



**K**eySpan Energy has completed our second quarter of solid earnings and we are confident we can achieve our 1999 targets. These earnings results are outlined in this edition of our Analyst's Report, as well as information on two major components of our business.

- Electric Business Unit Strategy and Performance
- Business Unit Spotlight: Houston Exploration
- 2nd Quarter Earnings

Please feel free to contact me at (718) 403-3265 if you need further information. We appreciate your investment and support of KeySpan Energy.

Sincerely,

A handwritten signature in cursive script, appearing to read "Mike".

Michael J. Taunton  
Vice President  
Investor Relations

# HEAT WAVE ENERGIZES KEYSpan

Interview with Anthony Nozzolillo, Senior Vice President, Electric Business Unit



## 1. What is the Current Environment for the Electric Business Unit?

As you know, we own 4000MW of electric generating facilities on Long Island. We recently acquired Con Edison's 2,168 megawatt (MW) Ravenswood electric generating site to increase our overall capacity to more than 6,000 MW. This makes us the largest investor-owned producer of electric power in New York State.

We also manage the Transmission and Distribution System (T&D) for The Long Island Power Authority (LIPA) and its 1 million customers. And, we recently formed a construction company that will design, manage and construct new electric facilities.

Our core competencies are clearly in electric generation and T&D. Our strategy is to build upon these competencies. For instance, we are interested in growing our generating business in 3 power pools - New York, New England, and Pennsylvania / New Jersey / Maryland. These pools are interconnected to New York. We know the infrastructure of the systems and the demographics of the customers. And we have been deeply involved in the development of the New York Independent System Operator and the new pricing policies as these regions move to more competitive structures.

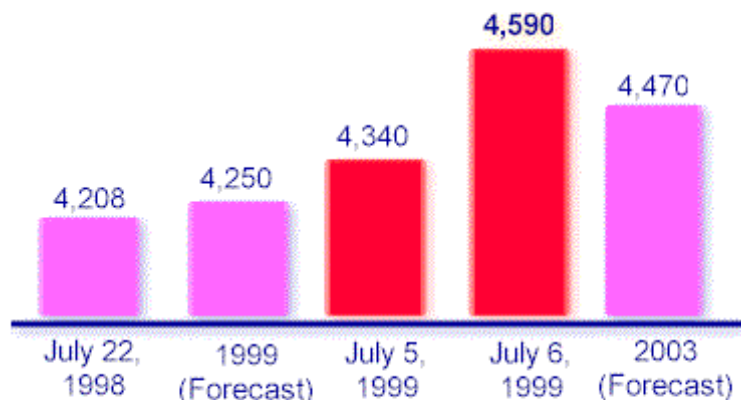
We have bid on some of the recent generating plant asset divestitures. We won the Ravenswood Plant, and we used our strict financial criteria to determine that the purchase prices of some other assets for sale were too high. We believe that our sophisticated model has allowed us to make the right investments. Right now, it is a 'seller's market'. We feel that there will be a second wave of asset sales in 2 to 3 years, which will likely be more of a 'buyer's market'.

On the T&D side, our main priority is to provide LIPA with excellent reliable service. Our track record is superior. We were the first utility in New York State to be ranked first in both frequency and average duration of electric outages. We can expand this T&D expertise if we merge with or acquire a combination utility in the future.

Our electric business will grow profitably. This year, we expect to earn our management fee from LIPA and additional incentives based upon our performance. Our

## Long Island Electric Peak Load

(MW)



**July 6th Usage Surpassed Forecast for 2003 !**

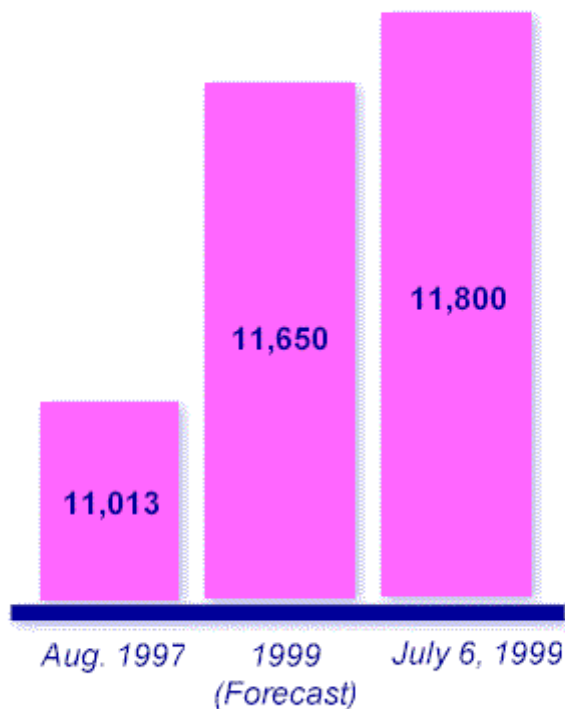
generation on Long Island will provide net income in excess of \$20 million, and Ravenswood will provide net income of \$30 million this year and double that for a full year in 2000. Any new investments will add to this earnings potential.

## 2. How did KeySpan handle the July Heat Wave?

The unusual temperature-shattering heat wave was a true test for the Company. It resulted in record demand for power and reflected our dedication to performance and reliability in maintaining the output capability of our generating facilities. On July 5 and July 6, Long Island had record peak loads of 4,340 MW and 4,590 MW, significantly eclipsing our previous peak load of 4,208 MW. KeySpan supplied 81% of Long Island's requirements. The summer energy requirements so far are 14% higher than the same period last year. New York City also had a record peak demand on July 6 and our Ravenswood Plant generated 25% of New York City's total demand for the day. Energy production at Ravenswood increased 152% from the same period last year.

Although there were some outages, the T&D system did not experience any significant problems and we fared better than many of our neighboring utilities. Our generation was 99% available. We added additional crews from within KeySpan - including 37 two-person restoration crews from Brooklyn Union - and 52 high voltage crews from other Northeast companies to assist in this massive effort. Our employees worked around the clock to restore service to customers who lost power for minimal periods. We were well-prepared.

### New York City Electric Peak Load (MW)



We also demonstrated a strong working relationship with LIPA. Although we have been working together for more than a year, this was our biggest test. Together, we were able to manage the situation and avoid a major crisis. We took aggressive steps to maintain service to our customers. We issued a public appeal to decrease usage and contacted major customers. We then imposed a 5% system wide voltage reduction. Collectively, these steps reduced usage by 250 MW and enabled us to avoid more severe measures such as load shedding and rolling blackouts.

**3. Why has the demand for electricity increased on Long Island?** In the past, electric usage on Long Island was flat or increased by about 1% per year. Now, we are realizing growth of

about 4% per year. There are a number of factors which explain the increased demand. First, of course, is the 20% rate decrease, which resulted in increased customer usage due to price elasticity. Next, the economic and population growth have lead to increased usage. Technology has also been a big factor as there has been a proliferation of computers, fax machines, efficient air conditioners and other modern amenities. And finally, the growth in tourism has dramatically increased usage. For instance, the demand on the South Fork of Long Island exceeded 160 MW, an amount not anticipated until the year 2004.

#### **4. What are your plans for building additional generation?**

We are going to build a 250 MW gas-fired cogeneration unit at Ravenswood. Con Ed has stated that the capacity required to provide power to NYC is deficient by 300 MW. KeySpan was aware of the need for additional capacity in the NYC area. We purchased Ravenswood as an opportunity to diversify our energy business and improve our ability to supply energy in the Northeast.

We have purchased two GE gas turbines. We are looking at other potential sites throughout the region to determine where the installation and use of these turbines would be most beneficial to the system. As illustrated during the heat wave, there is a definite need for increased capacity.

We are also looking at building new generation on Long Island, where there is a shortage. Currently, Long Island is a net buyer of electricity - with an import capability of about 1,000 MW. LIPA has publicly stated that they are looking for 3 new power plants that would generate a total of 225 MW of capacity across Long Island, beginning in the year 2001. These plants may be targeted for isolated areas such as the South Fork and Far Rockaway. We will consider building these plants if it is a good investment. We are also working with LIPA to determine the feasibility of building generation for next summer, since there will once again be a pressing need.

There should be a parallel path approach on Long Island with both new generation and a new tie line to New England. New generation on Long Island can be installed in the next two years. Longer-term solutions such as an interconnection to other facilities will take at least five years. At the same time, we are monitoring new technologies such as micro turbines, fuel cells and distributed generation. Our goal is to provide reliable energy to Long Island at the lowest possible cost and to expand our base of electric customers in the Northeast to become a premier energy company in the areas that we serve.

#### **5. How does the electric business fit in KeySpan?**

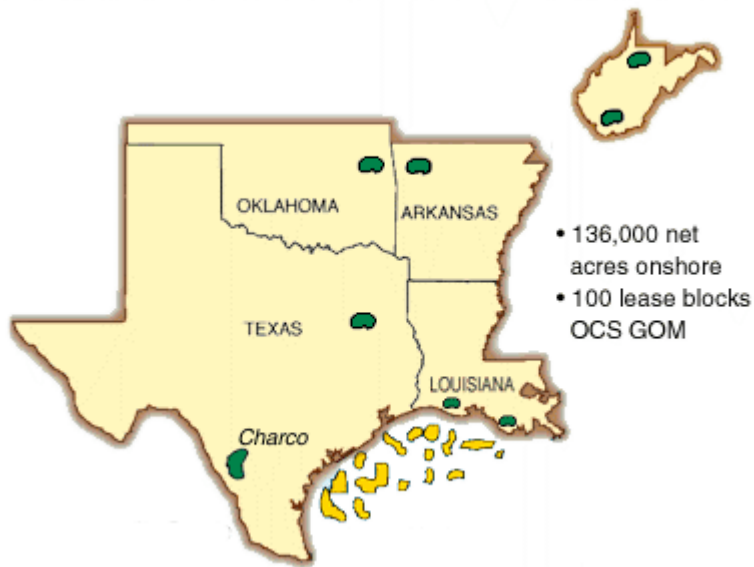
The employees in the electric business are excited about everything that is going on in the Company. Although the initial focus was on our gas business, some of the recent developments have highlighted the significance of the electric business. The electric growth on Long Island, the Ravenswood acquisition and the heat wave performance have energized the Company.

The new generation opportunities will provide growth for KeySpan. The generation will likely be gas fired. This means that new gas lines will be installed in areas that previously were not accessible. There will be system reinforcements required; our construction company will bid on these projects. And our subsidiary, KeySpan Energy Marketing, can potentially provide service contracts for the new customers' air conditioners and other equipment.

After one year, everything is coming together. We have built a strong relationship with LIPA. We have moved beyond the merger issues. We will contribute approximately \$60 million in net income this year and an additional \$30 million next year due to a full year of Ravenswood operation. And we are poised to build upon our competencies in generation and T&D as future opportunities become available.

## Business Unit Spotlight The Houston Exploration Company

*Each quarter, the KeySpan Energy Analyst's Report will focus on one of our business units. The following is a discussion by Mr. James G. Floyd, President and Chief Executive Officer of the Houston Exploration Company. Mr. Floyd began his career as a geologist in 1962 after earning both a BS and MS in Geology from the University of Florida. He held various positions in exploration, exploitation and corporate management until 1981. From 1981 to early 1986, Mr. Floyd served as President of Seagull E&P, Inc. He joined The Houston Exploration Company at the time of the company's founding in 1986.*



The Houston Exploration Company, formerly known as Brooklyn Union Exploration Company, opened its doors for business in early 1986. Jim Floyd and most of the other members of the management team have been there since the start. We merged with the onshore drilling operations of Brooklyn Union prior to our initial public offering of common stock in 1996. KeySpan Energy retained approximately 65 percent of our outstanding shares. Our shares are traded on the New York Stock Exchange under the symbol "THX." Over the past five years, we have grown reserves at a compound annual rate of 33 percent, and at year end 1998 we had 480 billion cubic feet equivalent of net proved reserves.

### **Growth Strategy**

First, our growth strategy is to build the company through the drill bit. In other words, we seek to increase our reserve base through drilling opportunities that could keep up drilling full time for four or more years. Our inventory is well balanced between higher reward, but higher risk, exploratory drilling located principally in the offshore Gulf of Mexico, complemented by lower risk exploitation and development drilling onshore in the Gulf Coast region and in West Virginia.

Forty percent of our reserve base is in the shallow waters of the Gulf of Mexico, approximately a third is in South Texas in the Charco field, and the balance of our reserves is located in South Louisiana, Arkansas, Oklahoma, East Texas and West Virginia. Acquisitions also figure prominently in our growth strategy. We use a conservative price forecast to ensure our financial targets can be met.

We have a good track record of acquiring reserves with additional drilling opportunities that fit with our operating strategy. Last year, for instance, we established a new core area in South

Louisiana and supplemented our position in the Mustang Island region of the Gulf of Mexico through acquisitions.

### **Operating Strategy**

Our operating strategy has remained unchanged since the company's founding. We concentrate our assets in core areas, maintain a high working interest and serve as the operator for more than 90 percent of our production. We take these steps to ensure we have one of the lowest operating cost structures in the industry. We lowered our operating costs from \$0.36 to \$0.34 per Mcfe in 1998.

We also tend to develop our drilling prospects in-house. Approximately 98 percent of our reserves are natural gas, and we probably have the highest percentages of natural gas of any publicly traded exploration and production company. We are first and foremost a drilling company. So, our strategy is to also ensure we are maintaining an active, and well balanced drilling program. Last year we drilled 37 wells, and this year we will drill probably more than 40 wells.

### **KeySpan Energy Joint Venture Drilling Program**

Earlier this year we formed an offshore joint venture drilling program with KeySpan Energy. Under the terms of this three-year program, we will jointly explore and develop approximately 55 offshore leases with KeySpan. This program provides KeySpan with a direct investment in the strategic reserve base of the Gulf of Mexico, and provides Houston Exploration Company with a capital-strong partner to help fund the exploration and development of the 55 or more prospects we have already identified in our undeveloped leases.

### **Outlook for Natural Gas Prices**

We are very bullish on the outlook for natural gas prices. The combination of increasing demand with decreased supply should spell stronger natural gas prices.

Because natural gas prices do have a significant impact on our operating results, we use financial instruments to hedge the price of approximately half of our natural gas sales. A \$0.10 move in natural gas prices has a \$0.20 per share impact, approximately, on Houston Exploration's earnings per share. So, by using financial hedges and establishing a floor price, we strive to protect the downside and enjoy the upside of rising gas prices.

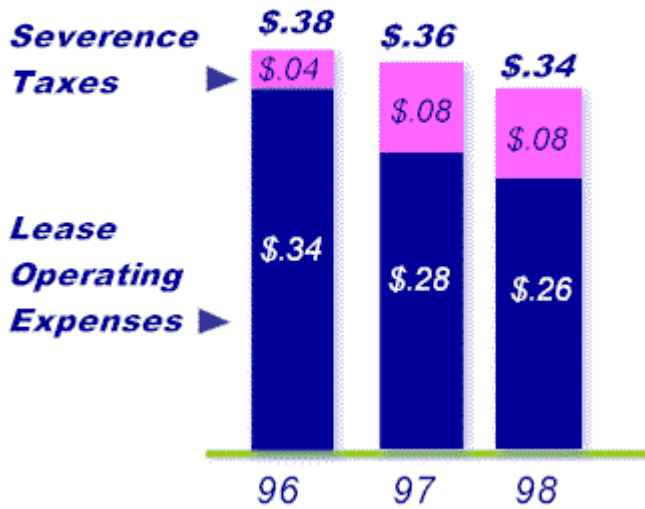
### **Growth Goals**

Our objective is to increase shareholder value by increasing reserves and production. From a measurement standpoint, we would like to achieve double-digit growth of both our reserve base and production. We can achieve this growth through our drilling inventory, supplemented by acquisitions when they are available. Since going public in September 1996, the stock market has recognized Houston Exploration's success and potential for growth. Houston Exploration Company has been one of the best performing stocks in our sector over that time period.

## Reducing Operating Expenses

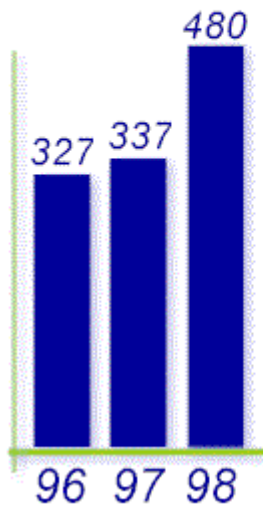
Lease Operating Expenses & Severance Taxes

Per Mcfe Produced



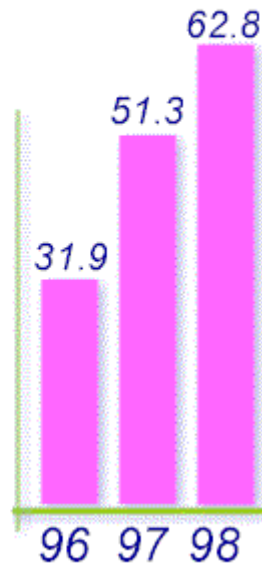
## Net Proved Reserves

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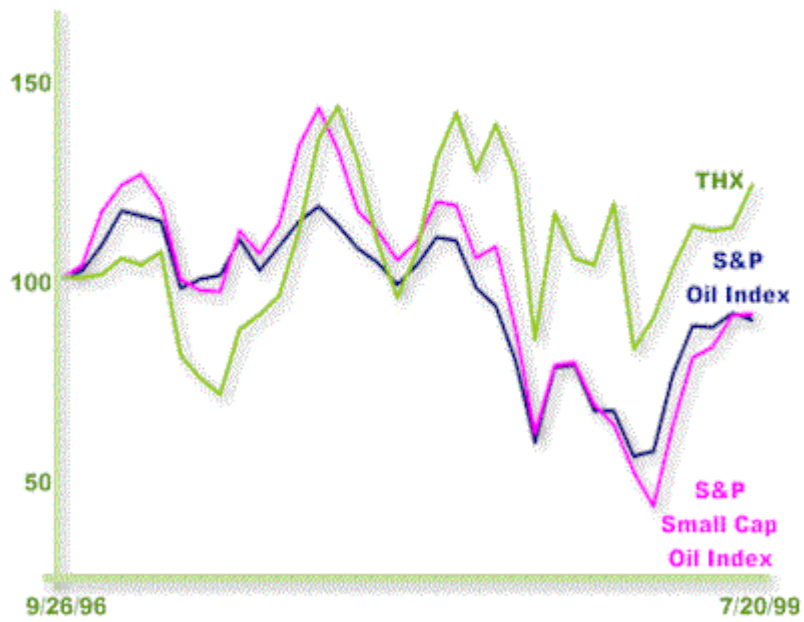


## Production

Bcfe



The Houston Exploration Company Stock Appreciation  
vs S&P Oil & S&P Small Cap Oil Indices



## KeySpan Reports Earnings For Second Quarter 1999

*Results Demonstrate Progress Since Merger*

On July 29, 1999 KeySpan Energy reported earnings of \$14.3 million, or \$.10 per share, for the second quarter of 1999. For the six-month period to date, results were \$148.8 million or \$1.05 per share. "Our second quarter earnings were ahead of expectations", said Chairman and Chief Executive Officer Robert B. Catell, "and we expect that earnings will be on target for the year."

### Earnings Per Share By Business Segment

	<b>3</b>	<b>6</b>
	<b>Mos.</b>	<b>Mos.</b>
Gas Distribution	\$.01	\$.86
Electric Services	\$.11	\$.22
Gas Exploration & Production	\$.02	\$.03
Energy Related Investments	\$.02	\$.02
Energy Related Services	-	(\$0.01)
Other	(\$0.06)	(\$0.07)
<b>Total</b>	<b>\$.10</b>	<b>\$1.05</b>

### Stock Buy Back Program

As of August 10,  
1999 we have  
repurchased 19.8  
million shares for a  
total of \$574  
million.

# Segmented Highlights

Three Months Ended  
June 30  
(In Thousands of Dollars)

	Gas Distribution		Electric Services <sup>1</sup>		Gas Exploration & Production		Energy Related Investments		Energy Related Services		Other		Total	
	1999	1998*	1999	1998*	1999	1998*	1999	1998*	1999	1998*	1999	1998*	1999	1998*
	Revenue	277,482		189,734		35,021		-		37,125		-		539,362
Cost of Gas	96,819		-		-		-		-		-		96,819	
Operations & Maintenance	88,148		108,120		6,326		1,580		37,327		565		242,066	
Depletion and Amortization	24,351		10,337		17,972		286		703		5,733		59,382	
Operating Taxes	45,836		28,447		113		1		-		2,748		77,145	
Intercompany Billings	867		10,398		-		-		-		(11,265)		0	
Total Expense	256,021		157,302		24,411		1,867		38,030		(2,219)		475,412	
Operating Income	21,461		32,432		10,610		(1,867)		(905)		2,219		63,950	
Earnings for Common Stock	1,220	(11,539)	15,037	51,155	3,326	3,472	2,448	(1,198)	(254)	(2,071)	(7,478)	(3,851)	14,299	35,968
Basic and Diluted E.P.S.	0.01		0.11		0.02		0.02		0.00		(0.06)		0.10	

XXX

Six Months Ended  
June 30  
(In Thousands of Dollars)

	Gas Distribution		Electric Services*		Gas Exploration & Production		Energy Related Investments		Energy Related Services		Other		Total	
	1999	1998*	1999	1998*	1999	1998*	1999	1998*	1999	1998*	1999	1998*	1999	1998*
	Revenue	993,312		364,271		61,541		-		78,557		-		1,497,681
Cost of Gas	408,073		-		-		-		-		-		408,073	
Operations & Maintenance	187,228		200,288		12,285		2,669		80,555		2,123		485,148	
Depletion and Amortization	48,605		20,265		35,029		618		1,472		11,579		117,568	
Operating Taxes	118,289		57,440		146		8		3		5,152		181,038	
Intercompany Billings	3,917		21,041		-		-		-		(24,958)		0	
Total Expense	766,112		299,034		47,460		3,295		82,030		(6,104)		1,191,827	
Operating Income	227,200		65,237		14,081		(3,295)		(3,473)		6,104		305,854	
Earnings for Common Stock	121,909	108,722	31,621	114,604	3,804	7,805	2,750	(1,864)	(1,693)	(5,728)	(9,560)	(4,233)	148,831	219,306
Basic and Diluted E.P.S.	0.86		0.22		0.03		0.02		(0.01)		(0.07)		1.05	

\* 1998 data is being given on a combined company basis only. It appears here in order to provide the financial community with data for comparison against KeySpan's 2nd quarter 1999 results.

<sup>1</sup> Electric Operations will not be comparable to other years, due to a change of business focus.

## **Company Updates**

### **Y2K COMPLIANCE**

On July 7 we successfully completed another major milestone with the filing of our July 1, 1999 PSC Y2K status report showing all systems associated with the safe and reliable delivery of gas to our customers at 100% Y2K ready with no exceptions. The report shows remediation of business critical systems at 96% complete and testing at 90% complete.

On July 22, KeySpan announced along with the Long Island Power Authority (LIPA) that the systems, equipment, and applications that play a critical role in the operation of the electric system serving Long Island are Y2K ready.

As part of our Y2K preparations, KeySpan and LIPA will take part in a national Y2K preparedness drill on September 8th and 9th, 1999.

### **Gerald Luterman Named Chief Financial Officer & Senior Vice President**

Formerly of American Express and Arrow Electronics, Inc., the world's largest distributor of electronic components and products, Mr. Luterman brings over 30 years of financial management experience to KeySpan.

### **David Manning Named Senior Vice President of Corporate Affairs**

Mr. Manning is the former president of the Canadian Assn. of Petroleum Producers, and served as Deputy Minister of Energy for the Province of Alberta from 1993 to 1995.

### **Coleen Ceriello Named Vice President of Strategic Planning**

Ms. Ceriello, with her diverse Company experience will play a critical role in overseeing the Company's strategic planning process.

Certain statements contained herein are forward-looking statements, which reflect numerous assumptions and involve a number of risks and uncertainties. Actual results may differ materially from those discussed in such statements. Among the factors that could cause actual results to differ materially are: available sources and cost of fuel; State and Federal regulatory initiatives that increase competition, threaten cost and investment recovery, and impact rate structures; the ability of the Company to successfully reduce its cost structure; the ability of the Company to successfully integrate acquired operations; the degree to which the Company develops nonregulated business ventures; the effect of inflationary trends and increases in interest rates; the ability of the Company and its significant vendors to modify their computer software, hardware and databases to accommodate the year 2000; and risks detailed from time to time in reports and other documents filed by the Company and its predecessors with the securities and Exchange Commission.