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Eye On ENERGY

A periodic publication of American Energy.®
Providing insight for making better energy decisions.

COMMODITIES UPDATE

By Mike Granstaff

March 2010 Natural Gas Report

The natural gas market had no difficulty making it through one of the coldest winters of the decade for the eastern half of the U.S. thanks to beginning the season with record high working storage combined with domestic natural gas production remaining at very high levels. The meteorological winter of December – February came in 4.5 % colder than the 30 year normal nationally. Approximately 2,100 Bcf of natural gas was withdrawn from working storage over this time frame matching the very cold winter of 2002/'03. The average meteorological winter withdrawal from working storage over the past 10 years is 1,730 Bcf.

For the winter season 63 % of the country experienced below normal temperatures. Several Arctic air masses dominated much of the United States during February, creating temperatures that were much-below average in the Deep South and below average in the Plains and Mid-Atlantic States. Both the South and Southeast climate regions experienced their seventh coldest February on record. Meanwhile, warmer-than-average temperatures dominated the Northwest and Northeast climate regions.

Although it was very cold in the U.S. this winter, last month's combined global land and ocean surface temperature made it the sixth warmest February ever recorded. Additionally, the December 2009 – February 2010 period was the fifth warmest on record averaged for any similar three-month Northern Hemisphere winter-Southern Hemisphere summer season, according to scientists at NOAA's National Climatic Data Center. This is based on records going back to 1880.

The winter withdrawal season is basically over now and traders are already focusing their attention on the refill season. Based upon price action there would appear to be very little concern over our ability to refill working storage to capacity by November 1st. NYMEX natural gas poked its head over $6.00 for only a brief period this winter and has been in a downtrend ever since. In fact, the EIA working storage report released on March 18th of an 11 Bcf withdrawal sent the natural gas market into another tailspin and is threatening to put a $3 handle on the NYMEX nearby contract.

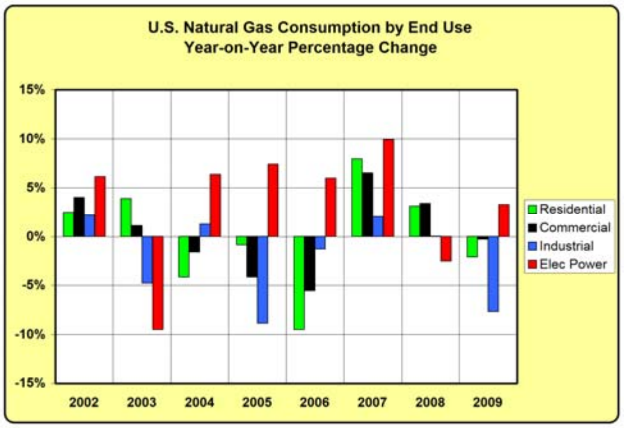
The small 11 Bcf withdrawal is reflective of the nice warming trend we've seen so far in March and the near term forecast of continuing warmth. In fact, if the forecast holds, March will end up being one of the top five warmest on record. It seems we just keep going from one extreme to the other anymore.

Working Storage

The EIA reported that 11 Bcf was withdrawn from working storage the week ending March 12th. We would normally expect to see a withdrawal of 42 Bcf for this reporting period. Working storage is now 1,615 Bcf which is 73 Bcf greater than the 5 year average and 40 Bcf less than last year. This is very likely the last withdrawal we will see this season as we project the beginning of the injection season to kick in a little earlier this year than normal. We would typically expect to see one, if not two more weeks of withdrawals but with the above mentioned warm forecast and high domestic production we should see an injection on the March 25th report.

Demand

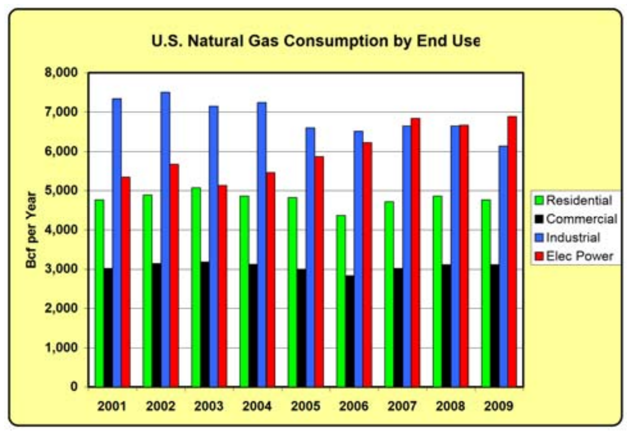
The most recent EIA monthly reports released by the EIA covered December therefore we now have the complete year of 2009 to look at and analyze. Of course there will be multiple revisions to the data over coming months but this is what it looks like today. The chart below reflects year-on-year percentage changes in natural gas demand by consuming sector.



The big loser was Industrial demand…down 7.7% from last year. Industrial demand actually recovered nicely from the depths of the recession when it was down 15% year-on-year in February. According to the most recent report, December Industrial demand was back up to the five year average. Industrial demand has been slowly trending lower for years as manufacturing continues to move offshore.

Low natural gas prices propped up the Electric Power sector in 2009 as natural gas-fired generators stole market share from coal-fired generators. Electric Power sector demand was up 3.3% year-on-year and regained its title as the largest consuming sector. Residential and Commercial sector demand was marginally lower year-on-year and in total, U.S. natural gas demand was down 1.6 % year-on-year.

EIA expects total natural gas consumption to increase by 0.7 % in 2010 and decline by 0.4 % in 2011. Cold weather during the first 2 months of this year accounts for this year's natural gas consumption increases.



Bottom-line, natural gas fundamentals remain very weak. Working storage is in good shape, winter is over, and we should be on schedule to see new record high working storage levels by the end of the injection season.

<u>Technical Analysis</u>

NYMEX May contract
Upside resistance is $4.65, $5.08, $6.72
Downside support is $4.00, $3.50, $3.15

By Sean Franke

Demand Response

In October, American Energy provided an update regarding the status of the electricity deregulation efforts in California. Since that time, the California Public Utility Commission, the Investor Owned Utilities, and Electric Service Providers have completed negotiations on how the Direct Access market will be phased-in. Here is a summary of the final ruling.

1. Total Load Allowed
The California Direct Access market will be allowed to add a specific amount of load during the four year phase-in process. For each utility, the total load allowed over the 4 year period is shown below.
    A. Pacific Gas & Electric – 3,100,000 MWh
    B. Southern California Electric – 3,562,000 MWh
    C. San Diego Gas & Electric – 462,000 MWh
2. Phased In Re-Opening
Of the total load allowed, there will be a phased-in reopening over the 4 year period for non-residential customers as shown below.
    A. Year 1 – 35%
    B. Year 2 – 35%
    C. Year 3 – 20%
    D. Year 4 – 10%
3. The reopening is scheduled to start on April 16, 2010.
4. Non-residential customers must submit a Notice of Intent to the respective utility.

The California PUC will implement the “first come, first serve” rule for participation in the Direct Access market. American Energy expects the Year 1 market cap to be achieved on the first day.

If you are interested in participating in the California Direct Access market please contact Sean Franke (smfranke@americanenergy.com).

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