



# The North American Natural Gas Market

2007 PESA Gulf Coast Texas District Meeting  
February 21, 2007

# North American Natural Gas Market

- **Structural Changes in Natural Gas Market**
- **Winter Weather**
- **Price Outlook**
- **Impact of Horizontal Drilling On Service Industry**

# Structural Changes in Natural Gas Market Last 7 Years

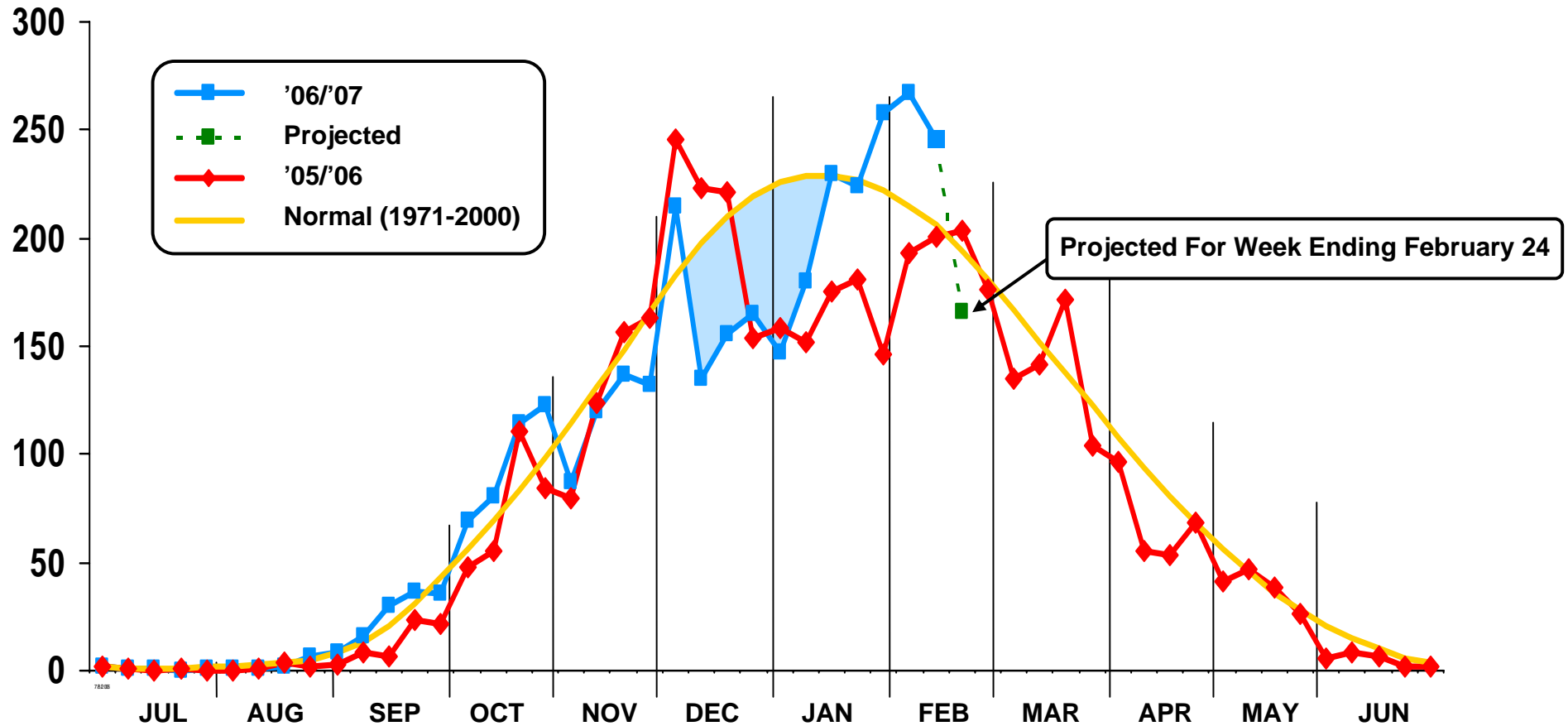
- **Residential and Commercial Space Heating Demand Have Significantly Increased**
- **Electricity Sector Demand for Natural Gas Has Exploded**
- **Industrial Demand Has Declined Dramatically**
- **Fuel Switching Capability Has Declined**

# Natural Gas Markets

## Results of Structural Changes

- **Gas Prices are More Sensitive to Weather Than in the Past**
- **Gas Price Volatility is Higher**

# U.S. Heating Degree Days\*



**Note: The HDD's Shown Above are for Weeks Ending at Midnight Saturday Whereas DOE's Storage Weeks End at 9 am Friday**

\* Gas Home Heating Customer Weighted from NOAA

# 2007 North American Natural Gas Supply Growth Estimates

	<u>YOY</u>
<b>U.S.</b>	<b>+1.4%</b>
<b>Canada</b>	<b>(2.5%)</b>

## U.S.

- **Gulf of Mexico Supply (Adjusted for Hurricane Shut-in) Still Falling Hard**
- **Onshore Resource Plays Offsetting Offshore Decline**

## Canada

- **Shows the Effect of a Decline in Drilling Activity**
  - **Production Growth Changes From +1% in 2006 to (2.5%) in 2007**

# 2005 - 2007E Natural Gas Prices Henry Hub (\$/Mcf)

- **2005**      **\$8.55**
- **2006**      **\$7.26**
- **2007E**    **\$7.50 - \$8.50**

# Natural Gas Macro

## What EOG Said November 29, 2006

- **2007 Gas Price Range - \$7.50-\$9.50 Dependent on Winter Temperatures**

**\$7.50      5% Warmer Winter**

**\$8.50      Average Winter**

**\$9.50      5% Colder Winter**

## What We Know as of February 20, 2007

- 1. First Half of Winter Has Been 17% Warmer Than Normal**
- 2. Canadian Production Falling**
- 3. U.S. Rig Count Peaked in August 2006**

## Conclusion

- 1. 2007 Gas Will Likely Average \$7.50-\$8.50 Depending on Second Half Winter Weather and Summer Heat**
- 2. No Structural Change to Long Term Gas Story Predicting  $\approx$  \$8.50/Mcf Equilibrium Price Assuming Normal Weather**
- 3. After 2010 LNG Will Play a Bigger Role in Gas Pricing**



# Trend Toward Onshore Horizontal Drilling

# EOG Drilling U.S. Onshore Horizontal Activity vs. Total

- **2006**      **30%**
- **2007E**    **≈ 50%**

# Industry Drilling U.S. Onshore Horizontal Activity vs. Total

- **2007E**      **10%**
- **2012E**      **35%**

# Implications of Horizontal Shift on Service Industry

- **Specialized Drilling Rigs**
  - **Top Drives**
  - **Smaller Footprints**
  - **No Derrick Man?**
  - **Rotary Steerable Systems**
  
- **More Individual Smaller Fracs Per Well**
  - **More Zonal Isolation**
  - **More Perforations**
  - **New Frac Techniques**

# North American Natural Gas Conclusions

- **Natural Gas Prices Much More Weather Sensitive Than Just 7 Years Ago**
- **In Spite of a Hot First Half of Winter, Natural Gas Prices Should Slowly Strengthen Throughout 2007 and Remain Strong in 2008**
- **North American Gas Drilling Activity Should Remain Reasonably Robust 2007 - 2008**
- **A Major Trend Toward Onshore Horizontal Drilling is Occurring**
  - **This Will Affect the North American Service Industry and Create Winners and Losers**



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