

## Crunch Time?

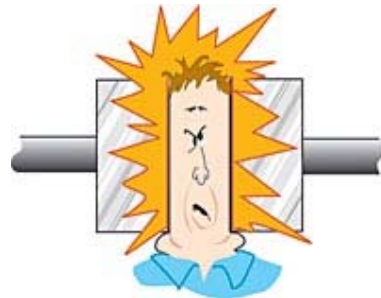
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### Prepare for Potential Energy Curtailments Now

A recent article in the *Chicago Tribune* reported a speech delivered by Alan Greenspan to the House of Representatives Energy & Commerce Committee. In it, he said the era of cheap and abundant natural gas in North America has ended, Canadian reserves can no longer be counted on to cover future increases in consumption, and gas imported from elsewhere will be the only counter to future shortages and drastic price increases. To reinforce the message, the article contained a Bloomberg graphic showing that the price of natural gas futures contracts had increased from about \$3.35 to \$6.33 per million BTU in the 12 months since June 2002. Worse, the trend showed no signs of leveling off. Elsewhere, I've read about low levels of underground storage and concerns of supply pinches again this winter.

How can this be? Industrial output is down and plants continue to close. Overall, the weather hasn't been exceptionally cold. Where's the gas going?

Part of the consumption increase can be tied to the rapid increase in the amount of electrical energy being generated with natural gas. Some old coal- and oil-fired plants are now operating on gas, and gas turbine-driven generators are popping up like mushrooms all over the place. This has been good for the environment, but it may provoke a crisis in supply.



Historically, energy prices have tended to follow the economy in general -- low demand, low prices. So, when manufacturers were just getting by on mediocre production levels, they had the comfort of knowing their energy costs were proportionally low, too. Not this time -- increased energy costs are gnawing into whatever remains of profit margins. As several companies have told me, "We're making product, but we're not making any money."

So what does all this mean to manufacturers who depend on natural gas to keep the lines running? It's hard to say -- in the past, pending crises like these sometimes faded away. Someone took corrective action, the conditions fostering the problem suddenly changed, or the whole thing turned out to be a lot of hype. What you do depends on how confident you are that you can get through the next year or two without the bottom dropping out.

Here's what I'd suggest, though:

1. Dust off those old energy reduction studies and see if they might help profit margins. New equipment and upgrades based on energy cost savings might look more attractive at today's gas cost levels. If you get hit by a full-blown curtailment, more efficient equipment won't save you, but at least you can put a little more money in the bank in the meantime.
2. Get cracking on a plan to deal with energy curtailments (see "Here's My Plan" in the October 2001 issue. You can access this column on this site.).
3. If you believe the threat of a future curtailment is very real, start investigating ways to dodge it, including:
  - **Standby Energy Systems.** Natural gas isn't the only way to heat most processes. LP gas is suitable for most of them, and fuel oil may work for some. They'll both require

some new equipment, so don't wait until the last minute before committing to a standby system.

- **Building Inventory.** I know this is the rankest heresy in this day and age of just-in-time manufacturing and finance departments casting a critical eye on unsold goods, but we're in a fundamentally different ballgame now. It's been 20 years since we last faced the prospect of someone shutting off the gas tap. During that period, industry has instituted manufacturing systems predicated on the assumption that raw materials, subassemblies and finished components would flow into and out of the plant exactly when needed and in just the right amounts.

In retrospect, we may have overlooked a couple of key components in the manufacturing flow. Anyone who has had a labor stoppage can identify one. Now we may have to add energy stoppage to the list. Continuing to insist on a manufacturing model that was ideal for 1990 could cause of a lot of pain in 2003.

- **Alternate Manufacturing Processes.** Consider methods that reduce or eliminate the need for heat processing. I'd hate to lose you as a reader, but you have to act in your own best interests.
- **Contracting Out.** Can the manufacturing steps requiring heat processing be subcontracted to a vendor with a more secure energy supply? Keep in mind that the most likely candidates are apt to be located a considerable distance from you. Otherwise, they'll be suffering from the same curtailments as you.

Whether or not you believe there will be gas supply interruptions in the next year or two, three things are clear -- the price of gas is steadily climbing, manufacturing is facing more competition for available supplies, and the market seems to be growing more unstable and volatile with each passing month. In light of this, you owe it to yourself to be prepared for an uncertain future.