

Natural Gas Winter Outlook

Winter
Heating
Season

2002 – 2003

February 2003
Update

NGSA
Natural Gas Supply Association

What's Happening With the Price of Natural Gas?

In September of 2002, the Natural Gas Supply Association released a report saying that due to market fundamentals, such as an expected normal winter increasing demand coupled with tight supply, higher natural gas prices may occur. That is exactly what has happened.

Like other commodities, natural gas prices are determined by a competitive market. A wholesale price emerges based on market fundamentals that pull the market up or down. The natural gas market is highly competitive, with hundreds of brokers buying and selling natural gas at hundreds of points around the continent as well as through futures products traded on the New York Mercantile Exchange.

So what is happening with the price of natural gas?

Demand is up: So far this year, the winter has been colder than last year for much of the country, and in the regions that mainly use natural gas for heating homes - the Northeast, Midwest and Mid-Atlantic states - it has been 29 percent colder than last year. Colder temperatures mean increased demand, especially by residential home heating customers, which represent 55 percent of U.S. homes.

In addition, recent indications are that industrial demand for natural gas may be rebounding. Data from the Institute for Supply Management reports that their index for manufacturing

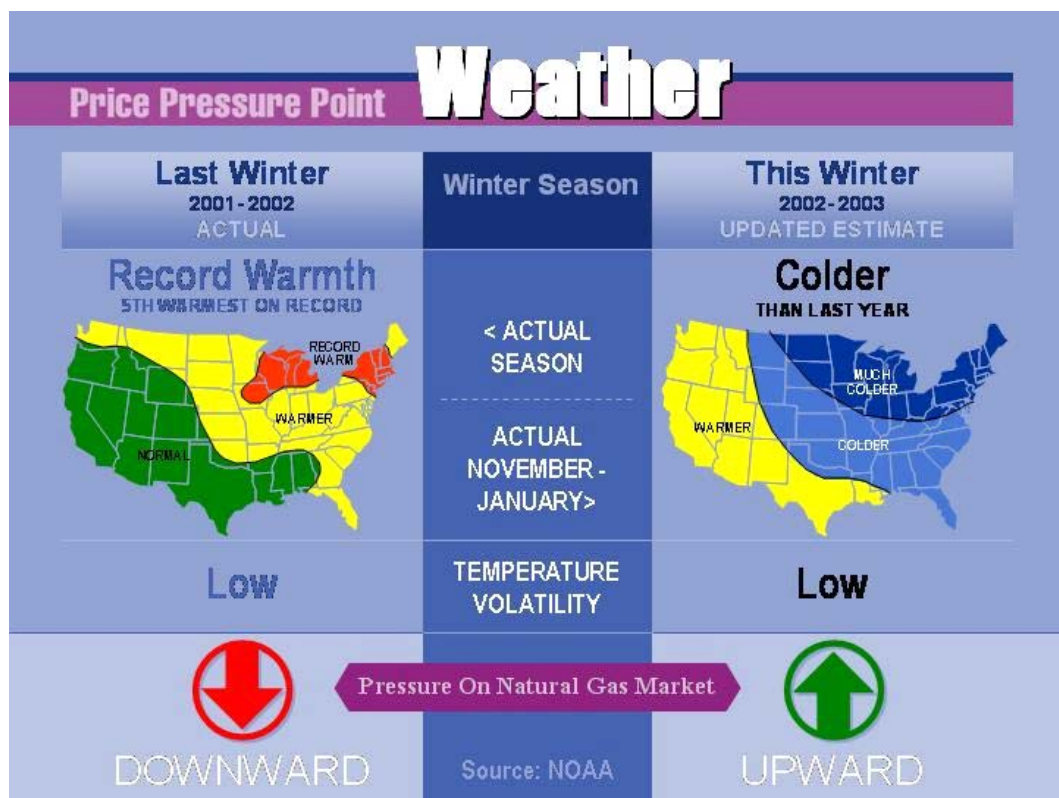
conditions rose to 54 percent in January from almost 50 percent in October, far above expected levels. The leading U.S. economic indicator announced recently by the Conference Board, another indicator of future economic activity, has also shown improvement suggesting economic recovery in the first half of 2003.

Moreover, natural gas that was bought early and put into storage for winter is being drawn down at a faster than average rate. Both the amount of natural gas in storage and rate it is withdrawn impact prices. While the cold winter has put pressure on storage operations, enough natural gas exists to pull through the winter. These abnormal withdrawals are indicative of tight market conditions and will leave us with low storage inventory, which may put a strain on next winter's supply.

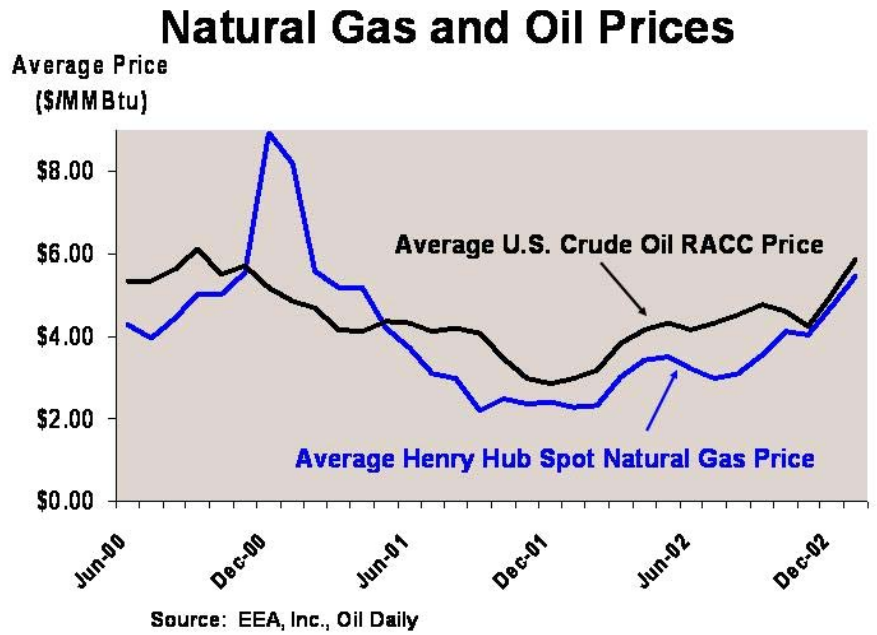
Supply is tight: The balance between supply and demand is tight because it takes time for the results of increased exploration and production (E&P) activity, responding to higher prices, to feed through to consumers:

- Producers are currently producing all they can as they face the challenge of producing natural gas from mature regions. Also, many new developments are deeper and more technically challenging resulting in increased costs and longer development times;
- Canadian supplies are suffering from similar problems plaguing U.S. producers; namely, slow drilling last year and steeper decline rates in mature fields are inhibiting their ability to increase production;
- Producers are doing everything they can to expand production from existing wells, and they have employed an average of almost 1,100 work-over rigs for the last three years;
- Natural gas prices dropped substantially from 2001 to 2002, and we saw a corresponding reduction in the record E&P activity levels we had seen up until then;
- When prices started to increase in April 2002, rigs drilling new natural gas wells also increased. Since mid-April, producers have increased the number of North American land rigs by 80 percent in response to higher prices.

Companies are in the process of analyzing new drilling opportunities and applying for permits, but the lag time can take up to 18 months before the natural gas reaches the market. In fact, while it may only take a few months to drill a successful producing well, it may take up to several years to secure the permits before drilling may begin.



Oil prices are up: In NGS's Winter Outlook, we outlined several factors that could pull the natural gas market up or down. One of the wildcards identified was the possibility of war with Iraq and increased oil prices. Although the oil and natural gas markets are separate, the prices for the two tend to move together due to interfuel competition in the industrial and power generation sector. Oil prices remain strong, not just from the threat of war with Iraq, but also due to striking oil workers in Venezuela. With oil prices up, we are seeing upward pressure on the natural gas market as well.

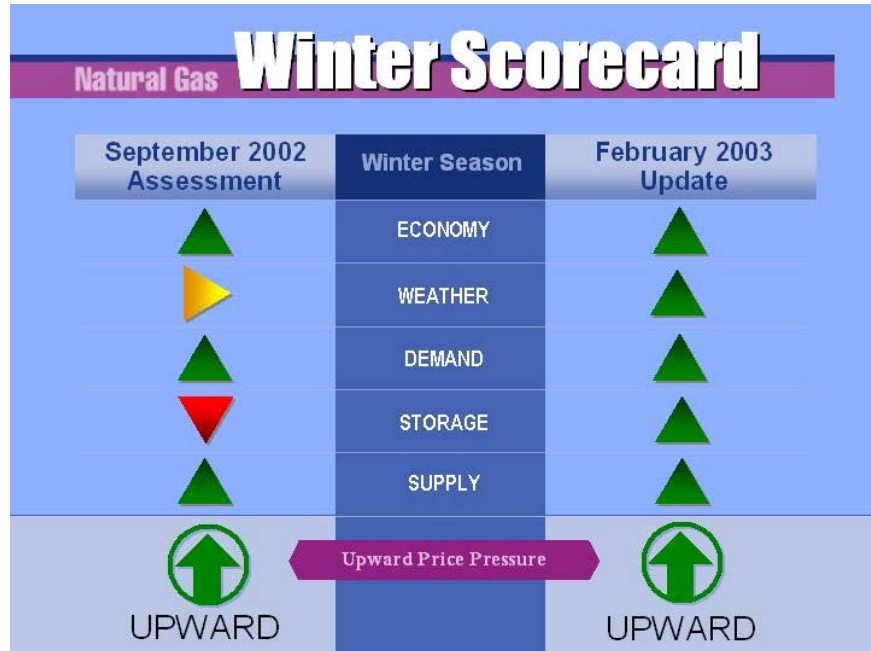


The Administration has released \$200 million in emergency funds for the Low Income Home Energy Assistance Program (LIHEAP). The money represents the remaining portion of the LIHEAP emergency money Congress appropriated for Fiscal Year 2002. The president already released \$100 million last fall. The emergency fund release comes on the heels of Senate approval of a \$2.0 billion appropriation for LIHEAP in FY03 and there is talk at the White House of increasing LIHEAP funding levels in FY04 as well.

What about the future of natural gas?

Access to supply is critical to the fuel of the future. According to the Energy Information Administration, the statistical arm of the Department of Energy, natural gas provides almost a quarter (24 percent) of the nation's energy needs, and natural gas is the fastest growing major energy source. Natural gas is a clean, safe, efficient and reliable fuel. Consequently, demand from customers is rising.

Residential customers are increasingly using natural gas, with 78 percent of new homes built in the U.S. choosing to heat with natural gas. The industrial sector is the biggest natural gas user, with six industries (food, paper, chemicals, refining, primary metals, stone, clay and glass) accounting for over 80 percent of industrial gas use. Electric power plants are also major consumers of natural gas, with 95 percent of plants being built today choosing to burn natural gas.



With about 84 percent of natural gas consumed in the U.S. produced in America, natural gas is a domestic fuel. The remainder comes from Canada (15 percent) via pipelines and in the form of Liquefied Natural Gas (LNG), which is shipped from overseas (1 percent).

A major concern of natural gas producers is the maturity of the existing resource base where drilling for natural gas takes place. Discoveries within the known basins are becoming increasingly smaller and the productivity of wells being drilled today has a shorter life. Consequently, planning for the future supply of natural gas must include access to new areas.

Producers are Working For Today...

In the short-term, producers are working to expand production both onshore and offshore. Producers are working with state and federal agencies to secure leases and permits to expand the production of natural gas.

Currently, many areas that may be available for exploration and where leases may be held have overlapping regulations that prohibit production operations. Producers are working with these regulatory agencies to reduce that permitting time. In addition, producers support the installation of new pipeline infrastructure in regions where natural gas may currently be stranded, such as the Rocky Mountain area, helping to bring more supply to consumers.

... And Tomorrow

Long-term access to supply includes access to both onshore and offshore areas that are currently off-limits. Currently, almost 40 percent of the natural gas found on government lands faces restrictions to exploration and production. One hundred percent of both the East and West coasts are unavailable for E&P activity, in addition to much of the Gulf of Mexico. These areas contain vast amounts of natural gas that can be safely and efficiently brought to consumers. Production basins in Alaska, the Mackenzie Delta in Northern Canada and Atlantic Canada also represent potential additional sources of supply that producers are working to develop.

In addition, an increasing amount of supply in the future will come from overseas in the form of Liquefied Natural Gas (LNG).

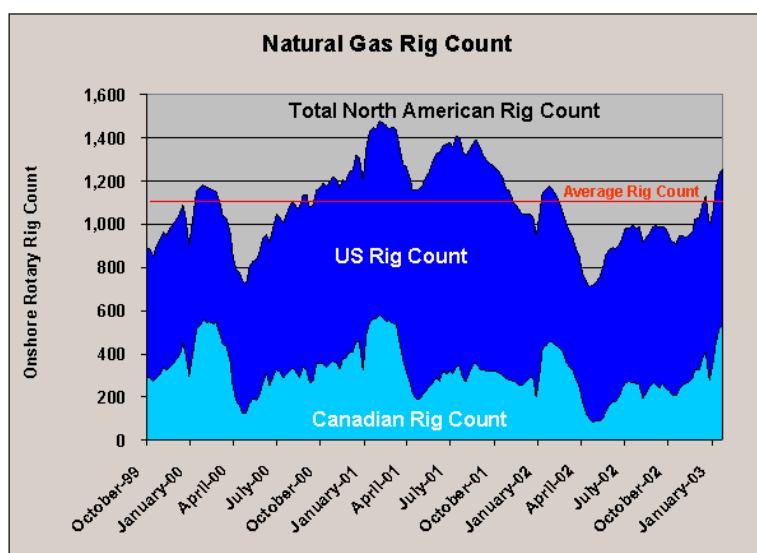
LNG, which is natural gas cooled to liquid form so that it can be shipped to U.S. ports, is becoming an important part of the U.S. supply portfolio. While LNG currently only represents one percent of supply, by

2010, it is expected to represent almost four percent of natural gas supply. Producers are working with federal agencies and Congress to support LNG's efforts to help broaden the nation's supply.

Every day producers of natural gas prove their commitment to the environment by using revolutionary new technologies that protect our natural resources, while bringing America this clean burning fuel. Using multiple technologies, producers are able to decrease the natural gas footprint by over 75 percent, while at the same time accessing previously unreachable resources.

In order to help keep America strong, the fuel of the future requires planning for today, and tomorrow, and that's what producers are doing.

For more information, please visit us on the web at <http://www.ngsa.org>.



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