing global demands on their respective limited supply. Based primarily on anticipated price support from crude oil, I believe we will be testing the \$10/MMBtu level for natural gas before the end of 2005.

While reviewing some of my old reports, I ran across my first mention of the energy sector entering the "golden era for natural gas" in October, 2003. At that time gas was hovering around \$5/MMBtu and oil was trading around \$28/Bbl. In this eighteen month period, oil prices have risen almost 100% while gas has risen only about 40%. I think the difference in price movements can be attributed to the full recognition of global demand exceeding global supply with regards to oil while only marginal recognition in the case of shrinking U.S. natural gas. In 2003, natural gas traded at a BTU premium to oil as opposed to a substantial discount at the present. Since 2003, mild weather over two winters and one summer has moderated the pressure on natural gas supplies through reduced demand. However, over the last eighteen months, gas demand has continued to grow while simultaneously becoming a cheaper fuel choice compared to oil. For this reason and others mentioned above, the prospects for natural gas pricing look as favorable as I've ever seen while the better days of the "golden era" lie ahead.

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## **The Bowers Gas Report**

Week ending: 3/11/05

Gas storage for the week ending 3/11/05 was 1379Bcf which was a withdrawal of 95Bcf over the prior week. This compares to the year ago level of 1104Bcf and the five year average of 1109Bcf, a difference of +275Bcf and +270Bcf, respectively. With 3 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 122Bcf per week to reach the trough level achieved in March 2004. Next week's report should show at least 90Bcf drawn down from storage.

This has been a historic week in the energy market. Several OPEC ministers have publicly stated that "there is no more that they (OPEC) can do!" in reference to providing more oil to the market. The oil market is now officially subject to the economic law of supply and demand. For those market analysts who have little understanding of the significance of this event, they will continue to deride energy prices as about to peak almost any day. In particular, those energy stock analysts who keep telling their clients that oil prices will soon be heading back below \$30/Bbl clearly do not have a clue about the supply/demand dynamics and are providing a tremendous disservice to their clients. Until we either reach the point of commercializing an alternative form of energy to compete against hydrocarbon-based fuels or face a global economic collapse for some reason, as the world economy grows, so grows the price of oil! Back in January, I said the surprise of '05 would be \$60/Bbl by the end of the year. It now looks like \$60 is right around the corner and we may be closing the gap on the inflation-adjusted trend line price of \$85/Bbl even quicker than I expected.

Natural gas continues to trade at a 23% BTU discount to crude oil. While we are now seeing increased levels of drilling for natural gas with the rig count over 1300 rigs, the projected new supplies continue to fall short of growing demand for gas. Some anecdotal evidence has recently come out that disputes vast industrial gas demand destruction caused by higher natural gas prices over the past few years. Various market players have often cited this "industrial demand destruction" argument as a reason to keep natural gas pricing low in the face of shrinking U.S. gas production. It now seems that industrial demand for gas remains robust and is poised to grow faster despite the higher natural gas price environment. Has someone been pulling the wool over the gas producers' eyes again! With strong support from the oil side, an \$8/MMBtu gas price looks very likely by the start of summer.

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## The Bowers Gas Report

Week ending: 3/4/05

Gas storage for the week ending 3/4/05 was 1474Bcf which was a withdrawal of 139Bcf over the prior week. This compares to the year ago level of 1147Bcf and the five year average of 1173Bcf, a difference of +327Bcf and +301Bcf, respectively. With 4 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 115Bcf per week to reach the trough level achieved in March 2004. Next week's report should show the last greater than 100Bcf draw down from storage for this withdrawal season. This current burst of cold weather almost now guarantees that the trough storage level after this withdrawal season will be slightly below 1200Bcf.

OPEC is running scared! I can tell this is happening because of the bountiful, but conflicting statements being publicly disseminated by every OPEC minister. They still have it in their minds that the global oil market places credibility in their rhetoric. Little do they know that their words became meaningless once the world realized that OPEC no longer had excess oil capacity to use as leverage in capping oil prices? Their last remaining weapon, which is fast becoming useless, is the ability to put a floor on oil prices by threatening to remove production. Under the present historically unique situation of global oil demand exceeding global oil supply there simply is no need for their last remaining weapon as the market takes control by moving oil prices steadily higher. Oil pricing will continue its upward march until we reach a market clearing price where the last marginal barrel of oil produced is bought by the last marginal oil buyer. With a global economic growth rate of 4% expected in 2005 and expected growth of 2-3% over the next few years, oil demand in excess of oil supply will be with us for quite awhile.

On the natural gas front, it was only in my last report when I mentioned that I expected the gas storers to start moving prices higher to get a jump on the injection season. It seems that they started this past week as natural gas prices have climbed dramatically and have also closed the natural gas to crude BTU discount to a still lofty 22%. Both the forward month and the twelve month gas strip could soon move above the \$8/MMBtu level which is earlier than my previously expected April-May timeframe. The twelve month gas strip closed today at \$7.61/MMBtu. Just for argument's sake, if natural gas traded on a normal 6:1 BTU basis, we would now be at \$9.16/MMBtu for the front month. For this very fact and because I believe the market will eventually realize that U.S. gas production cannot continue to shrink on a sustained basis, natural gas prices will be stronger this year than many could have imagined, present company excluded of course.

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## The Bowers Gas Report

Week ending: 2/25/05

Gas storage for the week ending 2/25/05 was 1613Bcf which was a withdrawal of 107Bcf over the prior week. This compares to the year ago level of 1198Bcf and the five year average of 1255Bcf, a difference of +415Bcf and +358Bcf, respectively. With 5 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 120Bcf per week to reach the trough level achieved in March 2004. Next week's report will show the effects of winter weather lingering in the Northeast and should indicate a withdrawal of over 100Bcf which will leave about 1500Bcf remaining in storage with 4 weeks remaining in the withdrawal season.

Although the discount for natural gas against its Btu equivalent in crude oil has now widened to 25%, we are receiving the strong price support from crude oil that I anticipated. The energy story this week has been April crude oil futures closing every day above the \$50/Bbl mark. In addition, this week's price movement contrasts sharply with last October's quick jump at \$55/bbl which then immediately fell back into the \$40's. The market is beginning the long process of finally accepting the reality of higher energy pricing now and into the future. We see this reflected in the twelve month crude oil futures strip which closed today at \$52.88/Bbl and the twelve month natural gas futures strip which closed at \$7.33/MMBtu.

Now that it looks like we avoided a down dip in natural gas pricing because of ill-conceived excess storage concerns, I believe the stage is set for a dramatic closing of the natural gas BTU discount to crude oil which I have so frequently mentioned over the last few months. My reasoning in this conclusion is very simple. As we conclude the winter withdrawal season, the gas storers need to immediately shift gears and begin injecting gas supplies into storage in preparation for next winter. Now that everyone in the gas business knows that U.S. gas production continues to shrink, the ability to obtain future supplies of natural gas becomes more uncertain with each passing month. This over-hanging "cloud of uncertainty" plus the pending arrival of summertime heat will press the gas storers into action well ahead of June in order to fulfill their obligations as gas suppliers. With gas supplies already constrained, the only possible rationing mechanism in the competition for a limited resource is pricing. With continued price support from crude oil, I believe we will finally see a sustained price move for natural gas to the \$8/MMBtu level during the April to May timeframe. Further support in my conclusion lies in the last three years worth of gas pricing during the spring shoulder season which has steadily been at higher price levels over each consecutive year. You better hold onto your shorts again, it may be time for another bumpy ride!

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## The Bowers Gas Report

Week ending: 2/18/05

Gas storage for the week ending 2/18/05 was 1720Bcf which was a withdrawal of 88Bcf over the prior week. This compares to the year ago level of 1314Bcf and the five year average of 1364Bcf, a difference of +406Bcf and +356Bcf, respectively. With 6 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 118Bcf per week to reach the trough level achieved in March 2004. Next week's report should reflect another relatively mild week of winter weather and show a withdrawal of about 80Bcf which will leave about 1640Bcf remaining in storage with 5 weeks remaining in the withdrawal season. Although a cold front did punch its way into the Midwest and Northeast at the end of the week, I expect little impact on storage as I will explain in the discussion below.

The investment markets are starting to believe that higher energy prices will be with us for awhile now. We can see this growing belief in two areas, publicly-traded energy stocks and energy futures. If you will recall, I mentioned in a previous report in early December, 2004 that OPEC's announcement to pull a million barrels of oil off the market beginning January 1 represented a signal to the market that for the first time ever a floor price of \$40/Bbl would be established for oil. At the time, energy stocks were priced as if oil would be priced at \$30/bbl and natural gas at \$5/MMBtu. With OPEC's latest pronouncements stating that \$50/Bbl oil might not hurt the global economy, stock analysts have begun ratcheting up their commodity price expectations to more properly reflect higher energy pricing. Needless to say, this simple change in expectations has caused the prices of energy stocks to explode upward this month as the energy companies' underlying asset value is also adjusted to reflect higher commodity pricing. As energy stocks are greatly under-owned by the broad investment market, this rise in energy stock prices could keep going for a very long time. As for energy futures directly, the twelve month strip for crude oil has now risen to about \$50.60/Bbl while the twelve month natural gas strip has risen to almost \$7.25/MMBtu. At these twelve month strip levels, we are rapidly approaching pricing as experienced last October when oil hit \$55/Bbl and we weren't expected to have sufficient natural gas to make it through the winter. Isn't it amazing how things can change when certain necessary commodities are in short supply and the market finally wakes up to reality?

With regard to natural gas storage, I believe that the normal buyers of gas for storage, such as pipelines and LDC's, are beginning to realize that deliverability of gas is a growing problem faced by our country. My belief is grounded in the fact that the owners of stored gas are behaving abnormally this withdrawal season by becoming very reluctant to pull those supplies out for consumption and instead are relying on currently produced gas for their winter needs. These gas storers would only behave in this manner if they believe that consumed gas supplies would require replacement at significantly higher prices later. Therefore, to insure that they're able to fulfill their obligations next winter season, the gas storers are leaving as much gas in storage as possible this withdrawal season. Problems in establishing appropriate gas pricing are created when people like gas traders attempt to use historical storage data as a gauge of natural gas supply. Clearly, in the face of declining U.S. natural gas production, the use of gas storage levels as a measure of determining future natural gas supplies is ill-advised and could be hazardous to one's pocketbook.

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## The Bowers Gas Report

Week ending: 2/11/05

Gas storage for the week ending 2/11/05 was 1808Bcf which was a withdrawal of 98Bcf over the prior week. This compares to the year ago level of 1480Bcf and the five year average of 1495Bcf, a difference of +328Bcf and +313Bcf, respectively. With 7 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 113Bcf per week to reach the trough level achieved in March 2004. Next week's report should reflect relatively mild weather conditions and show a withdrawal of about 80Bcf which will leave about 1700Bcf remaining in storage with 6 weeks remaining in the withdrawal season.

As the natural gas market begins to anticipate the end of the withdrawal season, the discount for gas to its Btu equivalent in crude oil has widened out to 27%. While natural gas maintains its status as the "red-headed stepchild" of the energy complex some interesting things are developing on the oil side these days. A study put out by OPEC confirms the 2005 global oil demand forecast of 84 million Bbls/day earlier announced by our very own Energy Information Administration. Meanwhile, global oil production in 2005 from all sources is currently pegged at 82 million Bbls/day. Any ideas where this difference between demand and production will come from? I won't keep you waiting by telling you that these barrels are coming out of the Saudi oil inventory held in their vast oil storage facilities. While the Saudis could keep this game going for several months without anyone noticing, they cannot keep it up forever. I have concluded that "forever" will be ending over the next few months as we begin seeing reduced oil deliveries to the Western countries, particularly the U.S. which will cause our inventory levels to fall off ahead of the critical summer driving season. As oil inventory in the U.S. begins to drop significantly, competition for the reduced oil supply will be the motivating factor which will drive oil pricing toward the \$60/bbl level. The good news for all of the gas producers is that oil will provide strong price support to natural gas pricing which will help move the market from the \$6/MMBtu level toward the \$8/MMBtu level.

Speaking of gas, will someone please tell the gas traders that paying too much attention to gas storage in today's market is highly misguided and very wrongheaded? First of all, the storage capacity of the U.S. has grown by about 5% over the last few years which makes the year over year comparisons to peaks and troughs irrelevant. Secondly, with U.S. gas production continuing to shrink, the market should be paying more attention to the availability of future supplies. Deliverability constraints from too low of a drilling rate, inadequate field personnel, declining quality of field production, and oilfield service shortages would tell anyone paying attention that multiple issues are involved which are preventing the industry from fulfilling the growing gas demand in this country. The only thing preventing us from having a full blown natural gas crisis up till now is the mild summers and winters in recent years and the delivery of Canadian gas. I guess the gas traders are thinking that the weather will never change and the Canadians will always bail us out. This might be wishful thinking!

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## **The Bowers Gas Report**

Week ending: 2/4/05

Gas storage for the week ending 2/4/05 was 1906Bcf which was a withdrawal of 176Bcf over the prior week. This compares to the year ago level of 1667Bcf and the five year average of 1644Bcf, a difference of +239Bcf and +262Bcf, respectively. With 8 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 112Bcf per week to reach the trough level achieved in March 2004. Next week's report should show a withdrawal of over 100Bcf which will leave about 1800Bcf remaining in storage with 7 weeks remaining in the withdrawal season. With little in the way of forecasted severe winter temps for the rest of February, I've prepared mentally to expect about 1200Bcf of gas in storage at the end of this year's withdrawal season. This level would imply that about 2100Bcf will have been withdrawn from storage for the entire withdrawal season and represents a mild winter event.

The natural gas discount to its BTU equivalent in crude oil has now widened to about 23% as the market is beginning to anticipate successfully making it through another winter without any problems in natural gas deliverability. It appears that we have yet again survived potential deliverability problems because of mild weather conditions. If my count is correct, I believe that is three consecutive winters and two consecutive summers of mild temperatures, and yet, natural gas prices have continued to trend upward. It seems that even mild seasonal weather has been unsuccessful at turning the tide against declining supplies of U.S. natural gas production. Not even with the assistance of increased drilling activity during this time period has the price trend faltered. I believe this is true testament to the fact that the availability of economic and viable drilling locations for natural gas supplies across the U.S. is very rapidly becoming scarce. We already know that newer wells being drilled are less productive than their predecessors in general. With field service costs rapidly rising and reducing the profitability of current gas production, the energy industry has yet to see the price level reached which will justify moving from the developmental drilling stage to the exploratory stage. Only after hitting the \$8/MMBtu level on a sustained basis will the industry be able to move onto the next plateau and replace the rapidly diminishing U.S. natural gas reserve base.

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## The Bowers Gas Report

Week ending: 1/28/05

Gas storage for the week ending 1/28/04 was 2082Bcf which was a withdrawal of 188Bcf over the prior week. This compares to the year ago level of 1894Bcf and the five year average of 1809Bcf, a difference of +188Bcf and +273Bcf, respectively. With 9 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 119Bcf per week to reach the trough level achieved in March 2003. Next week's report should show a withdrawal of over 160Bcf which will leave about 1900Bcf remaining in storage with 8 weeks remaining in the withdrawal season. However, this week's withdrawal number is highly suspicious; because it came in almost 30Bcf lower than the expectations of highly regarded sources and the general gas market consensus. We will probably see a downward revision next week as the EIA corrects for some currently unknown reporting error. The gas market sold off in response to the suspicious report anyway.

Oh boy, I really do not like the sound of rumblings coming from Venezuela these days. As a major supplier of heavy crude oil to the U.S., delivering about 2 million Bbls per day to Venezuelan-owned refineries located in the States, Hugo Chavez is making noise which very much sounds like he is about to change the rules of the game. We already know that Chavez has recently fostered a very cozy relationship with Fidel Castro of Cuba and the Chinese government, and that the Chinese have already promised substantial capital investment to Venezuela specifically targeting additional oil development. Almost simultaneously, Chavez has decided that oil contracts held by several U.S. oil companies will be changed to reflect significantly higher royalties that must be paid or else forego the contracts. Is Chavez taking a page out of the Russian government oil contract playbook? The typical Russian way of dealing with unfavorable contracts has been "If you don't like the terms of what an agreement says, just disregard the agreement and write in your own terms". This is usually called the "old bait and switch". Now Chavez is deploying the "old bait and switch" on the U.S. oil companies. The most recent grumbling from Chavez says that he is now uncertain whether the U.S. should be receiving Venezuelan oil because of the significant ideological differences between the two countries and that he might even sell their refineries located here. Let's stop for a moment to look between the lines of what might be going on and ask ourselves why Chavez would want to completely cut off the U.S. market located just a short distance across the Gulf of Mexico? Could it possibly be the promise of substantial Chinese oil development capital at very favorable terms in return for the 2 million Bbl per day currently going to the U.S.? We know that the Chinese are in a mad scramble for energy resources, particularly oil, and that they have the capability to pay any price necessary. What better way to secure oil supply than to pick the back pocket of the U.S. and grab supply normally delivered here? I know some could say that the Saudis have heavy crude available to replace any lost Venezuelan supply, but Saudi heavy crude is definitely more costly to the U.S. because of the greater transportation distance. In addition, how do we know that the Saudi's extra heavy crude hasn't already been pledged for future Chinese delivery? I think we can expect to see more situations like this in the very near future as the competition in the global market for scarce and tight oil supply runs head long into increasing global energy demand. The one aspect I feel for certain that will come out of the quickly shifting sands in the oil market is higher oil prices, possibly much higher oil prices.

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## The Bowers Gas Report

Week ending: 1/21/05

Gas storage for the week ending 1/21/05 was 2270Bcf which was a withdrawal of 230Bcf over the prior week. This compares to the year ago level of 2119Bcf and the five year average of 1991Bcf, a difference of +151Bcf and +279Bcf, respectively. With ten weeks remaining in the withdrawal season, we need to average a withdrawal rate of 126Bcf per week to reach the trough level achieved in March, 2004. Next week's report should now show a follow through with another 200Bcf+ withdrawal as the cold temps settled this week over the major gas consuming areas of the Northeast and Midwest. A moderating weather forecast for the first week of February should give us a withdrawal of at least 150Bcf in the following week's report.

In case someone didn't notice, the rig count in the U.S. has flat lined over the past five months. This piece of trivia when added to the latest Lehman forecast indicating a decline of over 3% in 2004's U.S. natural gas production should be of significant concern for gas consumers while simultaneously warming the cockles of gas producers' hearts everywhere. You see, despite drilling at a faster rate than a year ago, we continued to slip in gas production for the third consecutive year. Only through the good graces of our Canadian neighbors do we have gas supplies to meet the current gas demand in the face of inadequate drilling levels. The flat lining of the rig count simply implies that our gas supply situation will be getting worse because of the inherent depletion effects of current production on our gas fields. In addition, the new wells being drilled are less productive than previously drilled wells as the shortage of viable drilling locations plague the energy industry in the U.S. However, the benevolence provided by our northerly brethren may soon be short-lived as Canada's own energy needs override their ability to export gas to us over the next several years. The price implications for natural gas should be obvious as the march continues onward and upward.

I wanted to give a brief note on oil this week as the latest OPEC meeting just concluded. They decided to continue with their latest production quotas without cutting any further for the time being. The OPEC ministers state that "we believe that current oil pricing at \$50/Bbl is not harming the global economy materially and represents an acceptable price level". Let me translate that for you just in case you missed the message for the world. They like the sound of \$50 oil much better than \$40 oil, so if everyone gets comfortable with paying \$50 now, then everyone won't be as shocked when we start charging more than that next year. Do I hear \$60 around the corner?

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## The Bowers Gas Report

Week ending: 1/14/05

Gas storage for the week ending 1/14/05 was 2500 which was a withdrawal of 110Bcf over the prior week. This compares to the year ago level of 2303Bcf and the five year average of 2156Bcf, a difference of +197Bcf and +344Bcf, respectively. With 11 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 135Bcf per week to reach the trough level achieved in March, 2004. This next week's report will show this winter's first greater than 200Bcf withdrawal from storage. Given that the forecast for the upcoming week will not be quite as cold as the prior week, I look for the following report, for the last week of January, to show a withdrawal in the 180-200Bcf range. We are still likely to finish January with storage less than 2100Bcf with nine weeks remaining in the withdrawal season. After January, it will only take two big withdrawal weeks of the remaining nine to take gas storage close to the 1000Bcf level, a level regarded as normal for the end of a withdrawal season. Many weather pundits are saying that this winter is already through, but if you ask me, we should look no further than the Farmer's Almanac that predicted a very severe winter this year which doesn't bode well for a balmy February and March.

Despite my predictions of more winter to come which will knock back gas inventory levels, the market has now widened the discount of natural gas to its BTU equivalent in crude oil to about 23%. In addition, the much publicized removal of one million barrels per day of OPEC oil production from the market as of January 1 has achieved its intended effect. That is to place a floor price of \$40/Bbl on the world price of oil. However, what if I now told you that those barrels were really never taken off the market and that OPEC oil production actually fell because of their inability to sustain the high level of production desired by the market. How do you think the market would react to that piece of news? I can tell you that the price of oil would barely slow down on its way to \$60/Bbl. We actually started seeing OPEC oil production slip beginning in November. Once December production numbers are out, we will likely see them slip again to, lo and behold the one million barrel less per day level. Our very own Energy Information Administration is forecasting global oil demand in 2005 to rise to about 84 million barrels per day. The total estimated global oil supply, including OPEC, is currently about 82 million barrels per day. If this forecast is correct, which of the oil consuming countries around the world will be willing to forego their share of the two million barrel per day shortfall? I can guarantee you today; it will not be the Chinese. This growing Asian economy is in the wheeling and dealing mode cutting a deal with whomever and wherever around the globe. The Chinese will use their economic strength to place themselves as the marginal buyer of future crude oil supplies and will pay whatever the market is willing to bare. Given the current situation in the oil market, my prediction is that the surprise of '05 will be the \$60/Bbl level before the end of the year. I can almost hear the howls of laughter now, but before you write me off as a crackpot, let's list the present hot points from major oil producing regions around the globe. 1) Iraqi insurgents 2) Iranian nuclear proliferation 3) Nigerian unrest 4) Growing Muslim fundamentalism in Saudi Arabia 4) Russian re-nationalism of energy assets and 5) Venezuelan leadership saddling up to the Communist regimes of Cuba and China. Keep in mind that absolutely none of the items that I listed has anything to do with naturally occurring geologic depletion of oil fields. On second thought, maybe it has everything to do with geologic depletion of the world's oil fields. As more countries and their peoples begin to more fully understand the inevitability of declining global oil production and the resulting economic impact, we can likely expect higher levels of conflict as competition for a limited resource begins to change the global balance of power. As Americans, we better get our economic act together rather quick, because the pursuit of energy supply to sustain every country's economy will become the most pressing issue that the world faces for the remainder of this decade and the next.

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## The Bowers Gas Report

Week ending: 1/7/05

Gas storage for the week ending 1/7/05 was 2610Bcf which was a withdrawal of 88Bcf over the prior week. This compares to the year ago level of 2458Bcf and the five year average of 2289Bcf, a difference of +152Bcf and +321Bcf, respectively. With 12 weeks remaining in the withdrawal season, we need to average a withdrawal rate of 133Bcf per week to reach the trough level achieved in March, 2004. Next week's report will show a withdrawal in the 110-130Bcf range. Afterwards, the current arctic deep freeze over the entire Midwest which is expected to last two solid weeks will cause huge withdrawals in the last two weeks of January. I look for each of those reports to show withdrawals in the 180-200Bcf range. These large withdrawals would imply that we go into February with about 2100Bcf in storage with nine more weeks of withdrawals remaining. At this rate, it will not take too many more cold spells to eliminate any perceived excess gas in the storage system.

The natural gas discount to crude oil continues to grow and now is approaching 21%. While I have a difficult time rationalizing why a commodity in shortage should be discounted for any reason, I do understand who is completely in charge of the pricing mechanism. The NYMEX pit with its tunnel vision focus on weekly gas storage has been pushing natural gas prices around for many months now. How else can anyone explain higher pricing in November than December, and then again with higher pricing in December than January? Much of the trader's control over the natural gas market has created extreme volatility which is the lifeblood of a trader. The more volatility the better is the trader's mantra. These astute traders profit in the wide swings in prices by playing both sides of the market and not really caring which direction pricing goes. However, the real risk takers and providers of the physical gas which makes the natural gas market possible, meaning the gas producers, need as much pity as we can muster their way. The gas producer, in most cases, is paid for his gas based upon a particular gas market index which is locked in at the first of every month and will remain the same regardless of price moves within the month. Therefore, none of the volatility which delivers profit to the traders benefits the gas producer in any way. In addition, the pricing received by the gas producer resembles nothing like the prices that everyone sees from the NYMEX pit. Depending upon a gas producer's particular market, he is usually discounted several percent to the Henry Hub price which is the basis for NYMEX gas pricing. To add further insult, the gas producer's gas price is shaved even more because of discounts and charges applied by a gas producer's pipeline company for various services. After paying the pipeline company, the poor gas producer might receive only 80% to 90% of NYMEX pricing. The gas producer then must pay state severance taxes for the gas that he produces, which in Texas amounts to 7.5% of revenues. This is then followed by paying the mineral owner a royalty somewhere between 12.5% and 25% of revenues. Finally, the gas producer must pay the cost of gas well operations which may take another 20% off the gas price that he receives. When you add everything together, the gas producer is lucky if he nets out 50% of the NYMEX pricing in any given month. Given the number of fingers in the gas pie and the numerous risks involved, is it any wonder that gas producers are reluctant to drill more wells without more certainty in the price mechanism. The volatility created by NYMEX traders very simply fosters uncertainty which hinders the ability of the U.S. gas producers to provide sufficient gas supplies demanded by the market. The one certainty being created, in my mind, is that with natural gas supplies shrinking while gas demand continues to grow, natural gas prices down the road will be going up.

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