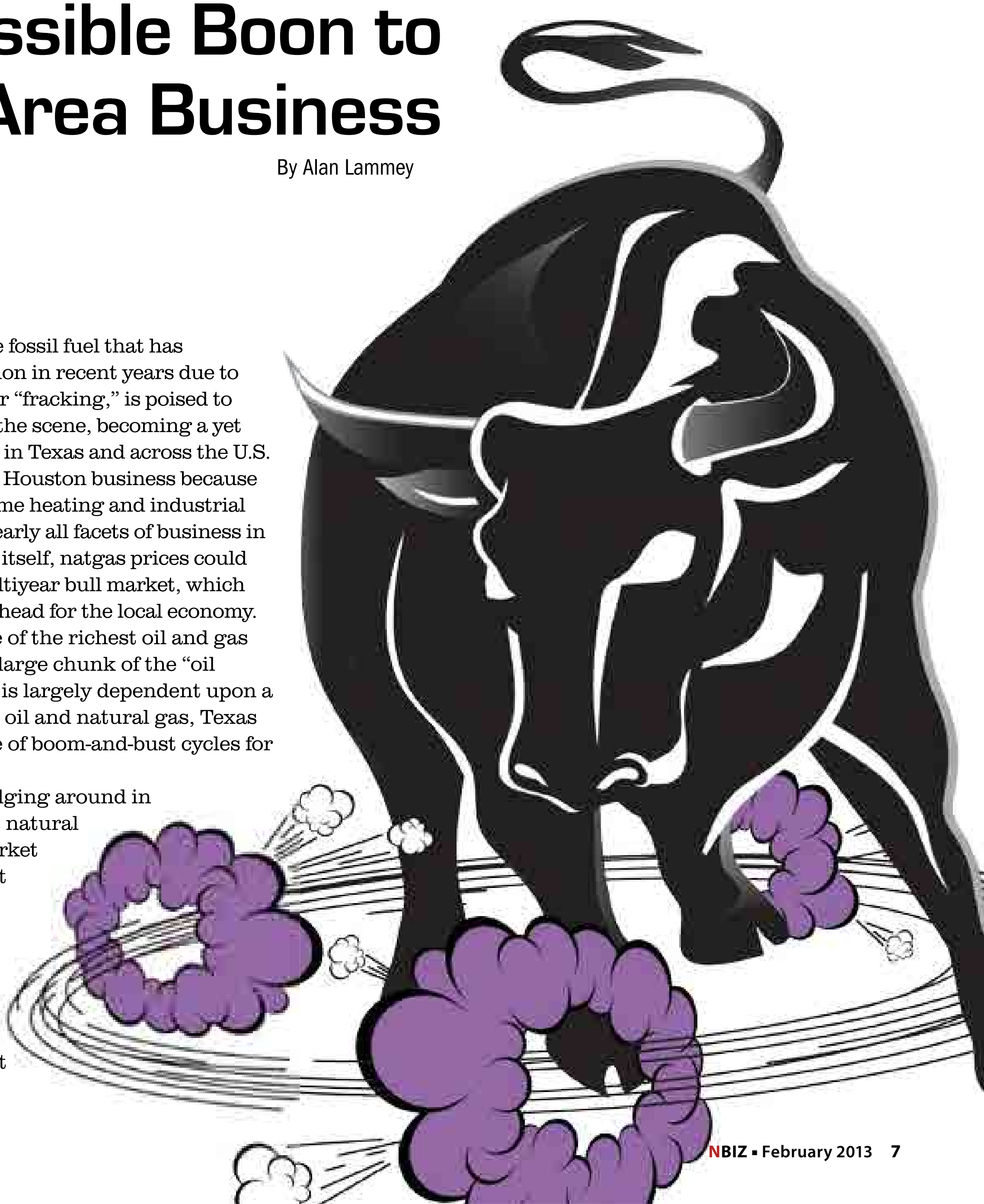
Re-emerging NATGAS BULL MARKET

Offers Possible Boon to Houston-Area Business

By Alan Lammey



Natural gas, a quiet little fossil fuel that has garnered lots of attention in recent years due to hydraulic fracturing, or "fracking," is poised to make an even bigger thrust onto the scene, becoming a yet more significant primary-use fuel in Texas and across the U.S. This is particularly good news for Houston business because as the demand for and price of home heating and industrial fuel grow, so will commerce for nearly all facets of business in the community. If history repeats itself, natgas prices could be on the cusp of a return to a multiyear bull market, which means bigger boon days may be ahead for the local economy.

It's no secret that Texas is one of the richest oil and gas states in America. But because a large chunk of the "oil wealth" in our neck of the woods is largely dependent upon a very volatile commodity price for oil and natural gas, Texas has most definitely seen its share of boom-and-bust cycles for many decades.

The fossil fuel that's been trudging around in the lower end of the price cycle is natural gas, which has been in a bear market for nearly five years now. But that could change rapidly, as market conditions and supply–demand fundamentals are changing to support a sharply higher priced natural gas market in the future—which will financially benefit the Houston economy, not to mention the rest of the region, for many years to come.

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Houston is widely known as the "Energy Capital of North America," but most people don't know about the vast concentration of energy-industry talent that resides in the Bayou City. In fact, it's been estimated that more oil and natural gas industry executive talent lives within a 40-mile circumference of downtown Houston than the rest of the world combined. This is a particularly good thing, because when the natural gas industry can keep jobs and business dealings close to home, it most certainly will.

In fact, presently the natural gas industry supports roughly 1.5 million jobs in Texas, and the industry is adding countless new employment opportunities in the Houston and surrounding areas at an impressive annual rate. At a time of high unemployment in our country, natural gas–related business stands ready to provide a huge array of much-needed jobs. The economic and business benefits are felt throughout the entire state: natural gas development creates jobs in almost all niches of business and contributes more than $100 billion to the Texas economy each year, including product sales, royalties, and property, state, local, and severance taxes.

Furthermore, natural gas companies and producers pay about five times more state and local taxes on a per-job basis than does an average company. This is obviously a boost to the Houston economy, as those taxes help support state and local services such as hospitals and first responders, while also providing funds that can be used to develop new roads, build new infrastructure, and make improvements in our schools. That means lots more jobs are being created in our area that aren't directly tied to the energy industry, but are certainly funded in part by energy-industry dollars.

Poised for Rebound, Springboard for Commerce

Despite all of these benefits, the truth is, natural gas prices have been floundering at the lower end of a historical price scale for several years. Therefore, as the commodity price begins to rise, it will only continue to offer an even greater level of prosperity for businesses ready to serve Houston's growing population.

Presently, the U.S. natural gas market is still sitting near the bottom of a 10-year price range, currently priced near $3.30 per million British thermal units (MMBtu). This low price is primarily due to two factors. First, last winter (the 2011—12 season) was one of the warmest winters seen in the U.S. in several decades, making seasonal natgas demand virtually nonexistent. Secondly, several years of non-stop drilling have occurred in prolific natural gas shale areas. The combination of these two fundamental drivers created a massive glut of the home-heating and industrial fuel.

While there could still be additional near-term downsides ahead for natural gas futures prices this spring, with prices potentially testing the $3/MMBtu area or perhaps a bit lower, the longer-term horizon suggests that the re-emergence of a natural gas–price bull market could offer one of the most remarkable and golden opportunities seen in many years. Businesses seeking to capitalize on another wave of wealth coming to the region need to stand ready to accommodate their customers, who will have money to spend.

From a historical price perspective, over the past five years, natural gas prices have been falling steadily. Prices hit historic highs of nearly $15/MMBtu in July 2008 and have persistently ground lower over the last several years, before bottoming out near $2.30/MMBtu last year. The low prompt month price of natural gas over the last few years and the potential for prices to drift even lower in the near term is pressuring dry natural gas producers to halt production along with other projects.

In fact, that slowdown in the drilling process is already underway, evidenced by steadily falling natural gas rig counts as reported by the weekly Baker Hughes rigs report, which, as of mid-January 2013, stands at just over 400 natural gas rigs. That's a stark difference compared to the presence of some 1,600 active natgas rigs in late 2008. As natural gas prices drift lower, chances rise that producers will reign in production, waiting to ramp it up again when prices become more favorable.

Massive New Demand Entering the U.S. Market

On the other end of the spectrum, the demand side, a virtual tsunami of new natural gas demand will be entering the U.S. market in 2013 and beyond. This creates a situation: a substantial reduction in gas production will be met with an equally considerable increase in demand in the not-so-distant future. All in all, this is a formula for a very highly supportive outcome for natural gas prices in the latter part of 2013 and subsequent years.

Major population growth in Texas is increasing gas-fired-electricity demand, while hotter temperatures in the U.S. Northeast are also notably spiking air-conditioning loads, causing a markedly larger demand for natural gas. In fact, the U.S. Department of Energy reported in January that natural gas-fired power generation exceeded the electricity produced by coal-fired plants for the first time in U.S. history. That's a big deal!

Add to that the fact that our nation will soon become a net exporter of liquid natural gas (LNG), coupled with a new initiative toward fleets of natural gas–powered long-haul trucks and the fact that a national refueling system is near completion (including locations along the major interstate routes across the U.S.). The bullish picture starts to become clearer and clearer.

So let's do the math: A combination of decade-low gas-rig counts, declining production levels, lower gas-storage injections, shut-in gas production, more rapid than expected shale-well declines across some of the most prolific shale production areas in the U.S., disappearing coal-power plants being replaced with gas-fired electricity—it all begins to add up to the formation of what could be a shockingly swift return of a bull natural gas market.

Finally, the biggest natural gas driver of them all always looms: the weather. Looking ahead, given the potential for colder winters and hotter-than-normal summer temperatures, as well as possibly dangerous Gulf of Mexico hurricane seasons that shut in offshore production, the prospect for a higher trending natural gas price almost seems to be a given. That could double prices to $6/MMBtu or perhaps more.

In a nutshell, the energy industry has been a cash cow to a huge array of business in the Houston vicinity. As the price of natural gas rises in the not-so-distant future, a new influx of cash and capital will enter the region, so businesses can expect more of the same success potential in the Bayou City for many years to come. **N**

Alan Lammey has 15 years' experience as a crude oil, natural gas, power markets futures, basis, and options market analyst and journalist. He is best known for his innovative and forward-thinking energy and financial market analysis. Alan has also hosted a radio program in Houston called Energy Week *for eight years.*

Additionally, he is a knowledgeable energy consultant, educating Houston-area businesses, both large and small, on how to notably improve their bottom line concerning electricity and natural gas expenditures. He has a multitude of clients, ranging from small retail stores to large big-box retails to city municipalities and everything in between. He can be reached via his website, www.TexasEnergyAnalyst.com, or at alammey@TexasEnergyAnalyst.com.