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Natural Gas Boom Coming—But So Are Major Obstacles

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The United States may be entering a golden age of natural-gas use, which is good news for consumers, but not necessarily for investors.

In the past three years, huge reserves of domestic natural gas have been brought to the surface with revolutionary breakthroughs in drilling technology to produce a 100-year supply of cheap, clean-burning fuel at current rates of consumption, experts say.

"This is a huge, huge breakthrough for U.S. energy security," says Pete Stark, vice president of industry relations for IHS Global Insight. "It's the biggest gift we could have been given—a reliable domestic supply that creates jobs, increases the Gross National Product, offsets the balance of payments. It's ours and it can be used."

Yet despite its huge potential, there are two major obstacles facing the industry—low prices and a push by Washington toward renewable energy.

Many energy experts and government officials see natural gas as only a "bridge fuel" to ease the country's transition from foreign oil and dirty coal to carbon-free energy powered by wind, solar, biofuel and nuclear sources.

President Obama's economic recovery package, for instance, earmarked nearly $70 billion for renewable energy projects. And federal and state tax credits still offset the expense of buying hybrid autos and installing solar panels or wind turbines.

But natural gas experts scoff at the suggestion that the fuel is of merely transitional value.

"The subsidy associated with renewables makes no economic sense," says Porter Bennet, CEO of Bentek Energy Services. "I think the government right now is picking winners and losers. They think renewable ought to be a winner and gas ought to be loser. They're making tremendous investments in the form of subsidies to make sure that happens."

Adds Stark of IHS Global Insight: "My biggest fear is that politically, D.C. still doesn't get it. The needle right now is biased toward renewable."

Pricing Problems

The other problem—for the industry and investors—is that the vast new supplies of natural gas are likely to keep prices low for a long time.

"The reality is that in a world of abundant supply and increasing production, prices will likely stay very low," says stock analyst Alan Brochstein.

As a result, he thinks the natural gas industry is on the road to "profitless prosperity."

"The clear winners (besides users of natural gas) will be the companies that enable the production, like drillers, machinery manufacturers, infrastructure companies, service providers, etc.," Brochstein says. "The exploration and production companies may or may not be good investments."

Even so, the industry is expected to see tremendous growth over the next few decades.

Though natural gas is a fossil fuel, it's far more efficient and cleaner-burning than coal or petroleum-based products. As such, natural gas companies will benefit greatly from a growing trend in the utility industry to convert existing coal-fired power plants to burn the more environmentally-friendly fuel.

In June, scientists at the Massachusetts Institute of Technology released a two-year study that envisions an increase in the use of natural gas over the next few decades, before subsiding in favor of renewables.

"The share (of national energy use) represented by gas is projected to rise from about 20 percent of the current national total to around 40 percent in 2040," said MIT researchers whose major sponsor was the American Clean Skies Foundation, a think tank created and funded by the natural gas industry.

The researchers envision a federal policy aimed at cutting greenhouse gas emissions by 2050 to a level roughly equal to half of 2005 emissions.

National policy will place an economic cost on such emissions, they say, and since natural gas emits roughly 50 percent less greenhouse than coal, it will enjoy a rosy, but short-term future.

"Though gas frequently is touted as a 'bridge' to the future, continuing effort is needed to prepare for that future, lest the gift of greater domestic gas resources turn out to be a bridge with no landing point on the far bank," researchers concluded.

After all, natural gas is still a fossil fuel and even its reduced carbon emissions are more damaging to the atmosphere than sun or wind.

"While gas is less carbon intensive than coal or oil, at the reduction level required by 2050, its [carbon] emissions are beginning to represent an emissions problem," the report explains. "However, even under the pressure of the assumed emissions policy, total gas use is projected to increase from 2005 to 2050 even for the low estimate of domestic gas resources."

As a long-range investment play, natural gas would seem secure. But its newfound abundance has stalled the industry's near-term growth, frustrating investors and executives.

"I believe at least half of our gas drilling is what I would call involuntary," outgoing Chesapeake Energy CFO Marc Rowland admitted in an earnings call last month. "It's being incentivized by something other than the gas price...It might be the need to hold acreage… And I think that's, in large part, true across the industry that there's an enormous amount of drilling today that is economic. It's just economic for reasons other than what current gas prices are."

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