NATURAL GAS PRICES REACH UNPRECEDENTED LEVELS

(As of 10/29/04)

In our last report, we indicated that natural gas prices don't always move on logic. Unfortunately, that statement proved to be very true at the end of October 2004. In just a few days, natural gas prices exploded to levels that are normally supported by only sub-zero temperatures. Throughout much of September, the November 2004 natural gas New York Mercantile Exchange (NYMEX) contract found a comfort level of around $.70 per therm, a level that already seemed too high for current conditions. However, in the last week of October, the November 2004 natural gas NYMEX skyrocketed, reaching as high as $.85 per therm before falling to expire at $.76 per therm. By comparison, last year, the November 2003 natural gas NYMEX contract expired at $.45 per therm.

What does this mean? For November 2004, natural gas commodity prices, which account for about 65 to 75 percent of a business' natural gas bill, may be as much as 40 percent higher than last year at this time. In addition, at this time, pricing forecasts for the remaining winter months of December through March are equally as dismal for pricing projections for future months on the NYMEX.

Recent Price Movements

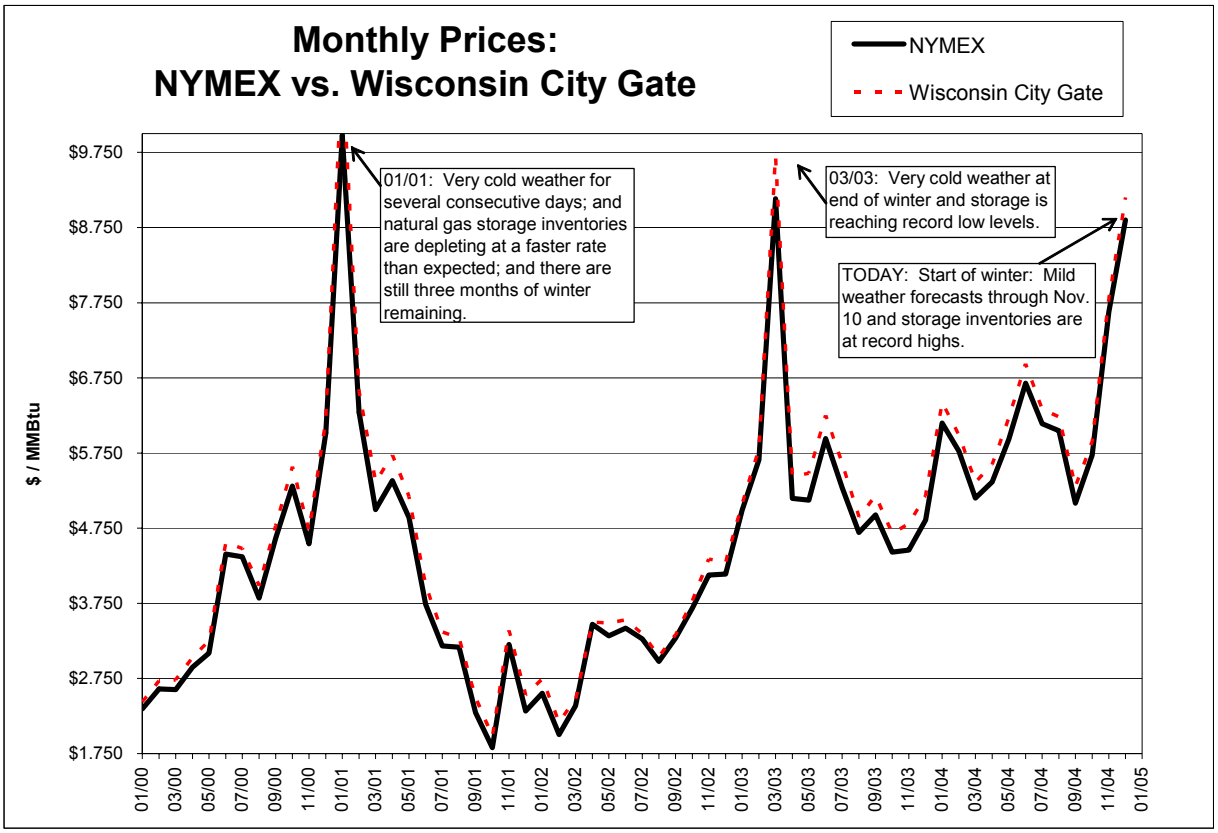
Historically, the movement of natural gas prices has been easier to explain as it was typically justified by fundamental factors, such as storage levels, weather, etc. However, over the past two years, as many large marketers have exited the industry, speculators now account for a larger share of the players that are buying and selling natural gas commodities on the NYMEX. As a result, speculators now have more influence over the direction of natural gas prices on the NYMEX. Because speculators buy and/or sell natural gas commodities to solely make a profit, it is very difficult to determine what action they are planning on taking and how that will influence natural gas prices.

Most believe that the primary impetus behind the recent upward price movement has been speculative trading – a factor that has influenced prices in the past year, but in the past week seems to have taken control. Typically, price moves caused by speculative buying or selling are referred to as "technical" moves. Technical moves cannot usually be sustained without underlying fundamentals to support those "technical" moves. However, because speculators now have more influence over natural gas prices on the NYMEX, it raises the concern that even if the recent price rise is technically driven, it may be sustained longer than expected. Worse yet, there are concerns that speculative buying and selling may even push natural gas prices on the NYMEX to even higher levels. Overall, as speculative activity continues to increase, it is becoming more and more difficult to explain natural gas pricing behavior.

How the NYMEX Impacts Prices Throughout the Nation

Natural gas prices on the NYMEX are representative of the cost of the natural gas commodity in Louisiana. The NYMEX serves as a benchmark for natural gas commodity prices throughout the nation. Therefore, as natural gas prices move up and down on the NYMEX, natural gas prices throughout the nation, typically move up and down as well. This also means that even if the NYMEX moves up or down for "technical" reasons, the price of gas in other regions, such as Wisconsin, will also likely move up or down.

This relationship is illustrated in the chart below, which compares monthly prices on the NYMEX to monthly city gate prices in Wisconsin. The city gate price in Wisconsin is comprised of the cost of the natural gas commodity and pipeline transportation only; utility distribution costs are not included. *NOTE: The cost per unit reflects prices in MMBtus. An MMBtu is equal to approximately 10 therms, and a price of $5.00 per MMBtu is approximately equal to $.50 per therm.*



The Most Troubling Signal

While the industry has been dealing with the influence of speculative trading for several years, the price action at the end of October is particularly troubling because it presents an unprecedented pricing scenario. As illustrated in the above chart, current pricing levels have only been reached two times before, and in both of these instances, there was an underlying fundamental problem involving cold weather and declining storage inventories that supported the price spike. That is just simply not the case today making current price levels difficult to justify and explain.

While most believe fundamentals will ultimately prevail, activity by speculators has shown a greater influence on prices in the past month than ever before, and if that continues to be the case, it becomes increasingly difficult to predict where prices might land, making gas budgeting for businesses extremely challenging.

The Current Fundamental Picture

Most feel that while there is support for natural gas prices at somewhat higher levels than last year, current price levels are greatly inflated. There are warranted concerns over an ongoing natural gas supply shortfall. However, many felt those concerns were already priced into the higher natural gas prices that have been in place for much of 2004. For that reason, many were surprised when natural gas prices surged to new highs at the end of October. Historically, natural gas prices have only reached current levels when it was extremely cold and natural gas supplies truly become an issue. At this point in time, there is only the perception that a supply shortfall could potentially exist if winter temperatures are colder than normal.

Another fundamental factor that typically points to lower prices is adequate storage inventories. In the Midwest and the Northeast, energy companies rely on storage during the winter months of November through March to meet customers' needs. Natural gas storage inventories are easily on pace to reach a new record level high, even with the production curtailments caused by Hurricane Ivan. With just one more week remaining in the storage injection season, natural gas storage inventories are just 5 bcf shy of a new all-time record. Typically, high storage levels, such as those today, put downward pressure on prices, but this year, natural gas prices have adamantly disregarded that usual price signal.

In addition, while long-term weather forecasts for the winter are somewhat mixed, near-term temperatures are expected to be normal to above-normal in many areas of the nation including the Midwest and the Northeast – areas where natural gas is consumed for space heating. Better yet, most weather forecasts indicate that with the current jet stream any bouts of colder temperatures will not likely last for more than a couple of days. If these weather forecasts materialize, it is very likely that storage inventories could remain at very high levels into November.

Do the Fundamentals Matter Anymore?

Yes. Unfortunately, even if natural gas prices do start paying attention to some of the current underlying fundamentals, such as record level storage inventories, natural gas prices are at such high levels that any decline to historical levels will likely take some time. With potentially warmer weather in November, natural gas prices could easily fall $.10 to $.20 per therm, but even with that type of decline, natural gas commodity prices for December could still be close to 40 percent higher than prices at this time last year. Conversely, however, if the weather turns much colder by the end of November, at that time, the fundamentals of cold weather and fears over a supply shortfall could push natural gas prices even higher.

At this time, the problem facing many natural gas buyers is how to interpret the recent, erratic behavior of natural gas prices. Do you wait for the fundamentals to prevail or do you accept the fact that technical trading has pushed prices to new, sustainable heights?

DEFINITIONS

Bear Market: A market in which prices are declining.

Bearish: One who expects a decline in prices.

Billion cubic feet (Bcf): 1,000,000 dekatherms

British Thermal Unit (Btu): The amount of heat required to increase the temperature of a pound of water 1˚ Fahrenheit. A Btu is used as a common measure of heating value for different fuels.

Bull Market: A market in which prices are rising.

Bullish: One who expects a rise in prices.

Burner Tip Price: The price of natural gas at the point of consumption (home or business).

Commercials: As it relates to the futures market, commercials are entities that are involved in the production, process, or merchandising of the natural gas commodity. These include large marketing companies, such as Dynegy, El Paso, Coral, and former players like Enron.

Commodity Price: The price of natural gas at the point of production.

Contango Market: A term used in futures trading to indicate that prices are progressively higher in succeeding delivery months than in the nearest delivery month. Also called forwardation.

City Gate Price: The price of natural gas at the interconnection between the interstate pipeline and We Energies' distribution pipeline.

Dekatherm: 10 therms

Front Month: Sometimes referred to as the nearby or spot month. This is the futures contract month that is closest to expiration. Trading of the front month expires three business days prior to the end of the first calendar day of the delivery month for the NYMEX natural gas futures contract.

Fundamental Analysis: An approach to forecasting natural gas commodity prices that is based on the premise that physical factors influence the specific price behavior of natural gas commodity prices. Fundamental analysis includes physical factors, such as supply and demand, natural gas storage inventories and weather.

Futures Contract: A legally binding agreement to buy or sell a commodity that is traded for future delivery under the provisions of exchange regulations. The standard NYMEX natural gas futures contract is for 10,000 MMBtu or approximately 10,000 dekatherms.

Long Position: As it relates to the futures market, one who has bought a futures contract to establish a market position or a market position, which obligates the holder to take delivery unless the contract is liquidated with an offsetting sale. Opposite of Short Position.

MMBtu: Approximately 1 dekatherm or 10 therms

New York Mercantile Exchange (NYMEX): A commodity exchange based in New York City where natural gas futures contracts are traded. Other energy futures commodities contracts are traded there as well.

Non-Commercials: As it relates to the futures market, non-commercials are generally speculative traders.

Open Interest: The number of natural gas commodity contracts on the New York Mercantile Exchange (NYMEX), which have not been satisfied by an offsetting sale or purchase or actual delivery.

Proved Reserves: Crude oil and natural gas demonstrated with reasonable certainty to be recoverable from known reservoirs under existing economic and operating conditions.

Settlement Price: The price established by the NYMEX Exchange Settlement Committee at the close of each trading session to be used by the clearinghouse in determining net gains or losses, margin requirements, and the next day's price limits. Calculating the weighted average of prices as the market nears closing derives the settlement price.

Shoulder Month: Normally defined as spring and fall months when energy demand is lowest.

Short Position: As it relates to the futures market, one who has sold a futures contract to establish a market position or a market position, which requires the seller to make delivery at the agreed upon price unless the contract is liquidated with an offsetting purchase. Opposite of Long Position.

Speculator: In the futures market, an individual who does not hedge, but who trades with the objective of achieving profits through the successful anticipation of price movements.

Storage: Facility used for the storage of natural gas; usually a cavern carved out of natural salt domes or depleted natural gas reservoirs into which natural gas can be re-injected and withdrawn with minimal loss.

Strip: The average of the prices for stated futures contracts.

Technical Analysis: An approach to forecasting natural gas commodity prices that examines patterns of price change, rates of change, and changes in volume of trading and open interest, without regard to underlying fundamental market factors.

Therm: 100,000 British thermal units or 100 cubic feet (1 ccf)

Trillion cubic feet (Tcf): 1,000 Bcf or 1,000,000,000 dekatherms

Volatility: The market's price range and movement with that range. The direction of the price move can be up or down.