

The New York Times

October 20, 2012

After the Boom in Natural Gas

By **CLIFFORD KRAUSS** and **ERIC LIPTON**

EVELYN, La.

THE crew of workers fought off the blistering Louisiana sun, jerking their wrenches to tighten the fat hoses that would connect their cement trucks to the Chesapeake Energy drill rig — one of the last two rigs the company is still using to drill for natural gas here in the Haynesville Shale.

At its peak, Chesapeake ran 38 rigs in the region. All told, it has sunk more than 1,200 wells into the Haynesville, a gas-rich vein of dense rock that straddles Louisiana and Texas. Fed by a gold-rush mentality and easy money from Wall Street, Chesapeake and its competitors have done the same in other shale fields from Oklahoma to Pennsylvania.

For most of the country, the result has been cheaper energy. The nation is awash in so much natural gas that electric utilities, which burn the fuel in many generating plants, have curbed rate increases and switched more capacity to gas from coal, a dirtier fossil fuel.

Companies and municipalities are deploying thousands of new gas-powered trucks and buses, curbing noxious diesel fumes and reducing the nation's reliance on imported oil.

And companies like fertilizer and chemical makers, which use gas as a raw material, are suddenly finding that the United States is an attractive place to put new factories, compared with, say, Asia, where gas is four times the price. Dow Chemical, which uses natural gas as a material for producing plastics, has assembled a list of 91 new manufacturing projects, representing \$70 billion in potential investment and up to three million jobs, that various companies have proposed or begun because of cheap gas.

“The country has stumbled into a windfall on the backs of these entrepreneurs,” said Edward Hirs, a finance professor at the University of Houston who contributed to a report that estimated that the nation’s economy benefited by more than \$100 billion last year alone from the lower gas prices.

But while the gas rush has benefited most Americans, it’s been a money loser so far for many of the gas exploration companies and their tens of thousands of investors.

The drillers punched so many holes and extracted so much gas through hydraulic fracturing that they have driven the price of natural gas to near-record lows. And because of the intricate financial deals and leasing arrangements that many of them struck during the boom, they were unable to pull their foot off the accelerator fast enough to avoid a crash in the price of natural gas, which is down more than 60 percent since the summer of 2008.

Although the bankers made a lot of money from the deal making and a handful of energy companies made fortunes by exiting at the market’s peak, most of the industry has been bloodied — forced to sell assets, take huge write-offs and shift as many drill rigs as possible from gas exploration to oil, whose price has held up much better.

Rex W. Tillerson, the chief executive of Exxon Mobil, which spent \$41 billion to buy XTO Energy, a giant natural gas company, in 2010, when gas prices were almost double what they are today, minced no words about the industry’s plight during an appearance in New York this summer.

“We are all losing our shirts today,” Mr. Tillerson said. “We’re making no money. It’s all in the red.”

Like the recent credit bubble, the boom and bust in gas were driven in large part by tens of billions of dollars in creative financing engineered by investment banks like Goldman Sachs, Barclays and Jefferies & Company.

After the financial crisis, the natural gas rush was one of the few major profit centers for Wall Street deal makers, who found willing takers among energy companies and foreign financial investors.

Big companies like Chesapeake and lesser-known outfits like Quicksilver Resources and Exco Resources were able to supercharge their growth with the global financing, transforming the face of energy in this country. In all, the top 50 oil and gas companies raised and spent an annual average of \$126 billion over the last six years on drilling, land acquisition and other capital costs within the United States, double their capital spending as of 2005, according to an analysis by Ernst & Young.

Now the gas companies are committed to spending far more to produce gas than they can earn selling it. Their stock prices and debt ratings have been hammered.

“We just killed more meat than we could drag back to the cave and eat,” said Maynard Holt, co-president of Tudor Pickering Holt & Company, a Houston investment bank that has handled dozens of shale deals in the last four years. “Now we have a problem.”

A Master Salesman

Aubrey K. McClendon, chief executive of Chesapeake Energy, had a secret, and he was anxious to share it.

He called Ralph Eads III, a fraternity buddy from Duke who had become his go-to banker. Mr. McClendon explained that he had quietly acquired leases on hundreds of thousands of acres somewhere in the southern United States — he would not say exactly where — that could become one of the world’s biggest natural gas fields.

But to develop the wells, he needed billions of dollars.

“I can get the assets,” Mr. McClendon told Mr. Eads, a vice chairman of Jefferies, according to three people who participated in that call, nearly five years ago. “You have to get the money.”

Get it he did. Mr. Eads, a pitch artist who projects the unrestrained enthusiasm of a college football coach, traveled the world, ultimately raising an extraordinary \$28 billion for Mr. McClendon’s “secret” venture in the Haynesville Shale, as well as other Chesapeake drilling projects.

Other bankers working in the glass office towers of downtown Houston were equally busy. While the skyscrapers are home to global giants like Chevron and lesser-known companies like Plains Exploration and Production, they also house storefronts for Wall Street deal makers who play a vital, though less visible, role in the nation's surging energy production.

Mr. Eads, 53, a Texas native, is a prince of this world. His financial innovations helped feed the gas drilling boom, and he has participated in \$159 billion worth of oil and gas deals since 2007.

A Sigma Alpha Epsilon fraternity brother of Mr. McClendon, he headed to Wall Street directly after Duke. He first earned a national profile in 2001, while working for the El Paso Corporation, a natural gas pipeline operator. Regulators accused El Paso of creating an artificial gas shortage in California in the previous year, contributing to a power crisis in the state. Although El Paso eventually settled the complaints for \$1.7 billion, Mr. Eads said El Paso was guilty of nothing more than coming up with creative financial transactions.

"I wake up every day thinking about how to finance big things," he said.

His tall, lanky frame and bellowing voice make him hard to miss, even in a large crowd. And his deal radar is never off, as he works the room at dinner parties and charity events.

That is how he met Jim Flores, the chief executive of Plains Exploration, who eventually invited him on a duck hunt.

After Mr. McClendon's urgent request for money, Mr. Eads put in a call to Mr. Flores to see if he might be willing to finance part of Chesapeake's Haynesville project.

"Aubrey and I have calculated it, and it might be the largest gas field in the world," Mr. Eads said he told Mr. Flores, noting early results from a single well that showed unprecedented gas flows.

The type of deal he pitched, nicknamed "cash and carry," was certainly aggressive and innovative. Plains would pay Chesapeake \$1.7 billion to gain ownership of about one-third of the drilling rights that Chesapeake had leased in the Haynesville. Plains would also commit to paying out another \$1.7 billion

to cover half of Chesapeake's drilling costs, in return for part of the future profits.

"It's going to be a great investment," Mr. Flores said on the day the deal was announced in July 2008.

But the deal, like others later struck by Chesapeake, benefited Mr. Eads and Mr. McClendon and their companies far more than the people writing the big checks.

Chesapeake spent an average of \$7,100 an acre on the drilling sites it had leased in the Haynesville. Plains paid Chesapeake the equivalent of \$30,000 an acre.

Jefferies and the other firms involved in arranging the deal made an estimated \$23 million on this transaction.

Much of the money that Mr. Eads raised for American gas drillers came from overseas oil and gas companies, like Total of France and Cnooc, the China National Offshore Oil Corporation. He told them the American shale revolution was an opportunity they simply could not afford to pass by.

"This is like owning the Empire State Building," Mr. Eads said, recalling one of his favorite lines. "It's not going to be repeated. You miss the boat, you miss the boat."

In China, he was in awe at just how much money was available to invest. One senior executive at a major Chinese oil company that Mr. Eads declined to identify, citing the confidential nature of the negotiations, explained that the country wanted to move as much as \$750 billion from United States Treasury bonds into the North American energy business.

Mr. Eads was only happy to oblige, helping to secure \$3.4 billion from the Chinese for Chesapeake through two deals.

Not everyone believed the story line of endless profits and opportunity. Mr. Eads said one oil company executive whom he would not identify had rejected his pitch, complaining, "The reason for the glut is you guys." The executive said he expected natural gas prices to plummet.

In private, Mr. Eads acknowledged that his pitches involved a bit of bluster.

“Typically, we represent sellers, so I want to persuade buyers that gas prices are going to be as high as possible,” Mr. Eads said. “The buyers are big boys — they are giant companies with thousands of gas economists who know way more than I know. Caveat emptor.”

Investment banking revenue at Jefferies reached \$1.1 billion in 2011, a record for the firm, up from \$750 million in 2007. Energy deals were cited among the biggest drivers of that surge, which came despite major problems at the firm because of its exposure to European sovereign debt.

Mr. Eads would not say how much he had been compensated for this bonanza. But Dealogic, a firm that tracks Wall Street transactions, estimated that Jefferies collected at least \$124 million in fees from Chesapeake since 2007, a large share of its overall revenue on oil and gas deals, which ranged between \$390 million and \$700 million during the same period, according to two different industry estimates.

Even before the recent round of deals, Mr. Eads was a wealthy man. He lives in a sprawling, 11,000-square-foot lakefront mansion in Houston and has a wine cellar with 6,500 bottles. In 2010, he bought an \$8.2 million home in the exclusive West End of Aspen, Colo., whose other homeowners have included Jack Nicholson and Mariah Carey.

Mr. Eads’s success has produced no shortage of jealousy in Houston.

“A lot of people don’t like him because he got ahead of everyone else,” said Chip Johnson, chief executive of Carrizo Oil and Gas, who made two big deals in which Mr. Eads was involved. “He got the reputation for overselling, but I have a hard time believing you can fool the big companies.”

“Without him,” Mr. Johnson added, “the country would not have had the huge gas supply as quickly as we did.”

Others have been more critical.

“He is like the bartender serving drinks for people who can’t handle it,” said Fadel Gheit, a managing director at Oppenheimer & Company, about Mr. Eads. “And the whole gas industry has gotten a rude awakening, a hangover, with gas

prices plummeting. The investment bankers were happy to help with a smile and get their cut.”

A Train Without Brakes

“Quit drilling,” T. Boone Pickens, the Texas oilman, barked to his fellow board members at Exco Resources, a small, independent drilling company based in Dallas that, like Chesapeake, had made a big bet in the Haynesville. “Shut her down.”

Mr. Pickens, 84, made billions of dollars as a hedge fund manager and wildcatter drilling for oil and gas. He borrowed heavily to build up the oil and gas reserves of Mesa Inc. in the late 1980s before losing the company during its financial difficulties a decade later, when drooping gas prices hurt its ability to repay debts and pay dividends. He wanted Exco to avoid a similar fate.

There was only one problem: under the contracts that Exco signed, it couldn’t stop drilling.

The company followed Chesapeake’s lead and struck its own \$1.3 billion cash-and-carry deal with the BG Group, a British gas company. BG paid Exco \$655 million in cash upfront and agreed to foot 75 percent of the bill for future drilling in the Haynesville in return for a share in future profits on the gas produced.

When the arrangement was made, it seemed like a winner all around. Exco had more than 53,000 acres of leases in the Haynesville, but like Chesapeake, it lacked the money it needed to drill on all the land. BG’s financing helped Exco to increase the number of rigs it had working in the Haynesville to 22 from four.

Nevertheless, the agreement, negotiated by Goldman Sachs, came with some important strings attached: Exco had to keep all 22 rigs drilling for gas, even as the price was dropping. BG wanted to reach certain targets for drilling wells and producing gas in the United States, and it was intent on sticking with the plan, even if its partner now insisted that it made no economic sense.

“They are great partners, but they have their pedal down around the world, and we are part of that,” Douglas H. Miller, Exco’s chief executive, explained to Wall Street analysts last year.

Mr. Pickens was furious. “We are stupid to drill these wells,” he said in a recent interview.

But Exco was not alone. Many of its fellow gas companies — including Chesapeake and Petrohawk — had little choice through last year but to keep drilling, no matter how low the price fell or how big a glut was forming.

It wasn’t just the cash-and-carry deals that were forcing them to drill.

The land that the natural gas companies had leased, in most cases, came with “use it or lose it” clauses that required them to start drilling within three years and begin paying royalties to the landowners or lose the leases.

Exco, Chesapeake and others initially boasted about how many acres they had managed to lock up. But after paying bonuses of up to \$20,000 an acre to the landowners, the companies could not afford to lose the leases, even if the low price of natural gas meant that drilling more wells was a losing proposition.

The industry was also driven to keep drilling because of the perverse way that Wall Street values oil and gas companies. Analysts rate drillers on their so-called proven reserves, an estimate of how much oil and gas they have in the ground. Simply by drilling a single well, they could then count as part of their reserves nearby future well sites. In this case, higher reserves generally led to a higher stock price, even though some of the companies were losing money each quarter and piling up billions of dollars in debt.

Just as in the earlier real estate bubble, the main players publicly predicted success even as, privately, their doubts were growing, court documents show.

Mr. McClendon suggested in August 2008 to Wall Street analysts that he had fundamentally transformed the once-risky, century-old oil and gas business into something with the reliability of an assembly line.

“We consider ourselves to be in the gas manufacturing business, and that requires four inputs in our opinion — those inputs are land, people, science

and, of course, capital,” Mr. McClendon told the analysts. “We think that’s pretty impressive and hope you do as well.”

But soon after, he told some Chesapeake employees that the company might have made some big mistakes. “What was a fair price 90 days ago for a lease is now overpriced by a factor of at least 2x given the dramatic worsening of the natural gas and financial markets,” Mr. McClendon wrote in an October 2008 e-mail that has since become public in a lawsuit against Chesapeake.

And as with so many other shale gas players, Chesapeake struck so many complicated financial deals that it couldn’t stop ramping up the gas factory.

“At least half and probably two-thirds or three-quarters of our gas drilling is what I would call involuntary,” Mr. McClendon acknowledged at one point.

For him, the drilling binge had some significant financial consequences. During the good times, Chesapeake paid him handsomely in cash and perks. He achieved a net worth of over \$1 billion, and he made it to the Forbes list of the 400 wealthiest Americans. He bought homes in Bermuda, Colorado and Hawaii, as well as a stake in the Oklahoma City Thunder basketball team.

An unusual company program also allowed Mr. McClendon to buy a small personal stake in Chesapeake’s wells. That is expected to reap more than \$400 million for him over the 15- to 20-year life of the wells, although it has strained his personal finances for now. An investigation by Reuters detailed how Mr. McClendon had borrowed heavily from Chesapeake business partners to help finance his share of the wells’ costs. That and other issues drew the scrutiny of the Securities and Exchange Commission, shook investor confidence in him and prompted a shake-up of Chesapeake’s board that included the removal of Mr. McClendon as chairman.

(Mr. McClendon refused requests to be interviewed for this article, and he did not respond to a list of questions.)

Mr. Eads appears to have fared better. He had seen the coming crash, and, as any master salesman would, found a way to play both sides. He continued to persuade new investors of the great potential in shale while telling his longtime clients to cash out.

"It is a great time to sell," Mr. Eads recalled telling Terry Pegula, the founder of East Resources, who had built up his own operation in the Marcellus region of Pennsylvania from one well to 75 over the course of one year. "With all these new plays popping up, I had a real concern gas prices would weaken."

Mr. Eads then helped arrange what will go down as one of the great early paydays of the shale revolution: the 2010 sale of East Resources, which Mr. Pegula had started with \$7,500 borrowed from family and friends, to Royal Dutch Shell for \$4.7 billion.

There were a handful of other such profit takers, including the Houston businessman Floyd Wilson, who created a company in 2003 called Petrohawk Energy with the intention from the start of selling it. Petrohawk drilled its first Haynesville well in 2008. Last year, it sold itself to an Australian energy conglomerate, BHP Billiton, in a \$15 billion deal that brought Mr. Wilson and other executives a payout worth at least \$304 million.

But for many gas drillers, there has been only pain.

Exco, whose production of natural gas was still rising in the Haynesville as of early this year, saw its credit rating downgraded in May. It reported a loss of nearly \$780 million for the first half of the year, before write-offs and other adjustments, even after it reduced its work force and rig count. BG, its joint venture partner, reported in July that it was taking a \$1.3 billion write-down on its shale gas investments in the United States, including the Haynesville deal with Exco.

Plains Exploration, which celebrated its first deal with Chesapeake back in 2008, reported a loss for the first quarter this year, but has since shifted heavily away from gas to oil production and is making money again. Warm weather last winter exacerbated the glut to historic levels, reducing prices even further, since so little gas was needed to heat homes in many parts of the nation.

Chesapeake's stock price sank this year after it was revealed that Mr. McClendon had taken a personal stake in Chesapeake wells and then used those investments as collateral for up to \$1.1 billion in loans used mostly to pay for his share of the cost of drilling those wells. The company is trying to raise \$14 billion this year by shedding assets, a goal it has almost reached with huge

recent sales of West Texas oil and gas fields and pipelines to Royal Dutch Shell and Chevron.

To help the company through this difficult patch, Mr. McClendon turned to his old friend, Mr. Eads. Jefferies & Company, joined by Goldman Sachs, offered Chesapeake an emergency \$4 billion unsecured bridge loan, at 8.5 percent interest, to give the company a lifeline until it could sell enough assets to keep afloat. (The company says it intends to pay back the entire loan this year from recent sales.)

In hindsight, it should have been clear to everyone that a bust was likely to occur, with so many new wells being drilled and so much money financing them.

But everyone was too busy working out new deals to pay much heed.

The bust has certainly hit the Haynesville hard. Some local landowners, having spent their initial lease bonuses, are now deeply in debt. Local restaurants and other businesses are suffering steep losses now that so many drillers have left town.

“At this point we’re struggling,” said Shelby Spurlock, co-owner of Cafe 171 in the town of Mansfield. The restaurant is decorated with wall collages of drill worker uniforms from companies that are leaving the area. Once open from 4 a.m. to 10 p.m. and employing four servers, the restaurant has cut its hours and is down to two servers. “Our very existence is in danger,” she sighed.

Mr. Eads, ever the deal maker, is unfazed. He tells anyone who will listen that the price of natural gas will eventually recover. He is making money, meanwhile, helping struggling companies and opportunistic investors strike deals at the new, lower prices.

“These shale assets are forever,” he said. “They are going to produce for a hundred years.”

Clifford Krauss reported from Evelyn, La., and Eric Lipton from Houston and Washington.

FINANCIAL TIMES

August 31, 2012 10:58 pm

Shale gas – burnt off

When too much capital chases a dream, not all of it survives. Many foresaw an alchemical process that would turn social connections to profit. They have watched half of the \$16bn invested in Facebook's public offering flutter up to money heaven. That may prove modest compared with the wealth sacrificed to the admirable idea that shale gas will create an energy-independent US.

The companies involved are recognising that, at current gas prices, their investments are in trouble. In August alone, BHP took a \$2.8bn writedown on the shale gas assets it bought for \$4.8bn just last year; Ultra took a \$1.1bn writedown on its holdings; and Quicksilver ate another \$992m. These follow July bloodlettings from Encana, BP and BG. More to come? There has been \$55bn in mergers and acquisitions involving shale gas assets since 2008, according to Dealogic, on top of companies' internal investments. Chesapeake alone has spent \$38bn in capital expenditures, net of asset sales, over that period.

Shale's defenders will argue that the value of gas reserves will recover with the gas price. Fair enough. The question, then, is whether we are heading for a sustainable price recovery.

The burden of proof is squarely on the shale bulls. Yes, the number of working gas rigs in the US has fallen by almost half over the past year, and natural gas inventories in the ground, while still above their five-year seasonal average, are trending towards normal levels. Prices, at about \$2.70 per million British thermal units, are off their \$2.00 April lows.

But, as Susquehanna research points out, recently 40 per cent of US gas demand has come from power generation. At about \$3.00, gas approaches cost parity with coal, and that demand begins to abate. It looks as if more capital must burn off before strong shale gas returns become a reality.

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FINANCIAL TIMES

Last updated: August 31, 2012 10:53 pm

Gas groups headed for large writedowns

By Ed Crooks



US natural gas companies are heading for large writedowns in their reported reserves as a result of the slump in gas prices – in some cases, putting their finances under pressure.

The reserves reductions will not be fully revealed until their full-year results are reported in 2013, but reflect the challenging economics of the US shale gas boom – which has seen production surge, but has sent prices plunging, and hit producers' earnings.

earnings.



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Diversification protects oil services providers

The performance of oil services companies usually lags that of oil and gas producers, so investors would be forgiven for fearing that second-half profits at these groups will be hit by the bursting of the US shale gas bubble, as happened at exploration and production companies in recent months, writes Rebecca Bream in London

But, although services groups have experienced some slowdown in demand as the likes of BP, BG and BHP Billiton have written off investments in US shale gas, many are protected by being diversified, offering a wide range of products for oil and gas projects, both onshore and offshore.

For example, in its second-quarter earnings, Halliburton said its North American rig count had fallen 17 per cent and its operating income from the region was down 19 per cent, with the number of its rigs engaged in US natural gas exploration and production at a 12-year low. However, the group added that it "continued to see activity shift from natural gas to oil basins during the quarter", and is focusing on selling its services to these more lucrative projects instead.

Schlumberger said its second-quarter revenues and profits

Although some of the impact is already priced in to market valuations, analysts have warned that investors may not be prepared for the scale of the reductions.

Last year, the Securities and Exchange Commission wrote to dozens of shale gas companies, calling on them to clarify how they had been reporting their reserves.

But reserves reporting is never an exact science, noted Dan Olds of Ryder Scott, the oil and gas appraisal firm – as companies need to use "experience and judgment" when analysing the geological and commercial prospects of their assets.

The scope for views to differ means revisions are difficult to predict.

"This round of reserve cuts is going to be more embarrassing for some companies than for others," said Duane Grubert, an analyst at Susquehanna Financial. "The guys who were too aggressive in booking reserves are going to stick out like a sore thumb."

US independent oil and gas companies including [Anadarko Petroleum](#), [Ultra Petroleum](#), [Southwestern Energy](#) and [Quicksilver Resources](#) reported non-cash charges for the second quarter of 2012, reflecting writedowns of the values of their gasfields.

At the end of the year, more companies are likely to follow suit – reporting not only the declining value of the assets but also shrinking volumes of proved reserves.

The first indication of the scale of the possible cuts came last month from [Chesapeake Energy](#), the second-largest gas producer in the US, which has been battered by concerns over its corporate governance and borrowings.

In its second-quarter results, Chesapeake wrote off 4.6tn cubic feet of gas reserves, equivalent to more than two months of consumption for the entire US. That was 24 per cent of its reserves, although the impact was offset by reserves additions resulting from exploration, making the net decline 7 per cent.

Most companies report annually, so the end of the year will be the first opportunity to see what has changed.

However, Philip Weiss of Argus Research points out that reserves writedowns may not be permanent. "It's not as if the reserves go away. If prices rebound they end up being written back in at some point," he said.

from North America fell "as a result of... continued pricing pressure in the US land hydraulic fracturing market". But it noted that the reduction in shale gas drilling was offset by "increased offshore activity - particularly in deepwater US Gulf of Mexico operations".

Analysts at Barclays Capital in London said a focus on rig counts can be misleading because, while there has been a drop in the number of shale gas wells being drilled in the US, the amount of equipment that services companies can sell to gas producers is still going up, as the wells become more complex.

And oil and gas drilling activity in the US remains close to historic highs, the analysts added, even after the recent fall in investment.

Services companies are also pursuing geographic diversification as a way to reduce exposure to low US gas prices.

Even if the cuts are only temporary, however, reported reserves are often important to company valuations, both for investors and in merger and acquisition deals.

Companies that are forced to make writedowns can also come under financial strain, because oil and gas banking covenants typically link borrowings to reserves. A company that suffers a decline in its reserves may be forced to renegotiate its credit lines or sell assets to raise cash.

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US Natural Gas Supplies Grew Last Week

By THE ASSOCIATED PRESS
Published August 23, 2012 at 10:55 AM ET

NEW YORK (AP) — The nation's [natural gas](#) supplies rose last week, the government said Thursday.

The Energy Department's Energy Information Administration reported that natural gas in storage grew by 47 billion cubic feet to 3.308 trillion cubic feet for the week ended Aug. 17.

Analysts expected a rise of 36 billion to 40 billion cubic feet, according to a survey by Platts, the energy information arm of McGraw-Hill Cos.

The inventory level was 12.1 percent above the five-year average of 2.951 trillion cubic feet, and 14.7 percent above last year's level of 2.885 trillion cubic feet, according to the government data.

Natural gas fell 10 cents to \$2.72 per 1,000 cubic feet in New York.

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FINANCIAL TIMES

May 29, 2012 8 24 pm

US natural gas falls back

By Emiko Terazono

US natural gas prices, which rebounded from their lowest levels in a decade last month, fell back on forecasts of a cooler summer and a possible fall in air-conditioning demand leading to lower gas use by utilities.

Natural gas prices have had a volatile run this year, falling below \$2 per million British thermal units for the first time in a decade in April, only to bottom out and rally almost 45 per cent over the past month.

A warm winter and fears that extra shale gas supplies would test storage capacity have depressed prices, but sentiment turned as government data revealed that the increase in inventories had slowed in April and May, amid production cutbacks and fresh demand from power plants switching from coal to gas.

Gas prices retreated in the past few days on reports that key gas consuming states such as Texas would encounter cooler temperatures this summer due to the expected El Niño weather phenomenon.

Gas-fired generators have traditionally been used to meet peak summer demand and more moderate temperatures are likely to translate to lower gas use by utilities, said Teri Viswanath, natural gas strategist at BNP Paribas in New York:

"The forecasts are that we will have a hot start to the summer, but the latter half will be cooler," she said, adding that rising stockpiles of coal, as more power plants have turned to gas, could force the burning of the bulk commodity before the end of the summer.

US natural gas
Henry hub (\$ per mBtu)



Natural gas for June delivery at Henry Hub in Louisiana, the futures pricing point, slid 1.9 per cent to \$2.52 per mBtu on Tuesday on the weather prospects.

The number of gas rigs may have fallen by more than 30 per cent in the US, but concerns of excess supplies could reappear. Although lower natural gas prices have accelerated the move among power plants to switch from coal, a shift back to the bulk commodity could occur if gas prices rise again, said analysts.

Shiyang Wang, commodities analyst at Barclays in New York, said the "spring spurt" in the displacement of coal-fired power plants did not mean the risk of gas storage filling up had vanished. "Prices need to average between \$2 and \$2.50 [per mBtu] to encourage enough coal displacement to prevent storage hitting capacity too early," she said.

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