



Energy [Natural Gas – US]

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Dow Jones U.S. Oil & Gas Index (DJUSEN)

DJ US OIL & GAS IND
as of 11-Feb-2009



Key Index Statistics¹

Price	417.33
Market Capitalization	N/A
52-Week Range	417.33-610.62
DJUSEN 1-Yr % Change	-31.65%
S&P 1-Yr % Change	-38.08%

Select Independent Oil & Gas Players by Mkt Cap (B)

Occidental Petroleum Corp (OXY)	45.18B
Apache Corp (APA)	24.38B
Devon Energy Corp (DVN)	23.37B
XTO Energy (XTO)	21.77B
Canadian Natural Resources Ltd (CNQ)	18.86B
Suncor Energy Inc (SU)	18.52B
Anadarko Petroleum Corp (APC)	18.19B
EOG Resources Inc (EOG)	16.07B
Chesapeake Energy Corp (CHK)	10.84B
Southwestern Energy Co (SWN)	10.70B
Enterprise Products Partners LLP (EDP)	10.26B
Talisman Energy Inc (TLM)	10.11B
Noble Energy (NBL)	9.12B

INVESTMENT THESIS

- Natural gas is abundant, economic, clean-burning, and fuel efficient. In addition, current domestic reserves are expected to be adequate to meet U.S. natural gas demand for at least 120 years.
- With the world economy projected to shrink this year, natural gas use will decline. Persistent, depressed economic conditions will keep prices low. Natural gas prices are unlikely to recover above \$6 per million Btu (MMBtu) until the beginning of 2010 in the absence a significant supply event, such as a hurricane, or an unforeseen demand increase.
- Unfortunately, for the U.S. natural gas industry, production is well-supplied and will grow in the near-term; near-term growth will exceed production declines from existing fields. Also, foreign natural gas projects may make over supply in the U.S. worse by diverting their extra gas here.
- Over the last six months, oil has precipitously dropped from over \$145 a barrel to less than \$40 (-72%). Less publicized, but nearly as severe, natural gas prices rose to over \$13 per MMBtu and have fallen to under \$5 per MMBtu (-62%).
- Crisis credit conditions are punishing highly levered firms. Persistent credit shortages and low natural gas prices will encourage consolidation in the industry. Market players with solid financials and liquidity may experience good opportunities to acquire reserves, technology and leases inexpensively.
- Pipeline companies, utilities and companies with long-range contracts are the best positioned to survive and possibly gain market share. Natural gas utilities in particular offer high dividend payouts and are supported by steady cash flows.
- However, firms with direct exposure to natural gas prices are experiencing drastic drops in revenue and should be avoided. If natural gas prices recover, production companies with the lowest cost structures and good liquidity may be the greatest gainers.

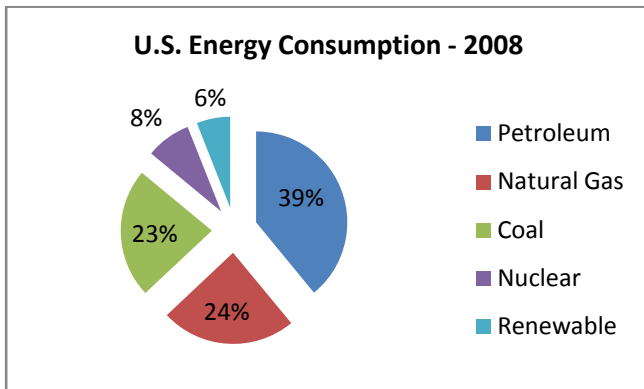
EXECUTIVE SUMMARY

Even with the passage of a stimulus package exceeding \$780 billion, new capacity and lower demand will keep natural gas prices low. As a result of low natural gas prices, the production segment of the industry will earn lower revenue.

Additional capacity added to meet higher demand in past years, and meant to capture higher prices, is now matching and sometimes exceeding current demand. This new supply is depressing prices. Additionally, economic declines internationally may drive international natural gas suppliers to seek storage and buyers for their product in the United States, adding more downward pressure on U.S. prices. The cyclical nature of the natural gas industry, its volatility and increasing globalization make it a poor near-term investment option. At this time, we advise underweighting the industry.

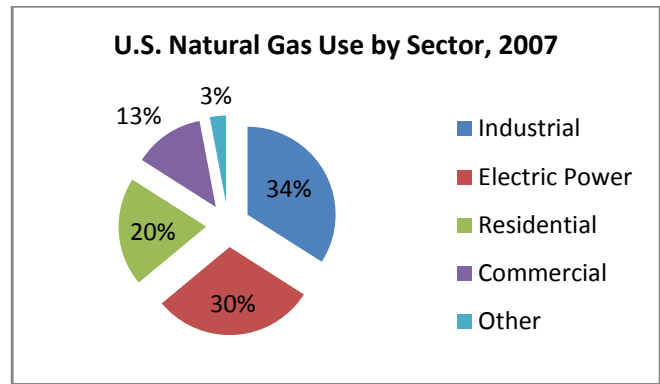
INDUSTRY DESCRIPTION

According to the Energy Information Administration (EIA), petroleum and natural gas currently provide approximately 63% of the total energy consumed in the United States. Natural gas accounts for 24% of this amount, up 2% from 2005.



Source: Report #DOE/EIA – 0383 (2009)

Natural gas use in the United States is primarily broken down into four categories: electric power, industrial, residential and commercial.



Source: EIA – Annual Energy Outlook, 2007

Over the past ten years, natural gas usage by electric power generators has grown by 4.1% annually, more than offsetting a 2.2% drop in industrial useⁱⁱ. Average annual commercial use has remained relatively constant, with growth less than 0.1%. Residential consumption growth has also remained stable in the last ten years, averaging only a 0.4% annual growth rate.

Interestingly, natural gas users face significantly different prices based on the characteristics of their use. Because residential customers require firm service and are more difficult to service, residential rates tend to be the highest and produce the greatest profit for servicing companies. Rates for industrial users are commonly low because they are high-volume users and are easy to service. Chemical makers are the largest group of industrial gas users, accounting for about 10% of total U.S. demandⁱⁱⁱ. Since electric power users are the most sensitive to changing prices of energy and may switch to alternatives, electric power users currently receive the lowest prices. For example, the EIA reported in December 2008 that residential users paid \$12.64 per Mcf; commercial users paid \$11.30; industrial users paid \$7.84; and electric power users paid \$6.96.

In 2003, Federal Reserve Chairman Alan Greenspan advocated quickly building liquid natural gas (LNG) terminals to manage a projected surge in imports in order to compensate for expected production declines domestically.^{iv} In response to his call for actions, six new terminals were built. Now these terminals are routinely idle. (Cheniere Energy Inc, Southern Union Company, and the El Paso Corporation own the top three terminals by capacity^v.) Similarly, in the late 1990s, many forecasted strong increases in natural gas demand—“with total usage going up to 25 trillion cubic (Tcf) to 30 Tcf per year—but to date, that growth level has not materialized”^{vi}. In November 2008, the EIA “projected that U.S. natural gas consumption would rise by 1.1% for full-year 2008, fall by 0.2% in 2009 and remain below 25 Tcf per year through 2030.”^{vii}

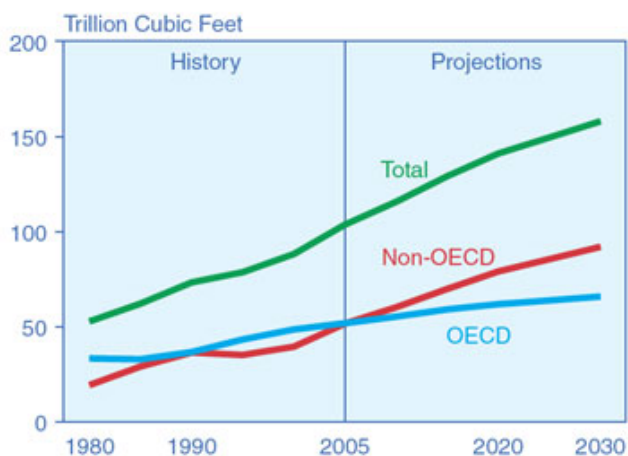


Consumption estimates have varied greatly in the past. Natural gas price volatility, natural disasters and economic conditions make estimating consumption difficult. Contrary to slow U.S. consumption growth expected by the EIA, we expect accelerating recessionary conditions to result in negative natural gas consumption growth for at least the next 12 months. All U.S. sectors using natural gas likely contracted in late 2008 due to market conditions. Industrial usage declined due to reduced demand for natural gas-intensive products. Commercial and residential users reduced consumption to lower expenses. On a positive note, lower prices resulting from lower consumption may encourage industrial users to switch to natural gas from other fuels in the near term.

In coming years, globalization of markets will make worldwide natural gas consumption increasingly important. If international consumption exceeds production, domestic U.S. producers will have an external market for their gas. If worldwide production exceeds consumption, more natural gas may be imported to the U.S.

In 2008, the EIA believed that OECD (Organization for Economic Cooperation and Development) countries would account for 27 percent of worldwide production and 42 percent of consumption by 2030.

Worldwide Natural Gas Consumption, 1980 - 2008



Sources: History: EIA, International Energy Annual (2005). Projections: EIA, World Energy Projections Plus (2008)

If natural gas demand in OECD countries grows as projected, more than one-third of the natural gas consumed in those countries will need to be imported.

Demand growth, such as in OECD countries, may help absorb LNG imports normally bound for the U.S., as U.S. demand slumps. In the absence of some external demand growth or a domestic supply constraint, growth

in U.S. supply combined with lower domestic consumption will keep downward pressure on natural gas prices. Rising prices and easier financing from 2002 to 2008 made it profitable for firms to develop "unconventional fields" such as the Barnett and Haynesville shales. Now, some of these unconventional fields in the U.S. are profitable even with natural gas prices as low as \$4 per MMBtu (Btu).^{viii}

Predicting a natural gas demand/supply balance has proven impossible, even for those most knowledgeable of the market; myriad uncertainties impact the market—weather, economic factors, new production, new efficiency technologies, etc. But, despite these uncertainties, the enormous size of U.S. natural gas consumption offers ample profit opportunities for firms. Low cost domestic producers are particularly well positioned to survive during lean times, buy assets cheaply, and react to changes in local demand quickly.

RECENT DEVELOPMENTS

New Capacity

In addition to increased U.S. domestic production from unconventional shales, new natural gas supplies are being added around the world.

On February 18, 2009, the Sakhalin II project LNG plant in Russia will start production. It will be the world's biggest plant, with an annual output capacity of 9.6 million tons.^{ix} New supplies from Yemen, Qatar and Indonesia are also expected to be added in 2009.^x In 2009, total worldwide capacity is expected to increase by 20%.^{xi} Zach Allen, a head of Pan EurAsian Enterprises, a management advisory firm that follows LNG markets, believes that LNG can be competitively priced as low as \$3 per MMBtu. With dozens of new tankers capable of carrying natural gas entering service and three new terminals on line in 2008 in the U.S., prices in the U.S. could potentially be driven below the \$4 per MMBtu level, effectively making shale production unprofitable. If this new capacity exceeds higher priced Asian and European market needs, the U.S., with its storage capacity, will be its next destination. Exploration and production companies whose revenue are driven by production volume and price will be particularly hurt by cheap, new sources of natural gas.

Supply Uncertainties

In the past year, supply disruptions, buffers against supply shocks and the globalization of the energy supply chain emphasized the growing importance of energy security for major importing nations. In January 2009, European countries suffered acute energy shortages because Russia stopped pumping gas through Ukraine to central and southern European countries.^{xii} Following an earthquake in 2007, Japan



kept a nuclear power plant out of service for more than eight months and used natural gas instead. Due to the interconnected nature of the natural gas supply chain, this unexpected use of natural gas in Japan resulted in reduced revenue at a new natural gas terminal in Louisiana. Natural gas originally intended for the U.S. terminal was diverted to Japan to meet the new demand and capture a higher price. In another example of supply disruption, Somali pirates hijacked a German LNG tanker during January 2009.^{xiii} Each of these situations adds additional concerns for natural gas customers, whereas domestic production would not risk these events.

Political Support

Policies of President Obama and his new Secretary of Energy, Dr. Chu, may significantly impact natural gas markets. The President’s goal to replace imported oil and other fossil fuels with a “clean-energy economy” powered by wind, the sun and biofuels does not mention natural gas. If renewable energy sources receive billions of dollars of support, the natural gas industry will be at a disadvantage. With natural gas being a cleaner burning resource than oil and being primarily produced in the U.S., it would not be politically astute to ignore or severely disadvantage this industry. To follow through on campaign promises though, President Obama may re-instate the executive order banning Federal Outer Continental Shelf oil and gas production. Such federal actions would negatively impact offshore drilling companies and companies providing offshore services. Overall, we think it is likely that the new Administration will assist the natural gas industry in a publicized effort to enhance the environment and adopt more natural gas transportation methods.

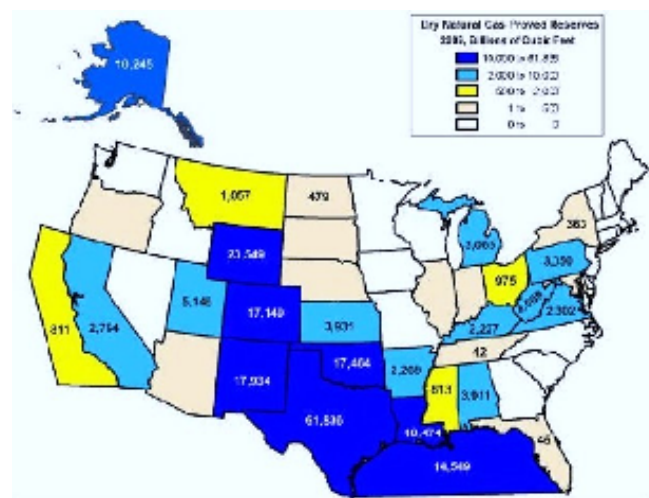
INDUSTRY TRENDS

Increased Capacity

International and national capacities have grown. Once considered unprofitable during periods of low prices, unconventional shales and offshore drilling are now producing beyond expectations and are profitable at current price levels. Unconventional natural gas production, led by gas shales, is expected to provide the majority of domestic growth in gas supply. This moderate growth in supply paired with reductions in consumer and industrial natural gas use, will result in spare capacity if demand drops further. Offshore drilling and expansion in Alaska may further boost excess capacity. Increased domestic natural gas capacity is good for the U.S, but not necessarily good for the industry. It reduces imports and increases energy security by lessening dependence on foreign imports, but extra supply reduces industry prices.

According to the EIA *U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves Report*, “natural gas proved reserves increased by 26,641 billion cubic feet in 2007. Increases from the onshore Lower 48 States more than offset offshore losses in proved reserves. Total discoveries in 2007 were 29,091 billion cubic feet (Bcf), which is 59 percent more than the 10-year average and 25 percent more than 2006 levels. Dry natural gas production grew to 19,466 Bcf in 2007, which is a 5 percent increase over 2006 levels”.^{xiv} Clearly, unconventional resources have significantly boosted reserves and production.

U.S. Natural Gas Proved Reserves, 2006

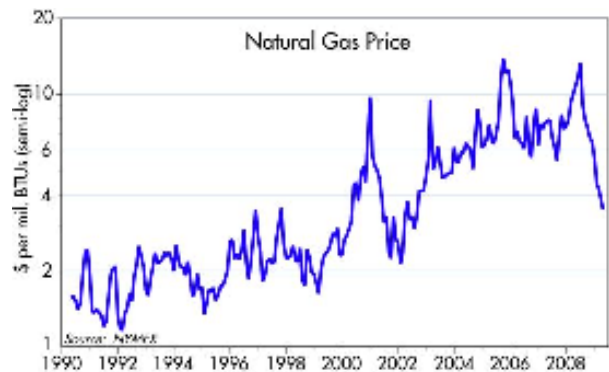


Source: EIA, Office of Oil and Gas

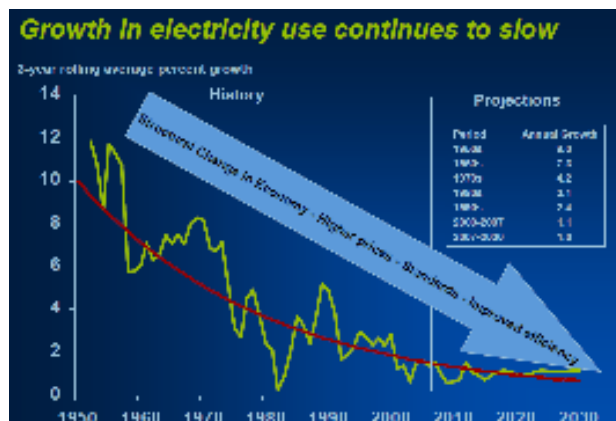
Lower Prices

Lower market prices will bring in much lower levels of revenue in 2009 and result in less industry investment, but possibly attract new customers. “From a low of \$5.20 per MMBtu, Henry Hub spot price, on September 4, 2007, natural gas prices rose quickly and steadily in 2008, reaching a peak of \$13.37 MMBtu July 1^{xv}” Prices have declined considerably from that peak, again reaching the \$5 level.

Natural Gas Prices (1990 – 2008)



Lower prices reflect a number of fundamental changes in the industry. First, the economic downturn has greatly reduced consumption. Both industrial and commercial users are focused on cutting costs and laying off employees; with fewer employees less energy is used heating buildings and producing products. Energy efficiency is also slowing consumption. The EIA estimates that growth in electricity use slowed from 9% per year in the 1950s to only 1% in 2007-2008.



Source: Annual Energy Outlook 2009 Early Release Energy Information Administration

Second, supply increases are lowering prices. "Through the first 11 months of 2008, domestic production increased by 6.7 percent in comparison with the same period in 2007, according to EIA's Natural Gas Monthly, despite estimated production shut-ins of more than 400 Bcf this fall as a result of hurricanes in September."^{xvi} Prices in most regions of the country, more than \$13 per MMBtu less than a year ago, are about one-third the record-high levels and they have now reached multi-year lows.

If natural gas prices remain low, as predicted, investments in new capacity will slow. Recently in the oil industry, OPEC nations delayed 35 oil-drilling projects as prices dropped and financing costs rose.^{xvii} Faced with the reality of sustained lower prices, companies must cut spending and find an appropriate match between supply and demand for their operations. Facing lower revenues, some natural gas exporting nations may be forced to embrace international companies. International energy companies may be the only party willing to invest in new energy projects.

Power Plants

In order to meet growing demand for electricity, the EIA predicts that 335 gigawatts of new electric generation capacity will be needed by 2025.^{xviii} Since natural gas-fired combined cycle generation plants have many advantages over coal-fired plants, the EIA expects that

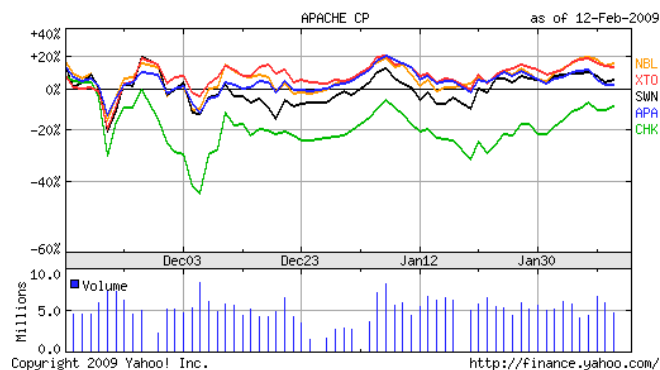
57 percent of new electric generation capacity built by 2025 will be natural gas combined-cycle or combustion turbine generation. Increased demand for electricity in general and retirement of older generation plants will create a requirement for electric generation that can be easily filled by natural gas use.

Natural gas power plants are a good alternative to fulfill new electrical generation requirements for a number of reasons. First, natural gas plants have relatively low capital requirements and can be scaled to a customer's needs. Second, natural gas plants are extremely energy efficient. According to NaturalGas.org, modern plants approach 60 percent efficiency, increasing electricity produced per unit of natural gas used, and increasing cost effectiveness. Third, natural gas systems can be quickly turned on and off to meet short turn requirements. Finally, natural gas is the cleanest burning fossil fuel; natural gas plants emit very few pollutants into the air. With more emissions regulations anticipated and uncertain market demand in the future, it is a smart business decision to build a natural gas plant instead of another electrical generator.

MARKETS AND COMPETITION

Corporate Makeup

The natural gas industry is very competitive, capital intensive, heavily regulated and extremely volatile. In order to compete, companies must have substantial capital to develop fields into production and take substantial risks. Proprietary information, economies of scale and integration across industries allow companies to achieve different levels of profitability. Within the industry, there are many formidable competitors. Seven operators who have significant natural gas exploration and production operations are highlighted on the next page.



Apache Corporation

Apache Corporation explores for and produces natural gas, crude oil, and natural gas liquids. The Company has operations in North America, Egypt, Western



Australia, Poland, and the People's Republic of China.^{xix}

XTO Energy Inc.

XTO Energy, Inc. is a natural gas producer that acquires, exploits, and develops long-lived oil and gas properties. The Company's properties are concentrated in Texas, Oklahoma, Kansas, New Mexico, Colorado, Arkansas, Wyoming, Louisiana and Alaska, all located in the United States.

Anadarko Petroleum Corporation

Anadarko Petroleum Corporation is an independent oil and gas exploration and production company with international operations. In the United States, the Company operates in Texas and surrounding states, the Rocky Mountain region, Alaska, and the Gulf of Mexico. Internationally, Anadarko has exploration and/or production operations in Africa, Asia, South America, and the Caribbean.

Chesapeake Energy Corporation

Chesapeake Energy Corporation produces oil and natural gas. The Company's operations are focused on developmental drilling and producing property acquisitions in onshore natural gas producing areas of the United States and Canada.

Southwestern Energy Company

Southwestern Energy Company is an integrated energy company primarily focused on natural gas. The Company explores for and produces natural gas and crude oil. Southwestern Energy also conducts operations in natural gas gathering, transmission, and marketing, as well as natural gas distribution.

Talisman Energy Inc.

Talisman Energy Inc. is an independent oil and gas producer. The Company has operations in North America, the North Sea, and Indonesia. Talisman is also conducting exploration in Southeast Asia, Algeria, Qatar, Colombia and Trinidad.

Noble Energy Inc

Noble Energy is an independent energy exploration and production company. The Company operates throughout major basins in the United States including the Rocky Mountain region, the Mid-continent region, the Gulf Coast and in the deepwater Gulf of Mexico. Noble operates internationally in South America, the Middle East, Asia, the North Sea, and West Africa.

	D/E	P/E	ROE	ROA	EV/EBITDA
Apache	0.3	5.21	28.29	15.54	2.667
XTO Energy	0.69	9.53	17.56	8.59	6.185
Anadarko	0.66	5.58	18.38	6.55	3.325
Chesapeake	0.47	3.18	13.28	6.18	4.334
Southwestern	0.3	20.59	29.95	13.75	8.658
Talisman	0.36	4.28	28.07	12.51	2.323
Noble	0.36	7.07	25.32	11.08	3.702

Source: www.moneycentral.msn.com (Metrics are TTM)

Among these competitors in the U.S. natural gas industry, all are trading at less than nine times earnings, with the exceptions of XTO Energy and Southwestern. XTO Energy shows a surprisingly low \$19M in cash and debt of \$11.12B. Chesapeake also had a lot of debt, \$14.35B, when compared to its cash of \$1.96B. Due to debt concerns, Chesapeake's stock price is down over 50% while others in the industry are down less than 40%. Given depressed share prices, stronger players in the market could acquire reserves or otherwise consolidate the market by purchasing weakened and vulnerable companies. Major integrated oil and gas companies that earned large profits during 2007 and 2008 could look to acquire smaller firms with financing problems. With less than 25% debt and sizable cash positions, Apache and Noble appear to be best prepared for additional declines in the market.

Innovation

Recent advances in technology, past high energy prices and increasing concerns about energy security have sparked innovation. New technology has made old ideas less costly and new ideas potentially viable. Royal Dutch Shell is building an \$18B plant in Qatar to transform natural gas to diesel fuel^{xx}. If successful, this advance could radically alter the natural gas industry, enabling Shell to turn natural gas into higher-value fuel and lubricants. While Shell's gas-to-liquid (GTL) fuel improves the performance of a car, it sells at a premium to conventional diesel and may not be profitable at current oil and gas prices. I think that widespread acceptance and distribution of such an alternate fuel is highly unlikely. Royal Dutch Shell, ExxonMobil, Chevron and the U.S. Department of Defense have all taken similar gambles and thus far not achieved large scale success.

Australian coal seam gas is more likely to keep downward pressure on international natural gas prices and potentially push excess gas into the U.S. market. As advances in technology have lowered the cost of recovering gas from unconventional sources in the U.S. for Chesapeake, so too have advances made recovery of coal seam gas in Australia more viable. In the past, less expensive sources were pursued.



Nationalization of assets, political pressures and violence in countries like Venezuela, Russia and Nigeria though encouraged broader thinking. Driven to safe, investor-friendly countries that are close to lucrative end markets, energy companies increased oil and gas deals in Australia last year to \$16.6 billion according to Price WaterhouseCoopers^{xxi}. While possibly contributing to lower international natural gas prices in 2012, when five LNG plants are scheduled to start-up in Queensland, coal seam gas could be an opportunity for Chesapeake. Chesapeake's technical expertise and experience with unconventional sources could make it an appealing partner for an international firm.

ECONOMIC OUTLOOK

GDP & Unemployment

On November 28, 2008 the Financial Times reported that "economic confidence in the 15-country [Euro zone] crashed this month to its lowest point since August 1993" and "economic news has been consistently gloomier than expected." Similarly, in the November 26, 2008 Wall Street Journal, it was reported that "The U.S. consumer is in major trouble, with wage and salary income growth evaporating, credit extremely tight or unavailable, home prices continuing to decline" and "gross domestic product declined at a 0.5% annual rate in the July-September period." In addition, unemployment is estimated by Goldman Sachs to rise as high as 9% in 2009, with companies like Citigroup laying off 53,000 employees. According to the November 24, 2008 Business Week, corporate "profit margins have been shrinking for two years." The November 21, 2008, Economic and Stock Market Commentary concluded that "the recession...likely to be severe, lasting...until the final half of 2009" and "the recovery will be slow and uneven." In January 2009, Labor Department data reported that 598,000 jobs were lost, the most in 34 years.

In light of these economic conditions and higher unemployment, international and domestic consumers, and companies are cutting back. Cutbacks by consumers and businesses are reducing demand for natural gas and contributing to lower prices. Negative growth GDP and associated unemployment in the international community will also diminish natural gas demand and potentially cause a worsened oversupply condition. With 20 million Chinese returning home unemployed after the Chinese New Year and British joblessness hitting a 12 year high, consumers worldwide are saving, not spending. The February 16, 2009, Business Week reported that the U.S. savings rate rose to 3.6% in December 2008 and could reach double digits by yearend. Savings, rather than consumption, will delay an eventual recovery.

Worsening international economic conditions are likely to exacerbate natural gas use reductions, and further depress natural gas prices as well. Not only is growth decelerating sharply in large nations, such as China, India and Brazil, but some emerging economies also surprised economists by reporting negative inflation-adjusted GDP.^{xxii} Russia, for example, went from expecting over 6% inflation-adjusted GDP growth, to estimating more than a 1% decline.^{xxiii} Declining trade, shrinking investment and slumping commodity prices will reduce demand for goods, and result in lower commercial and industrial use of natural gas. We believe negative GDP growth for the remainder of the 2009 will depress natural gas demand, and begin to recover in two years.

In addition to consumer spending declining and lower GDP numbers, Standard & Poor's is also forecasting difficulties for companies. In 2009, S&P expects a "massive increase in corporate bond defaults, which likely will be accompanied by a sharp increase in bankruptcies as well."^{xxiv} Distressed companies will spend less on natural gas, produce fewer products, and pay fewer employees. All categories of natural use will decline.

Low Interest Rates

Lower interest rates should help speed a recovery by stabilizing mortgages rates, increasing consumer lending and encouraging more commercial lending. Due to bank bailout uncertainty and unknown levels of bad debt risk on bank balance sheets, we think credit markets will be slow to thaw. Unlike past recessions, I think the combination of housing, credit and financial crises will prolong recessionary conditions and delay recovery. Companies and individuals have little to no capacity to extend purchasing and the government is constrained. Interest rates are at the lowest level possible and with high debt loads, both the national Treasury and individual citizens need to delever.

CATALYSTS FOR GROWTH

Supply Disruptions

In 2007, according to the EIA, domestic U.S. production accounted for 83.4% of total U.S. natural gas supply while Canadian production provided 13.4% and LNG imports made up the remaining 3.2%. With roughly 17% of natural gas imported to the United States, supply disruptions in any major natural gas producing country can have some impact on the U.S. market. Supply disruptions, such as hurricanes or a tanker hijacking, add uncertainty to market and will increase prices while reducing supply.



Lower Prices/ New Uses for Natural Gas

Lower natural gas prices, particularly if lower in comparison to oil or other substitutes, will cause countries, companies and individuals to seek out new ways to use the cheaper source of energy. Building more natural gas power plants, powering vehicles fleets with natural gas and GLT, like Royal Dutch Shell, are just a few of the new uses proposed for natural gas that would boost demand. T. Boone Pickens is a vocal advocate for increasing use of natural gas in transportation. Since transportation is a major use, if they major use, of energy in the world, transitioning even a fraction of the 230 million gasoline-powered cars would make a significant difference. Some companies are experimenting with the change. UPS has deployed over a 160 natural gas trucks.^{xxv} By 2004, Honda had about 130,000 vehicles running on natural gas.^{xxvi} Without a major technological advance though, perhaps GTL, natural gas use in vehicles will be small and kept to fleet vehicles.

Government/Environmental Regulations

New laws could increase downward pressure on prices or boost prices. With Democrats controlling the both the executive and legislative branches, there is a chance that they will remove or restrict land opened for drilling, and cause prices to increase. Federal mandates to use cleaner energy, particularly for electricity production and transportation, would also result in higher natural gas consumption by encouraging construction of new natural gas-fired power plants and possibly conversion of vehicles to natural gas. Clean Air laws would support hybrid purchases and encouraging energy efficient home improvements could have a negative impact on the natural gas market. If the hybrid is LNG powered, it would increase natural gas use. Otherwise a non-LNG hybrid would be increasing fuel efficiency and negatively impacting natural gas.

Capital Market Access

Some firms in the natural gas industry are highly levered and maintain high levels of debt to fund capital intensive projects and ongoing operations. Current tightness in the capital markets is restraining capital available and straining some balance sheets. As capital markets and the economy recovers, funding costs will decline and enable management to proceed with valuable projects while spending more time on operations, rather than worrying about funding sources.

INVESTMENT POSITIVES

- Natural gas is abundant, relatively cheap and cleaner for the environment than other fossil fuels.

Demand worldwide will rebound quickly to past levels when the U.S. economy recovers.

- New domestic sources of natural are less expensive to produce. Lower production costs should result in higher profits, particularly when demand recovers.
- Current depressed prices, relative to other energy alternatives, are encouraging more investment in natural gas-burning power plants and conversion of more homes to natural gas. These conversions add to demand, and in many cases are permanent.
- Global warming concerns and international agreements are increasingly pushing use of cleaner fossil fuels. With the conversion of some government and commercial vehicles already completed, an initial infrastructure of 1,500 natural gas stations currently exists. The Obama Administration is expanding use of natural gas vehicles.

INVESTMENT NEGATIVES

- Based on new natural gas recovery techniques and new finds in the United States, U.S. natural gas production is over-supplied and is expected to grow in the near-term, in excess of declines from existing fields. In addition, foreign LNG projects are expected to divert more gas to the U.S. A ready supply of natural gas and gas in storage will keep prices depressed.
- With the world economy projected to shrink this year, natural gas use will experience declining use. Persistent, depressed economic conditions will keep prices low. Natural gas prices are unlikely to recover above \$6 per million Btu until the beginning of 2010 in the absence a significant supply event, such as a hurricane, or an unforeseen demand increase.
- Popular alternative energy options that exclude natural gas because it is a fossil fuel will harm natural gas' long-term consumption and development.

VALUATION

Caught in a downward economic spiral of low to negative economic growth, increasing unemployment, difficult credits markets and declining personal wealth, consumers and the government have little room to increase spending and even less confidence in the future. Despite near zero interest rates, the Fed and Treasury buying \$100's of billions in assets and a stimulus package over \$750 billion, company earnings and unemployment will continue to falter. When the S&P falls below 800, we would selectively buy undervalued industry stocks with little debt and strong earnings. A note of caution: be sure that companies



have restated the value of their reserves (frequently at year end) or that you have considered re-valuation of reserves in your valuation.

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