

## U.S. Natural Gas: A Buyers' Market For How Much Longer?

*Written by Terry Newendorp, Chairman and CEO, Taylor-DeJongh*

The current low natural gas price environment serves as a catalyst for extensive debates on the viability of proposed shale gas to LNG schemes and additional uses of cheap natural gas. We'd like to consider whether such projects are as much a bow to producers as some commentators have suggested.

First, it is easy to get excited when comparing a Henry Hub price of under USD 3/MMBTU to the liquids-linked price of USD14–16/MMBTU paid by Asian consumers of LNG. This spread is obviously attractive, even after accounting for liquefaction and transportation costs from the Gulf of Mexico to Asia. Cheniere Energy estimates the (liquefaction and transportation) costs to be about USD6/MMBTU.

At such a low Henry Hub price, even shipping LNG to Europe appears likely to be profitable, though the margins are thinner since the European cost threshold is much lower, given the ability of Europeans to switch to other sources of gas, or to use different fuels altogether.

But investing in long-term liquefaction capacity and betting on low Henry Hub prices for the next 20 years, is a tough business proposition. It is possible that increased LNG exports from the U.S., coupled with LNG coming from the proposed Australian and East African LNG projects, could eventually arbitrage away much of the current price imbalance in the global gas markets.

However, in domestic U.S., LNG exports will have to compete for natural gas feedstock with other industries vying for the same prize. Cheap natural gas already sparks enthusiasm among the petrochemical and fertilizer producers in the U.S. who see the low prices as a major opportunity to reignite domestic production. The reaction from power utilities has been more muted, given their recent historical ride on gas prices ranging from USD 4 to USD 12. But cheap gas will certainly drive increased investment in gas-fired power plants.

The Energy Information Agency believes that increased demand for cheap natural gas either from petrochemical/utilities users or from LNG exporters, will likely lead to an increase in Henry Hub prices, thus reducing some of the projected profit margins of LNG producers.

The current global natural gas glut cannot last forever. Natural gas producers with significant exposure to dry gas basins realize this and have taken appropriate measures to refocus on liquids production. Some companies can do nothing more than close some of their operations and move on to the next opportunity, as EQT Corp. plans to do with its shale gas drilling in Kentucky. Others have redirected their drilling programs to more liquids-prospective plays. Chesapeake Energy recently announced its decision to re-focus its capex spending away from dry gas. The move had been long expected, but was nonetheless surprising in its scale and boldness. Equally impactful was the action of some of Chesapeake's significant competitors— within days ConocoPhillips, Continental and Consol announced similar cuts to their natural gas production and capex targets.

Chesapeake, the largest natural gas producer in the U.S., is unequivocally stating its preference for liquids-rich plays, cutting rigs drilling for dry gas, curtailing dry gas production and pushing the completion of dry gas wells as far into the future as possible. Savings are being re-invested into liquids-rich plays. Chesapeake is reportedly even walking away from leases that do not offer attractive returns.

ConocoPhillips announced its decision to shut-in some of its dry gas production, indicating that the firm expects the long-term Henry Hub price to get back to USD5/MMBTU–USD6/MMBTU as more producers cut down their spending in developing dry gas plays.

The above-noted companies (and most others) will continue drilling for liquids-rich plays, producing substantial volumes of gas in the course of these operations, but the obvious intent to curtail unrestricted drilling for gas appears to be a serious move by U.S. independents to cope with today's low gas prices. Commodity markets took note of these companies' press releases, and natural gas futures went up almost 8% the day Chesapeake announced the planned cuts. Prices crept further up in the few days that followed. A week, a few weeks, or even a few months does not make a long term trend. But U.S. gas producers are clearly redirecting their drilling programs to the century-old truism of the oil industry: find liquids and dispose of the associated gas for whatever marginal price you can get.

**The U.S. finds itself in a rather unusual situation of reasonable elasticity of supply in a vital energy resource with many industrial demands, only one of which is export LNG. Even though demand for gas continues to increase, it can be met with a readily produceable fuel supply and gas prices will face a slow but steady upward pressure in coming years.**