

February 10, 2012

Dear clients and colleagues,

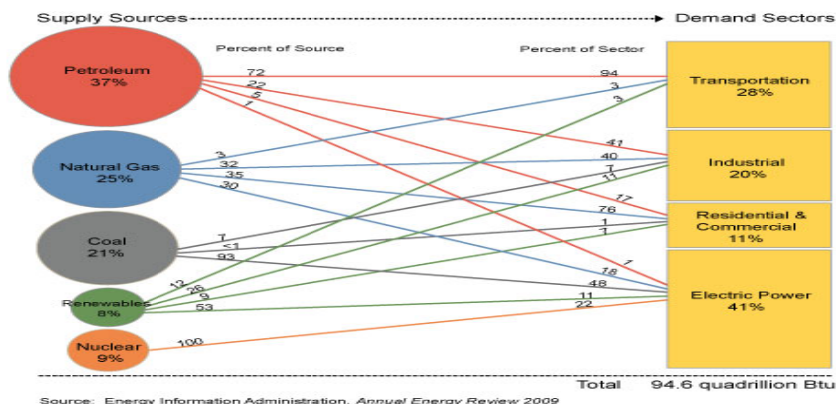
### Bullish on natural gas? Are we serious?

After approaching US\$14 per mcf in the fall of 2008, natural gas prices are now below US\$2.50 per mcf, the first time in 10 years that gas has been this cheap in the winter heating season. Yet we have many reasons to be bullish on medium to long-term natural gas prices, despite the warmest winter in 60 years and a largely shared consensus of very low long term prices due to the abundance of supply brought by shale gas.

### Capital re-allocation

U.S. natural gas producers are quickly re-allocating capital away from dry gas to liquids. Announcements from a number of companies from Chesapeake to Encana confirmed this. The natural gas rig count has declined from 936 last October to 720 last week and should continue to decline. Prices north of \$4.50 per mcf are needed to invest in natural gas. Once producers convert to drilling wells that produce \$10-\$15 per mcf, which they get from liquids, they won't go back to drilling natural gas, even at \$6-\$7 per mcf. Bears argue that drilling liquids still produces a lot of gas, not alleviating the supply problem. But history showed clearly that capital re-allocation led to reduction of supply.

If supply does not go down, let's turn to demand.



The chart above shows the supply and demand of energy by sources.

### Growing industrial demand

US natural gas prices are the lowest in the industrialized world and well below heavy fuel and oil-based naphtha. As a comparison, prices are above \$15 per mcf in China and Japan and above \$8 in Europe. The US economy is recovering, every day, we hear of industrial companies moving production back to the USA. Even the petrochemical industry has announced investment in the US, for the first time in over 10 years.

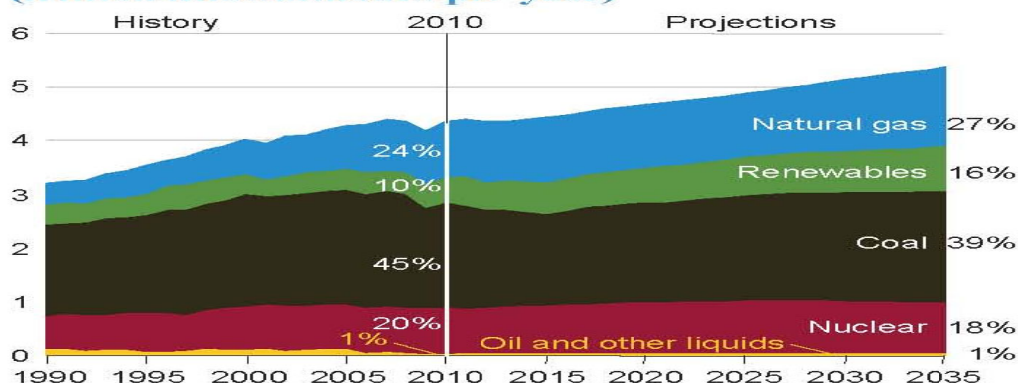
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## Electricity generation

Natural gas is the source of approximately 25% of the electricity generation in the US. It produces about 30% less carbon dioxide than burning fuel and 45% less than burning coal. With no new coal plant being built, natural gas should grow to over 30% of electricity generation in the next 20 years.

**Figure 3. Electricity generation by fuel, 1990-2035**  
(trillion kilowatthours per year)



Source EIA

## Natural gas as a transportation fuel

The US presently ranks 14<sup>th</sup> in natural gas engine sales and has 1,300 fueling stations. The number 1 ranking goes to Pakistan with over 3000 fueling station and over 2.3 million natural gas vehicles. For automobiles, the additional cost for an engine using natural gas is \$3,000 compared with \$3,300 for diesel and \$8,000 for an electric hybrid. Fiat, a leader in natural gas vehicles sold 127,000 cars last year in Europe and is now planning to bring many models to the US. Honda started offering its Civic powered by natural gas earlier this year. But the biggest and nearest opportunity is in the heavy duty market, road trucking, buses, garbage trucks, etc. One just has to look at the stock price performance of Westport innovation (WPT CN). Why?

With diesel prices at over \$4 today, the savings opportunity with natural gas is enormous. Consumers can save \$1.50 per gallon, a payback of 1 year for a heavy truck equipped with a natural gas engine.

And what about the fueling infrastructure? Buses and refuse vehicles are ideally suited as these trucks come back and refuel at the terminal. For trucking, President Obama recently announced increased investments to extend the Los Angeles-Salt-Lake City corridor as well as create other corridors.

## Conversion of LNG import to export facilities

By 2015, the US and Canada will become exporters of LNG. The first export terminals have already been approved. One can see natural gas become a global market just like oil is today. You may want to look at BG Group PLC or Cheniere Energy to get more details.

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In conclusion, ***we believe that Natural Gas is one of the most mispriced commodities in the market today.*** Our portfolio is well positioned to benefit from the upcoming rise in the price of natural gas with Comstock Resources (CRK US), Unit Corp (UNT US) as well as names such as Ormat Technology (ORA US) a power producer whose tariffs are linked to natural gas prices.

Have a good week.

The Global Alpha Team

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