



World Crude Oil and Natural Gas Markets: Trying to Find New Direction

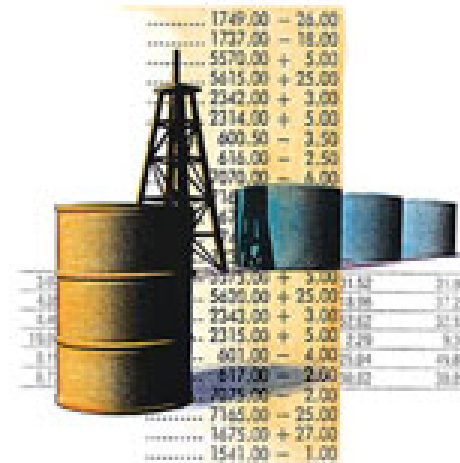
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Current State of the Energy Markets?



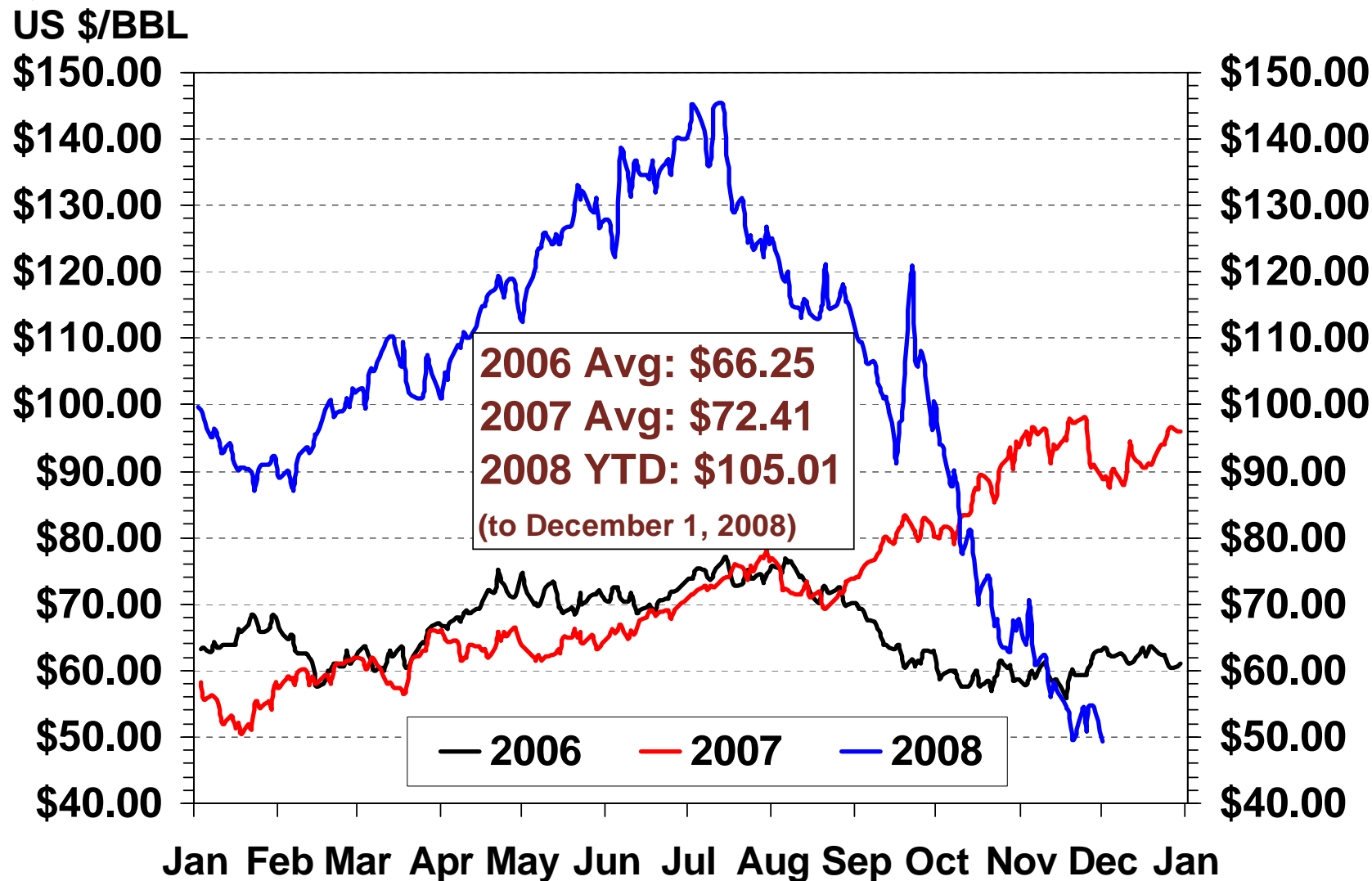
World Crude Oil Markets



The Present Situation

- Crude oil prices have undergone their most spectacular meltdown in history, likely to surpass the sell off of 1986 in percentage terms.
- After overshooting to the upside in early July, the market has done the reverse in Oct/Nov. De-leveraging and credit/margin issues have merely made the sell off even worse than likely justified by the fundamentals.
- The market is slowly finding lows in the US \$55 to US \$65 per barrel range, with most, or all, of the negative news already factored into price expectations.
- Main concern now is: how fast or slow a price recovery?

Nymex WTI Crude Oil Prices

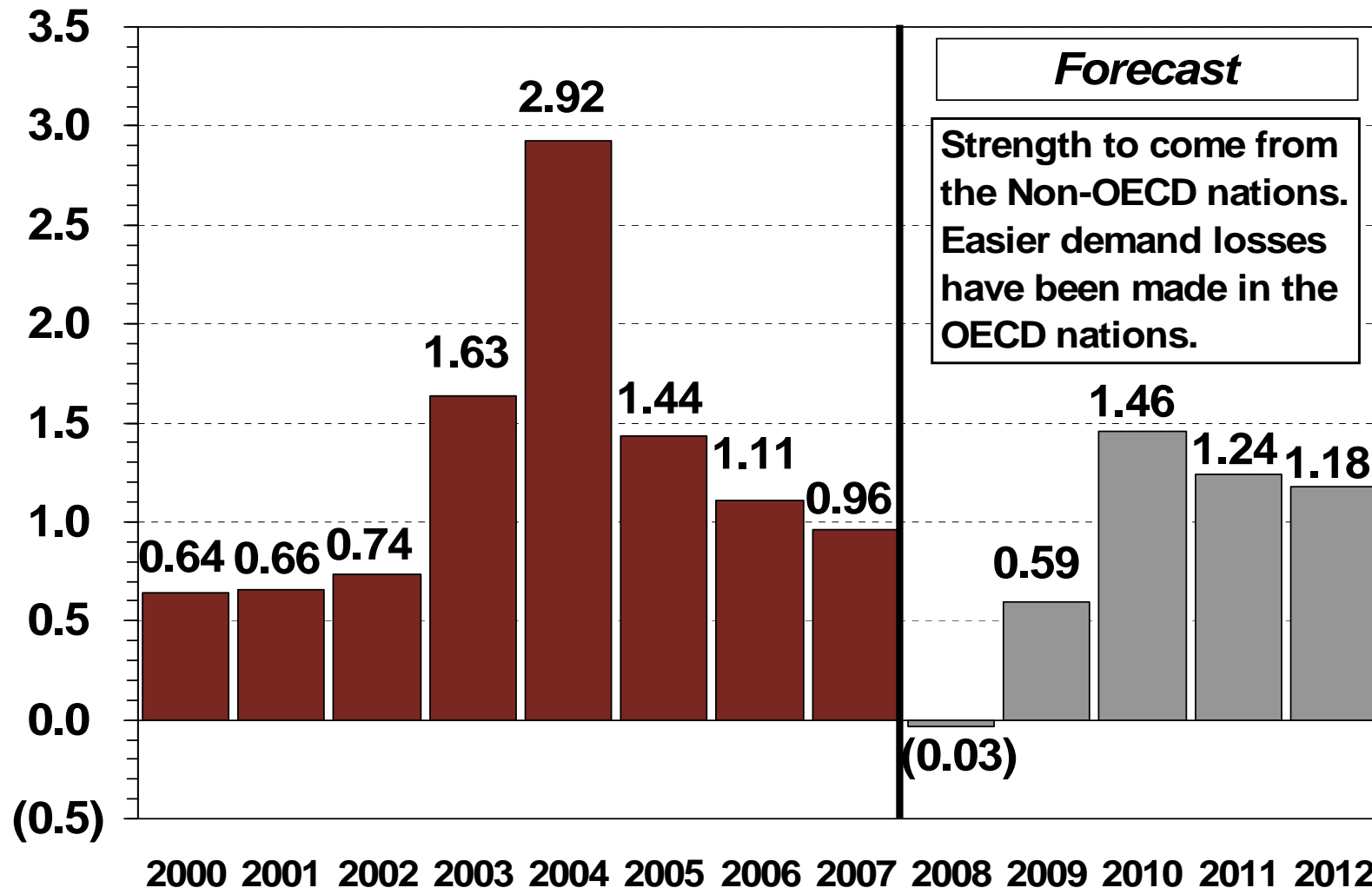


Grappling With Demand Issues

- After five years of looking for a demand response to rising prices, the market has finally got what it wanted: evidence of widespread demand losses.
- The credit crunch has only made the present demand situation worse by crimping consumer spending.
- Unclear is how widespread the demand loss for refined products will be and how long lasting.
- A distinction has to be made between demand erosion and demand destruction; the latter is more permanent, but seems to be lacking when compared to the 1980s.
- Short painful downturn followed by a recovery, or more protracted demand weakness and a slow recovery?

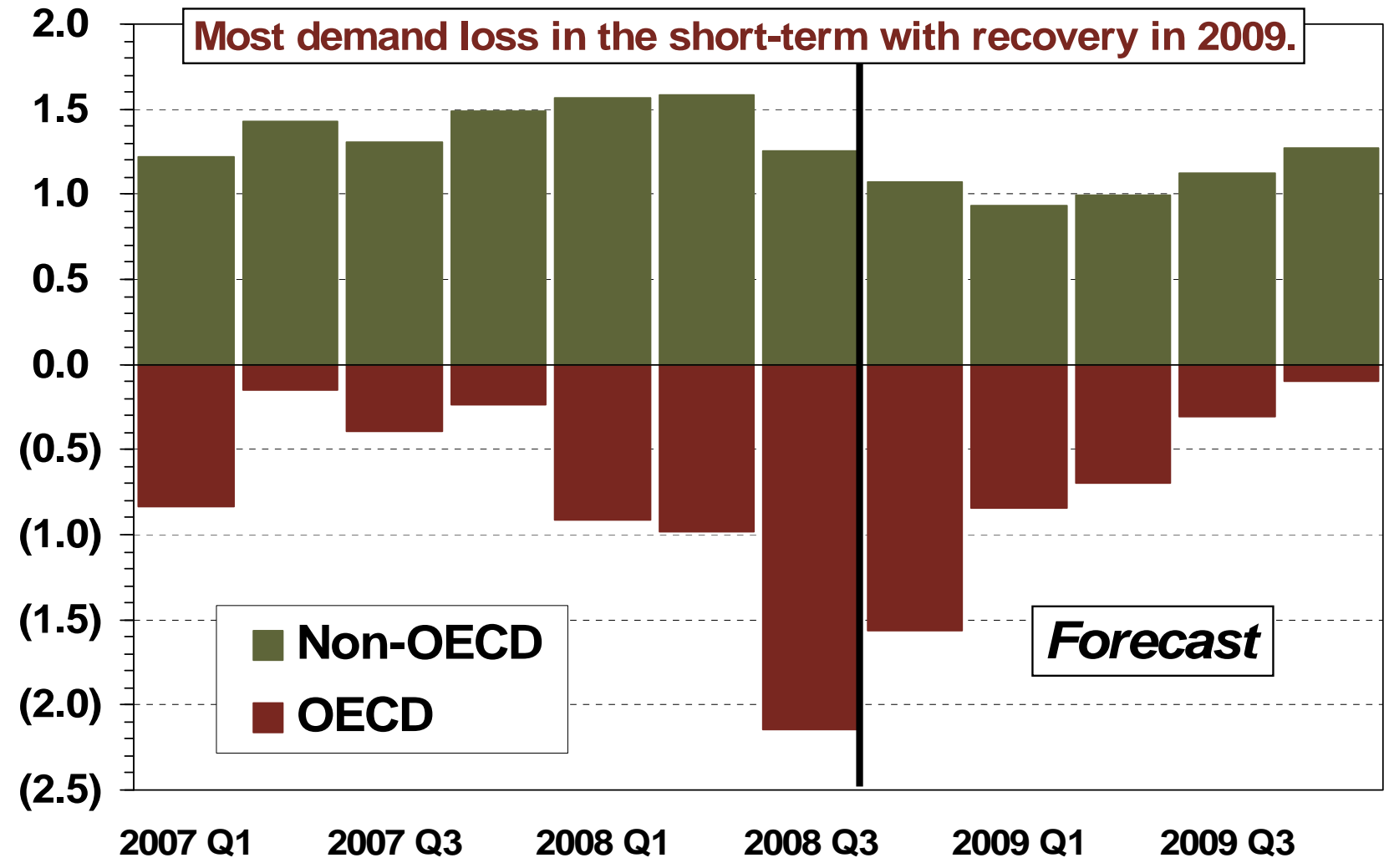
World Crude Oil Demand Growth

Million B/d



World Crude Oil Demand Growth (YoY)

Million B/d



Source: FirstEnergy Capital Corp., IEA.

More Thoughts on Oil Demand

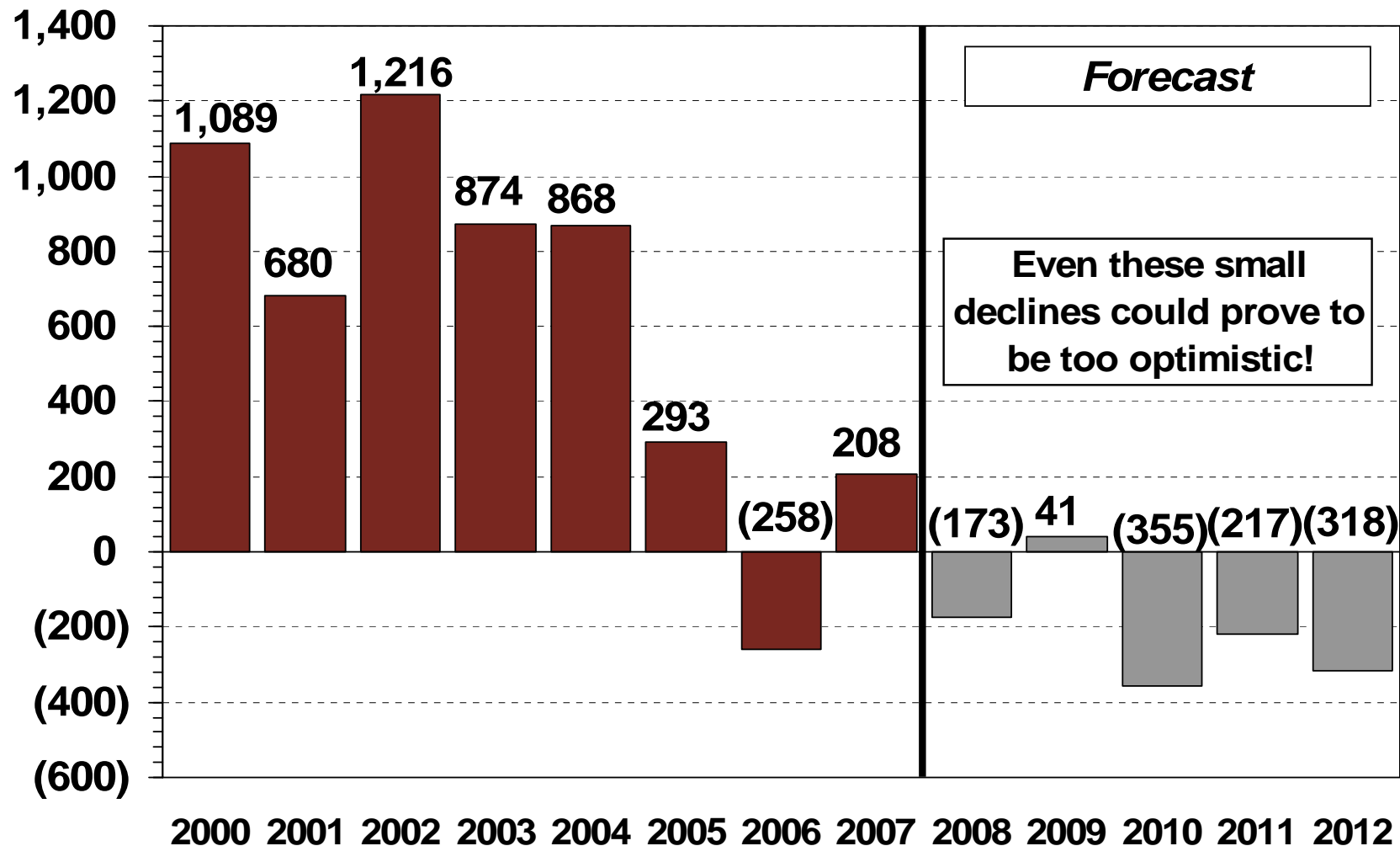
- Do not underestimate the power of price signals! Prices have fallen more than 60% in just a few months, compared to a 10% to 20% decline in 4 years in the early 1980s.
- Structural nature of demand is very different now than in the early 1980s. Permanent demand loss options available now are few, compared to that earlier era.
- Non-OECD (developing) economies have better demographics, price caps/subsidies, and more interventionist governments that will support energy demand growth.
- We are looking for a steady rebound in demand by mid-2009 than most are expecting.

Still Not Enough Talk About Supply

- Although demand is dominating current thinking, it also takes supply to make a market.
- The nature of tight supply is shifting. Less emphasis on refined products, to a growing view that crude oil will now set the basis of measuring market tightness.
- How fast to tighten oil balances? OPEC has already shown surprising flexibility and determination to withdraw barrels from the market. Another round of production cuts is likely with the December 17th meeting.
- Views on Non-OPEC growth are diverse, but this may be the factor that tightens balances (and perceptions) very quickly, given likely poor supply performance.

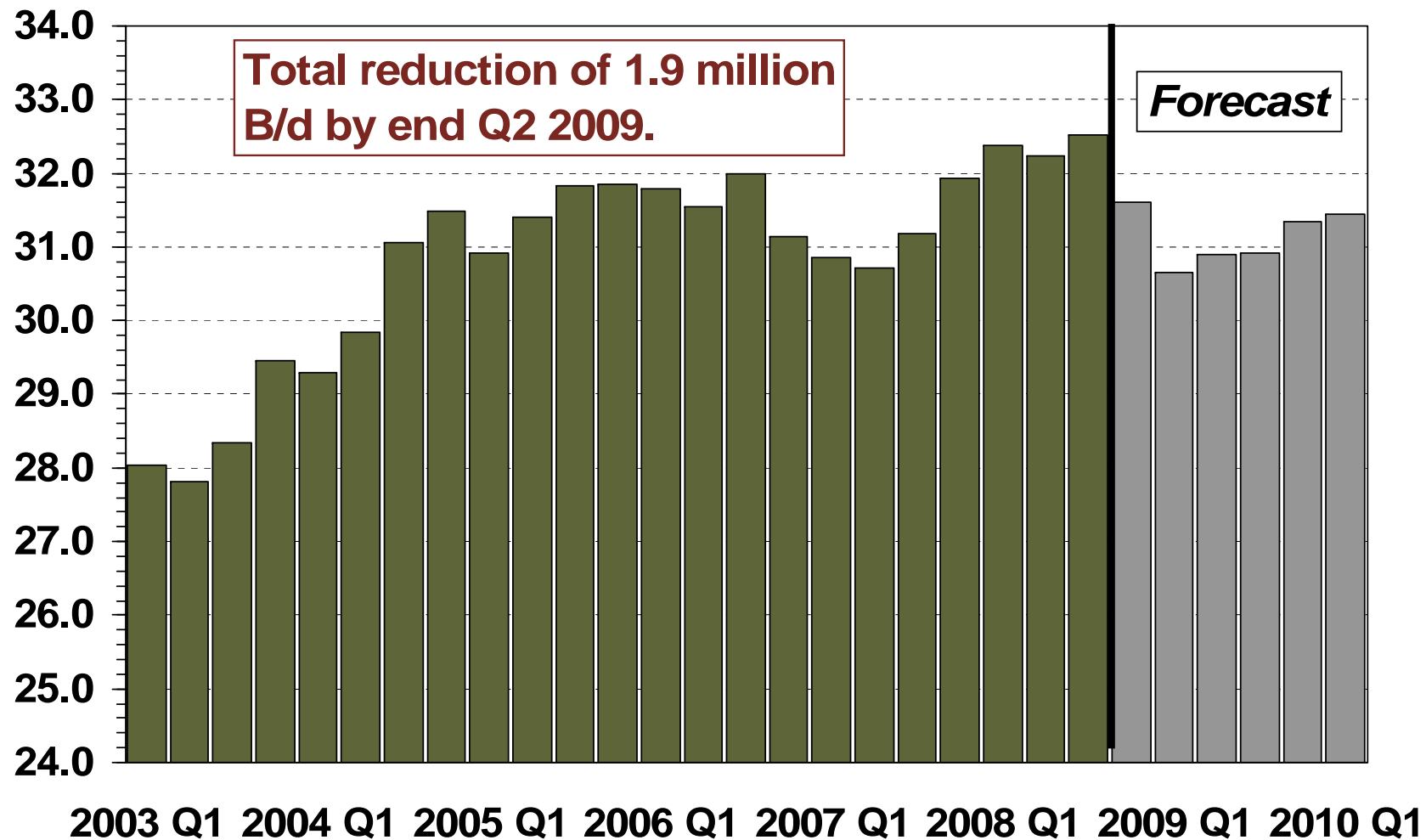
Non-OPEC Crude Oil Supply Growth

Thousand B/d



OPEC Crude Oil Supply Growth

Million B/d



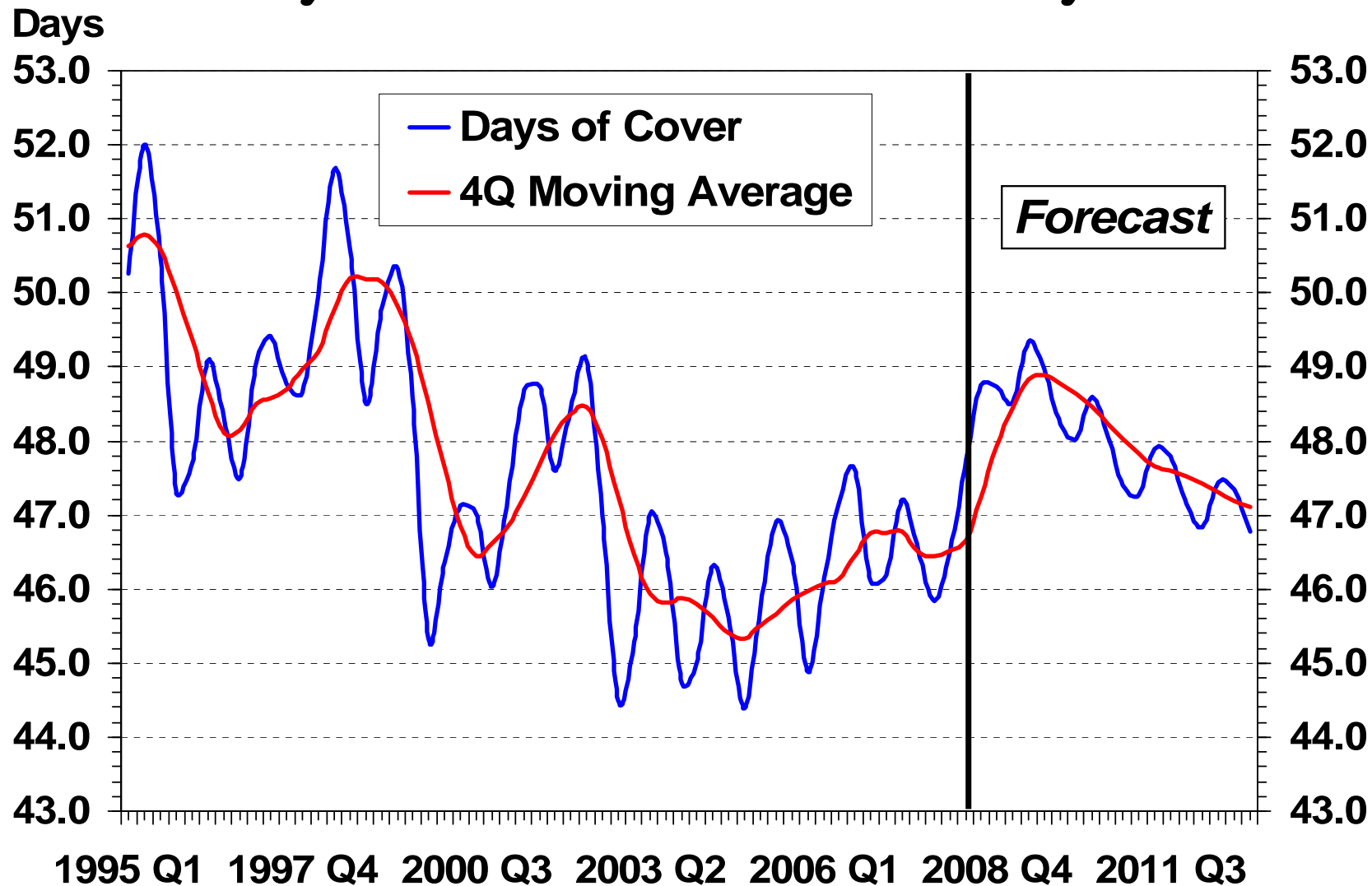
More Thoughts on Supply

- Current prices sub-US \$70 are below marginal full cycle supply costs in Non-OPEC. Some projects are now running up against cash costs.
- Credit issues will likely hit Non-OPEC supply first and make a bad situation only worse. Some investment decisions are already being delayed or cancelled in Non-OPEC and OPEC!
- We expect that deteriorating supply conditions will only be slowly recognized, but will form the basis for a price recovery sooner in 2009, rather than later.
- OPEC is already hinting at the consideration of a “universal” price floor being needed to ensure sufficient crude oil supply when making its production decisions.

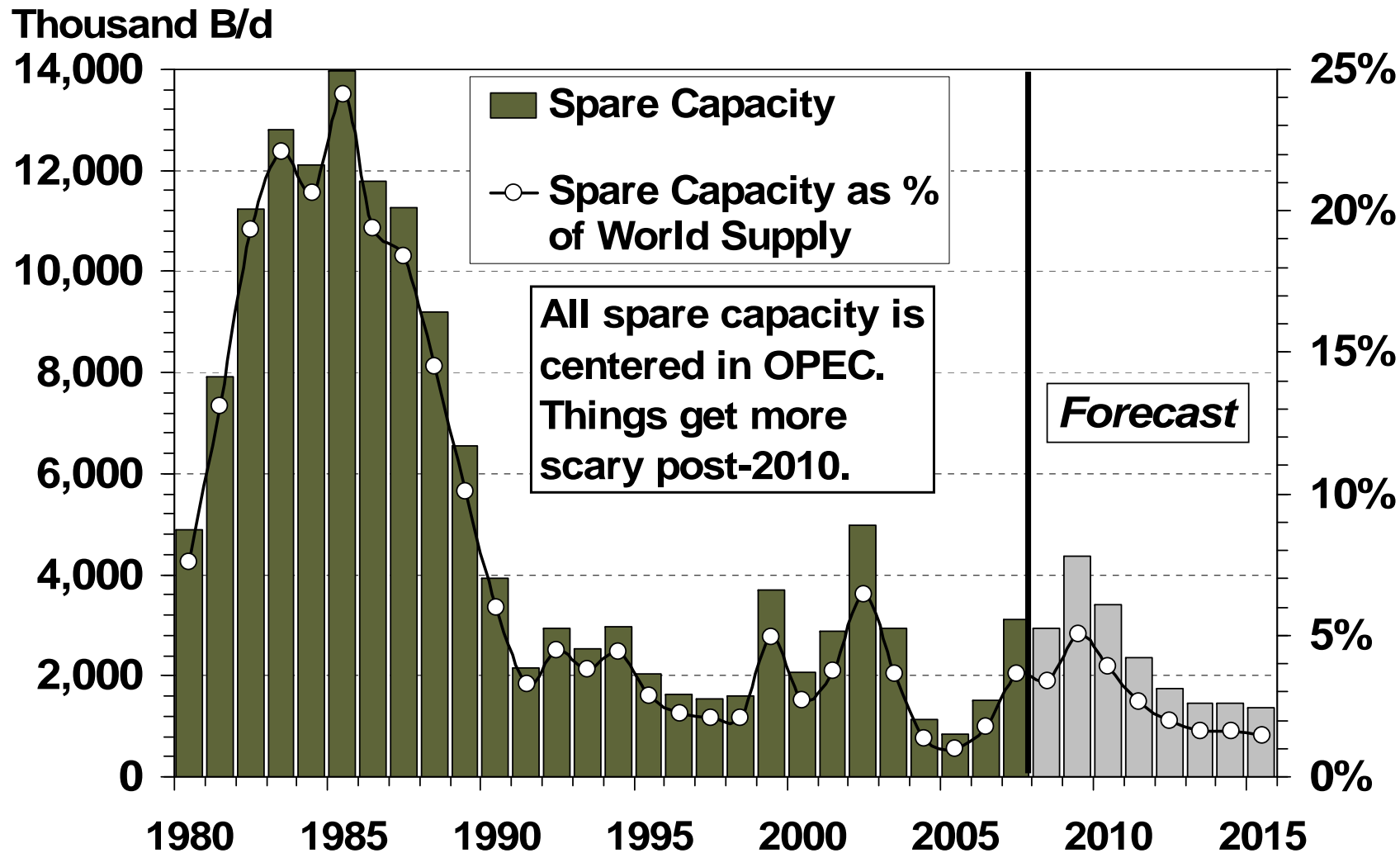
Other Issues of Importance

- Spare wellhead capacity will rise in the short-term on OPEC supply cutbacks, but will be far below the levels seen in the early 1980s. Lowers price volatility.
- Inventory tightness still exists for some categories of refined products, especially for those that are needed heading into the current heating season.
- Days of global forward inventory cover are likely to peak in the near-term, easing downward pressures on the market in 2009.
- Most liquidity-driven selling has likely run its course, while equity and dollar sentiment remain potent day-to-day price drivers.

Global Days of Forward Inventory Cover



Global Spare Wellhead Productive Capacity

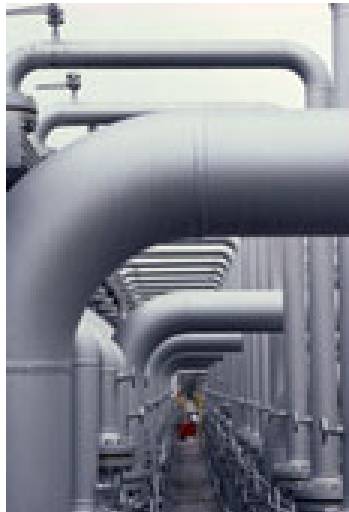


Source: FirstEnergy Capital Corp., IEA, US DOE/EIA, Pennwell.

Crude Oil Conclusions

- We see prices remaining under pressure in the very short-term, but elements are starting to build for a move higher before the end of the year. Tightening of balances via supply factors will begin to emerge more convincingly in the data by year-end.
- Demand meltdown on the scale of the early 1980s is highly unlikely; price signals are already fostering a positive demand response.
- There is no Non-OPEC supply bailout this time! OPEC is showing determination to cut.
- Prices could recover to the US \$80s to US \$90s range by early 2009, pushing to triple digits by H2 2009.
- Long-term, still looking at US \$120 per barrel.

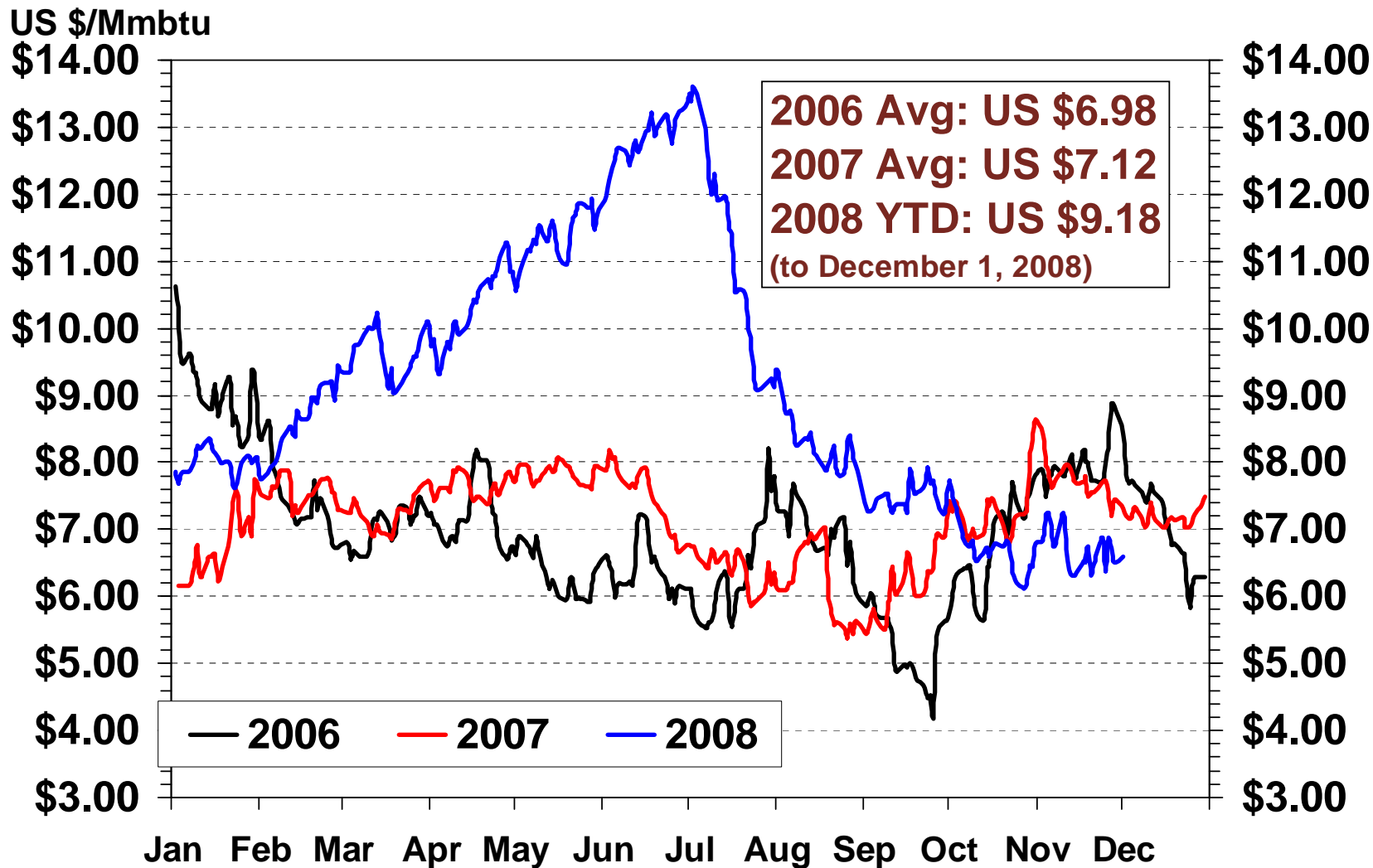
World Natural Gas Markets



Natural Gas at the Winter Crossroads

- Like crude oil, natural gas has suffered a major pricing implosion from the unrealistic price levels of mid-year.
- Prices have fallen to the point where most supply basins are no longer economic.
- Unlike crude oil, the natural gas market is not grossly oversupplied, but suffering blowback from the weak commodity space, economic concerns, and negative broader market sentiment.
- Present winter pricing strips are effectively writing off the winter before it has even begun – not realistic.
- Although we suggested going more bearish at mid-year, the massive sell off still does not make us bullish.

Nymex Henry Hub Natural Gas Prices



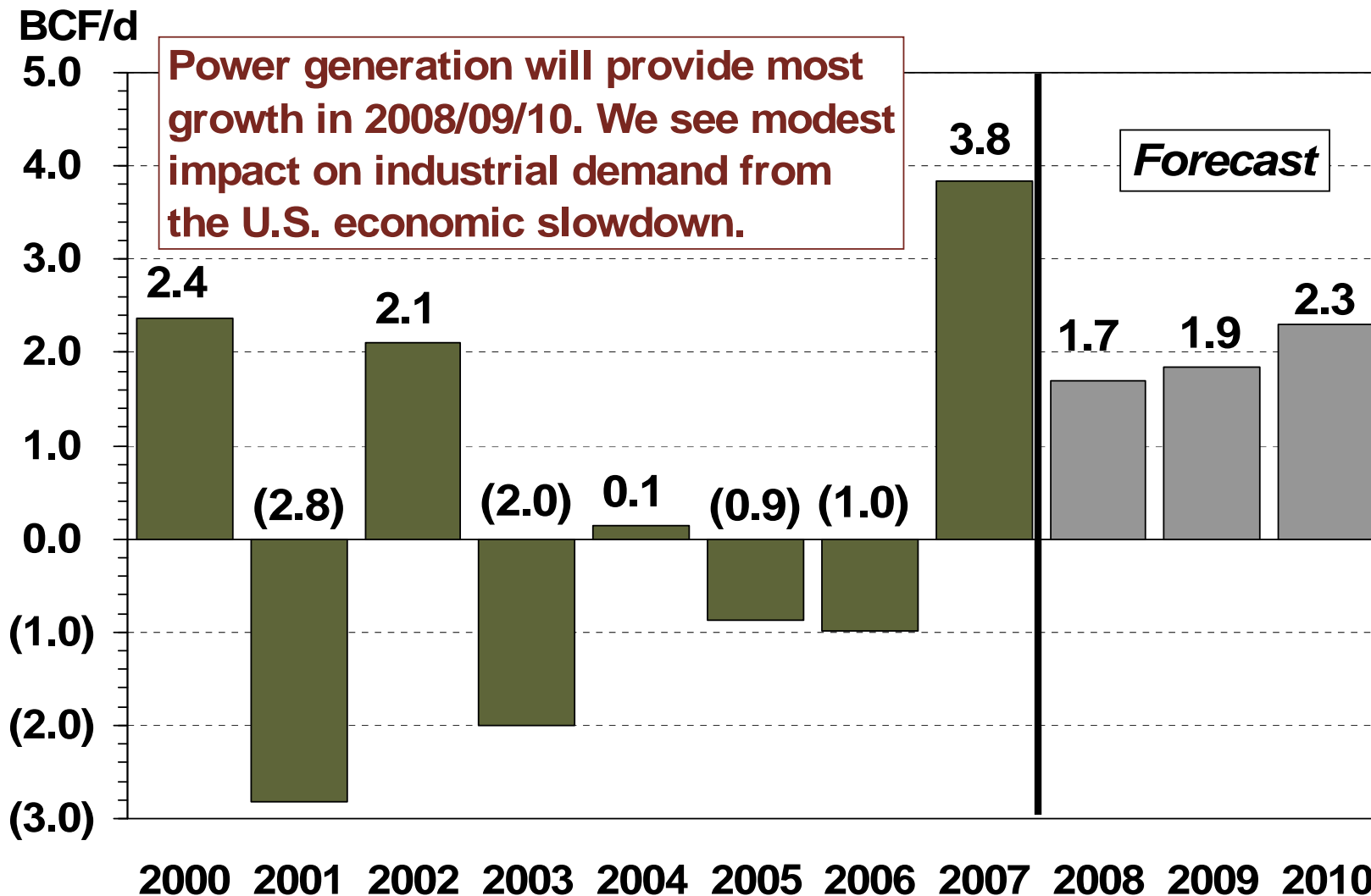
Spinning the Demand Story

- U.S. non-weather related gas demand has held up fairly well through the latest financial turmoil, but will not be completely immune. Some positive offset from lagged effects of U.S. dollar depreciation, while industrial's share of total demand is smaller than ever.
- More gas-fired power generation is still being installed, and will carry forward to 2009 for now.
- Demand is being influenced by weather effects more than ever – nearly impossible to forecast.
- Severity of the upcoming winter will set the tone for gas demand – everything else is a secondary consideration until the heating season is over.

U.S. Industrial Gas Demand Growth



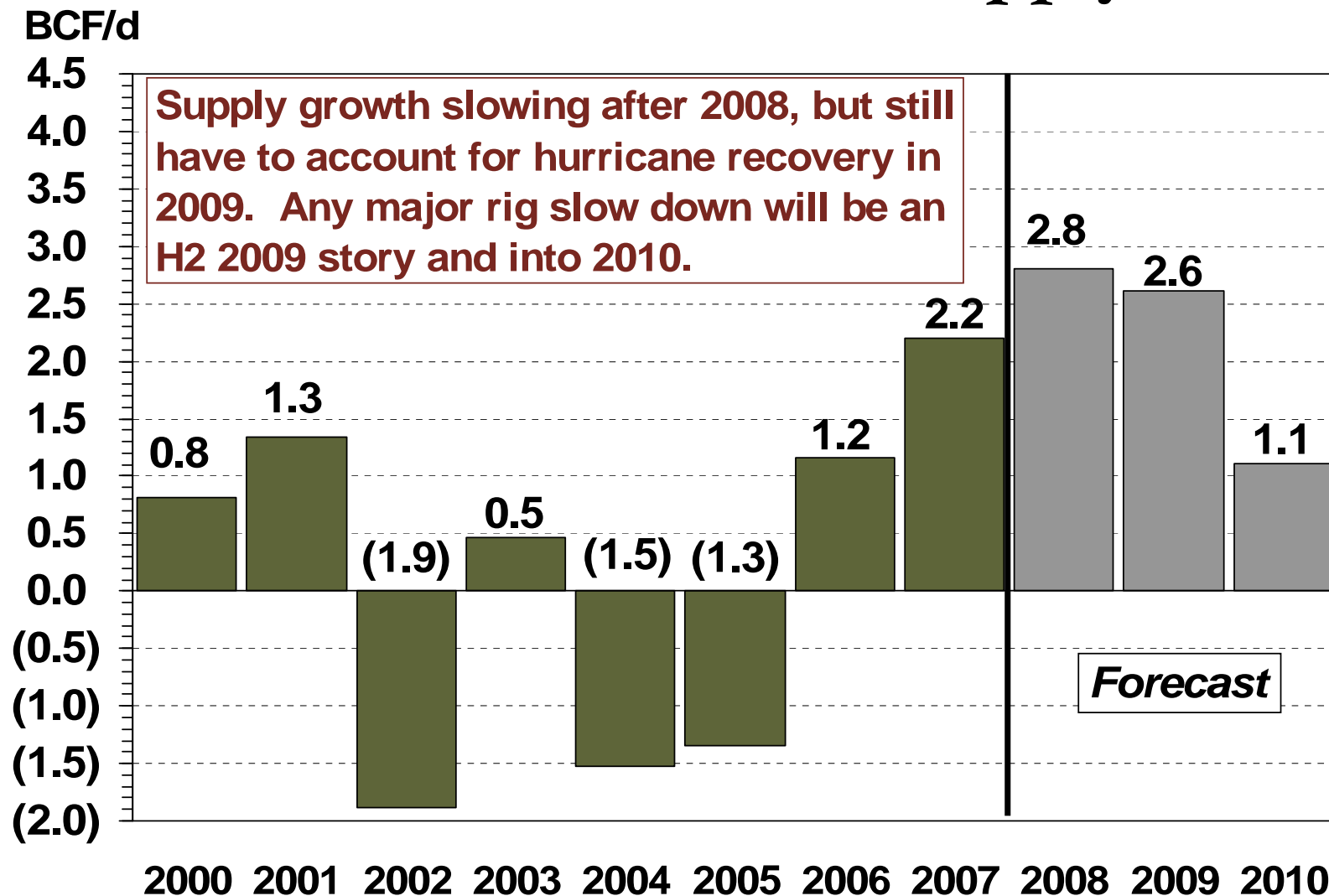
U.S. Natural Gas Demand Growth



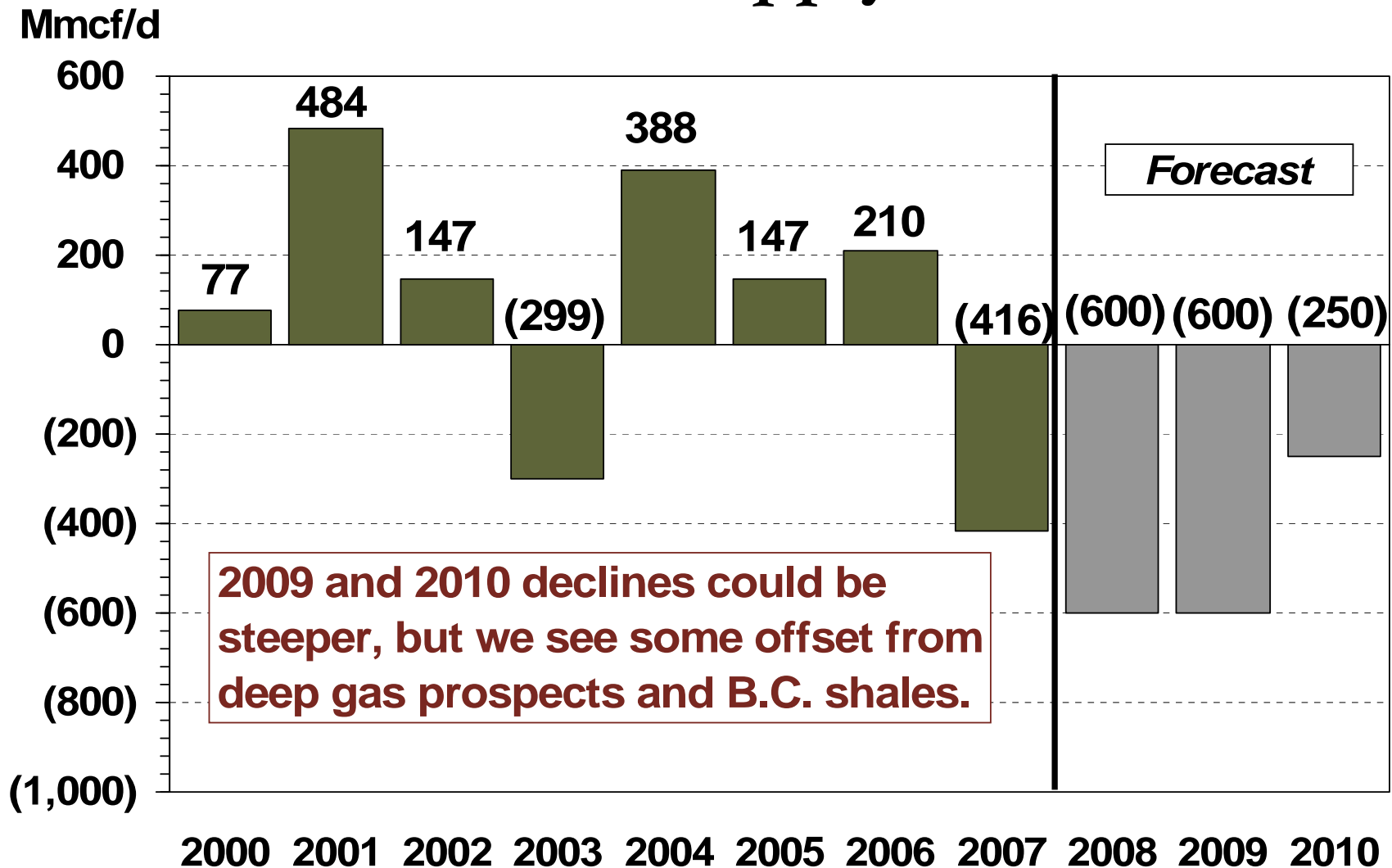
Natural Gas Supply Overhang Continues

- It will be the supply issues in the medium and longer term that will dominate price direction (outside of weather influences).
- We see still solid U.S. supply growth for 2008 and 2009, but on a slowing track. Canadian supply will remain in decline into 2010.
- We see LNG as becoming a potential price bearish influence in H2 2009 or earlier. Could partly offset any price upside from domestic supply impacts of the credit crisis via slower drilling.
- Would need to see a very large downturn in U.S. drilling activity before even thinking more price bullish for 2009. Still not in the cards - yet.

U.S. Domestic Natural Gas Supply Growth

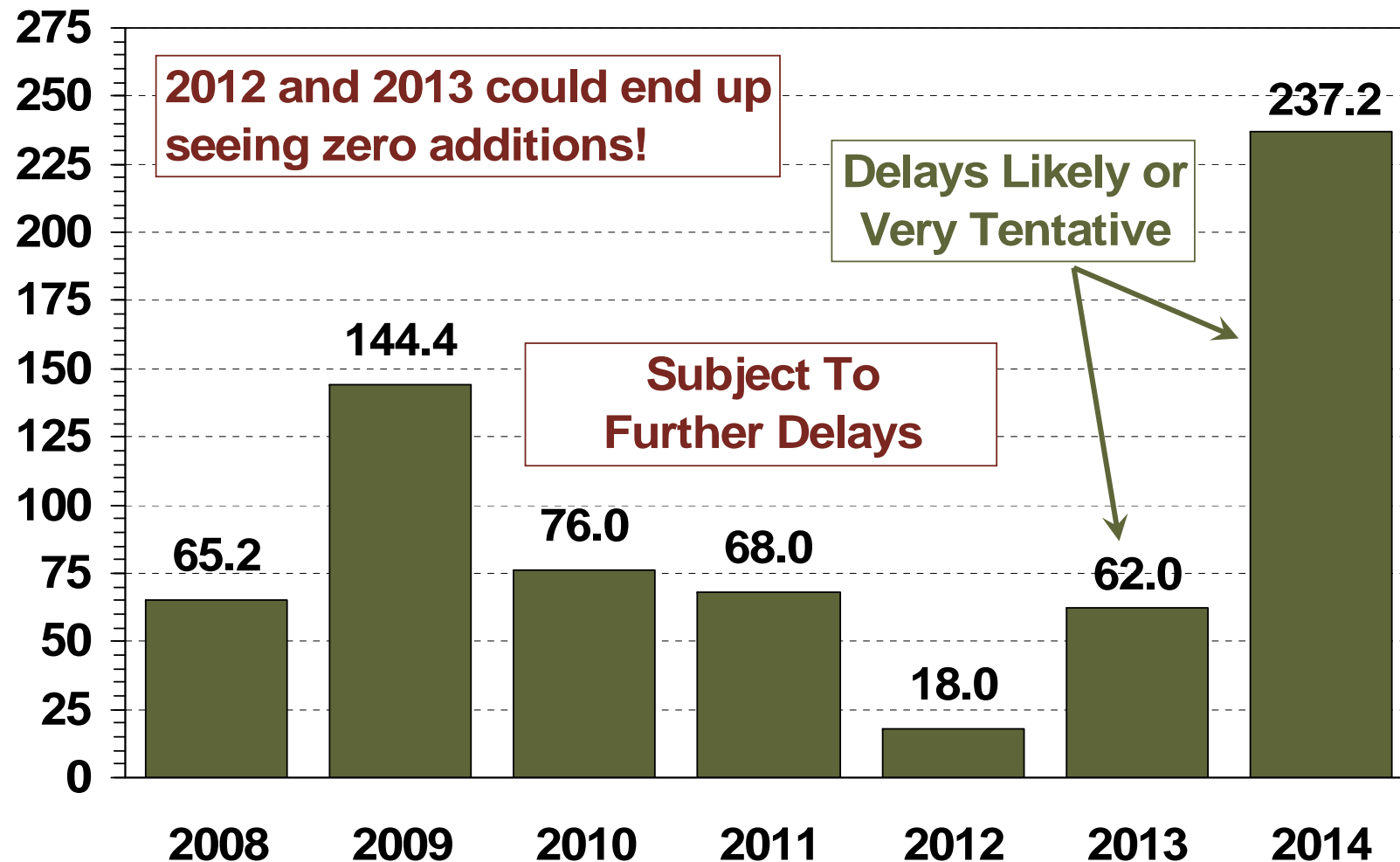


Canada Natural Gas Supply Growth



LNG Long-Term Liquefaction Growth

BCF/Month



More Thoughts on Supply

- Lots of debate on credit crisis impacts on the rig count and the speed of any pullback in drilling.
- We see little change in Canadian gas rig counts, with some increased activity in the foothills and B.C.
- Lower Canadian exports can still be offset by U.S. domestic supply growth and additional LNG.
- Some indications that LNG global market balance is improving with the presence of more LNG trains having come on-stream recently.
- Why LNG to the US in 2009? The netback will still be positive, demand elsewhere will be satiated, and there will still be an excess of LNG supply.

Natural Gas Storage Considerations

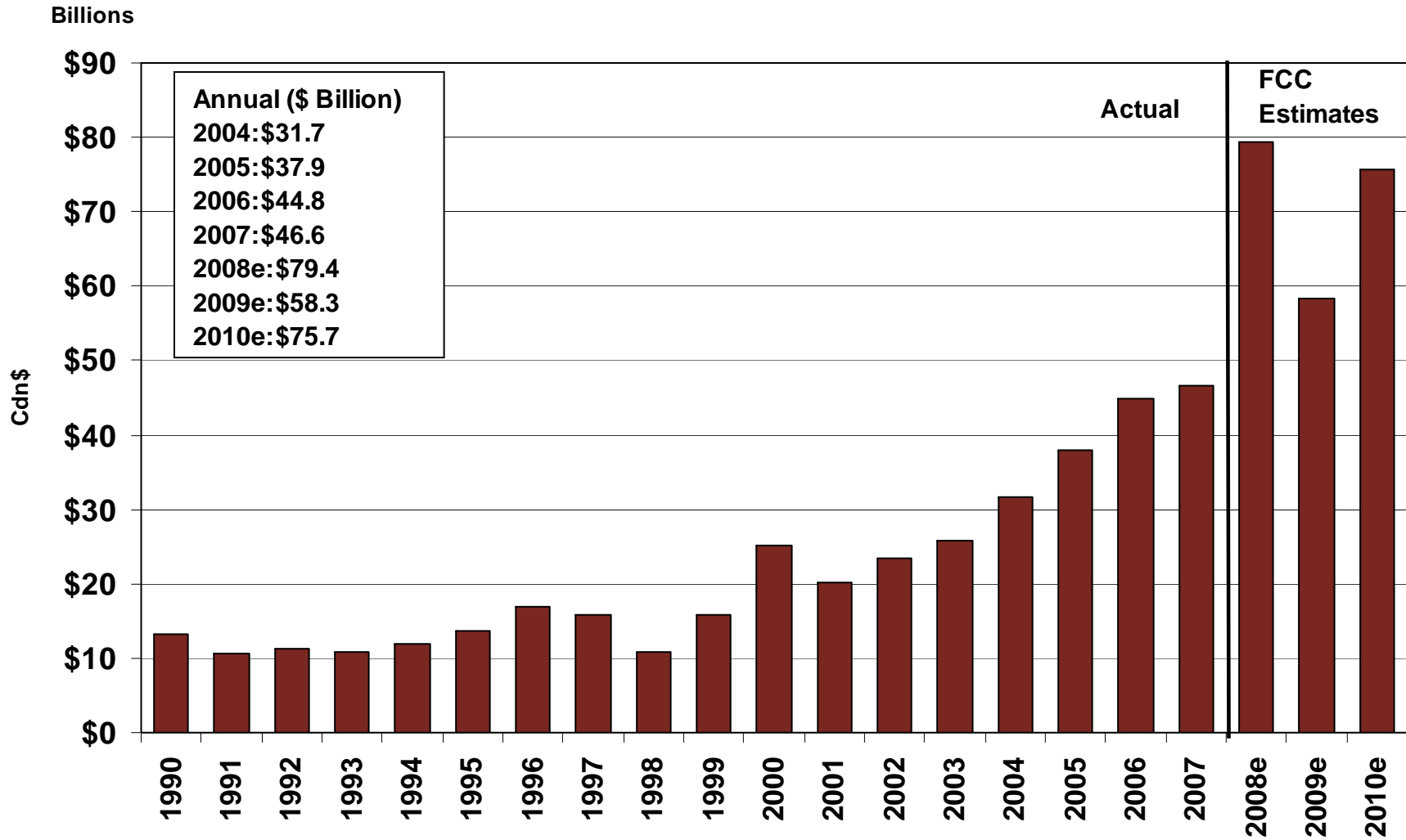
- Storage levels, “high” or “low”, always set the tone for pricing in a season or year.
- Between potential negative surprises on demand and possibility of still solid supply growth/LNG, storage looks to be remaining comfortable in Canada and the U.S. for the balance of 2009.
- Weather is the wildcard – warm/cold winter could create a swing as much as 400 to 500 Bcf on projected storage levels.
- Assuming normal winter, we see U.S. storage levels exiting sub-1,400 Bcf; Street estimates for March 2008 storage exit seem to be unrealistically high, in our view.

Natural Gas Conclusions

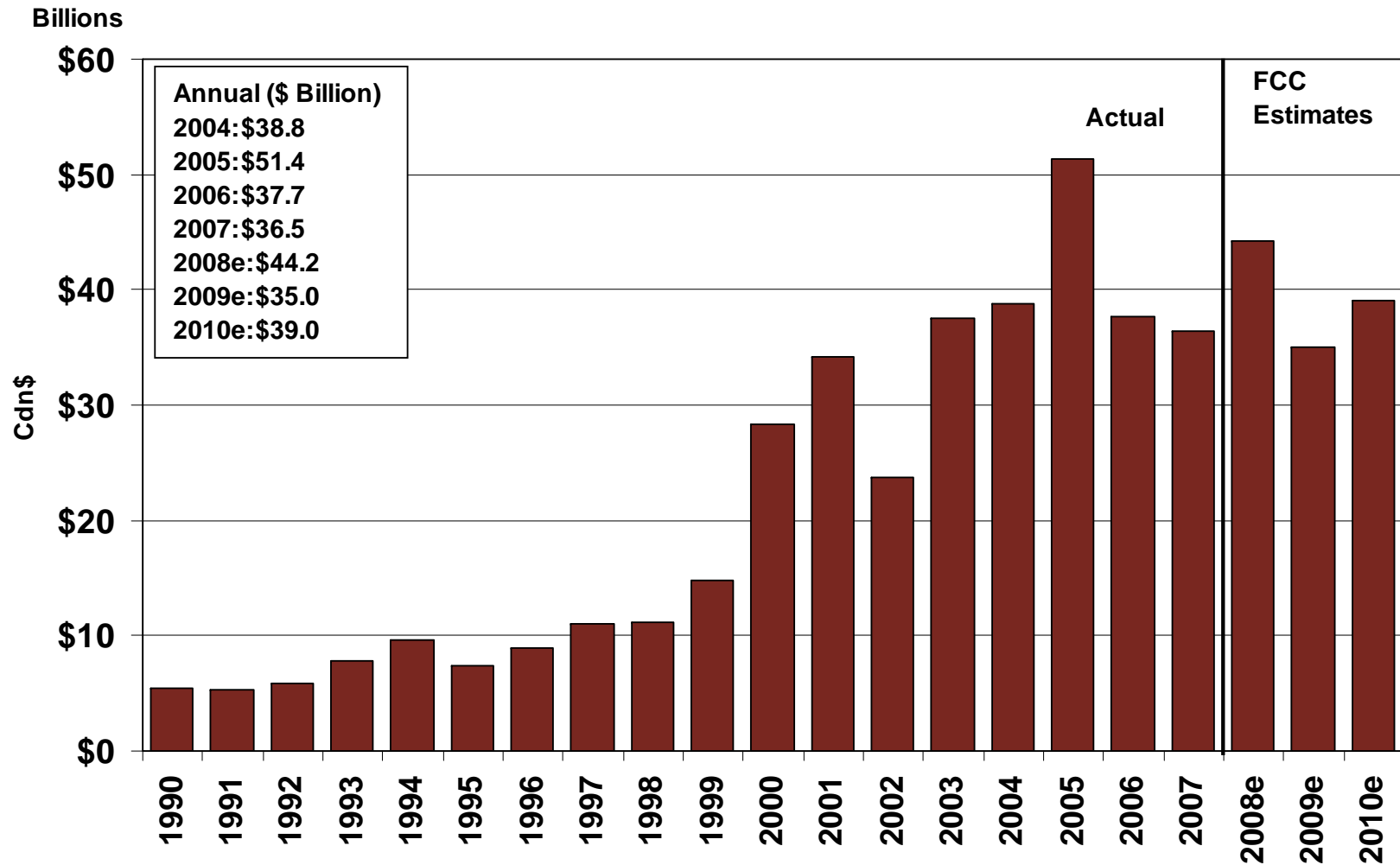
- We believe the market has put in the price lows for this year at around US \$6.50 per Mmbtu.
- We expect some seasonal price recovery into winter, but any sustained price strength will be wholly dependent on the severity of the winter. Credit issues will take a backseat to the weather for the time being.
- Unlike the oil story, supply issues create a price bearish influence once LNG flows are factored in. We see storage remaining comfortable for the balance of 2009. Winter weather is the wildcard. We need cold!
- Modest downside risk to our 2009 US \$8.00 forecast, but long-term thinking still at US \$11.00.

What Does Our Price Outlook Mean To The Canadian Energy Sector?

Canadian Annual - Oil Revenues

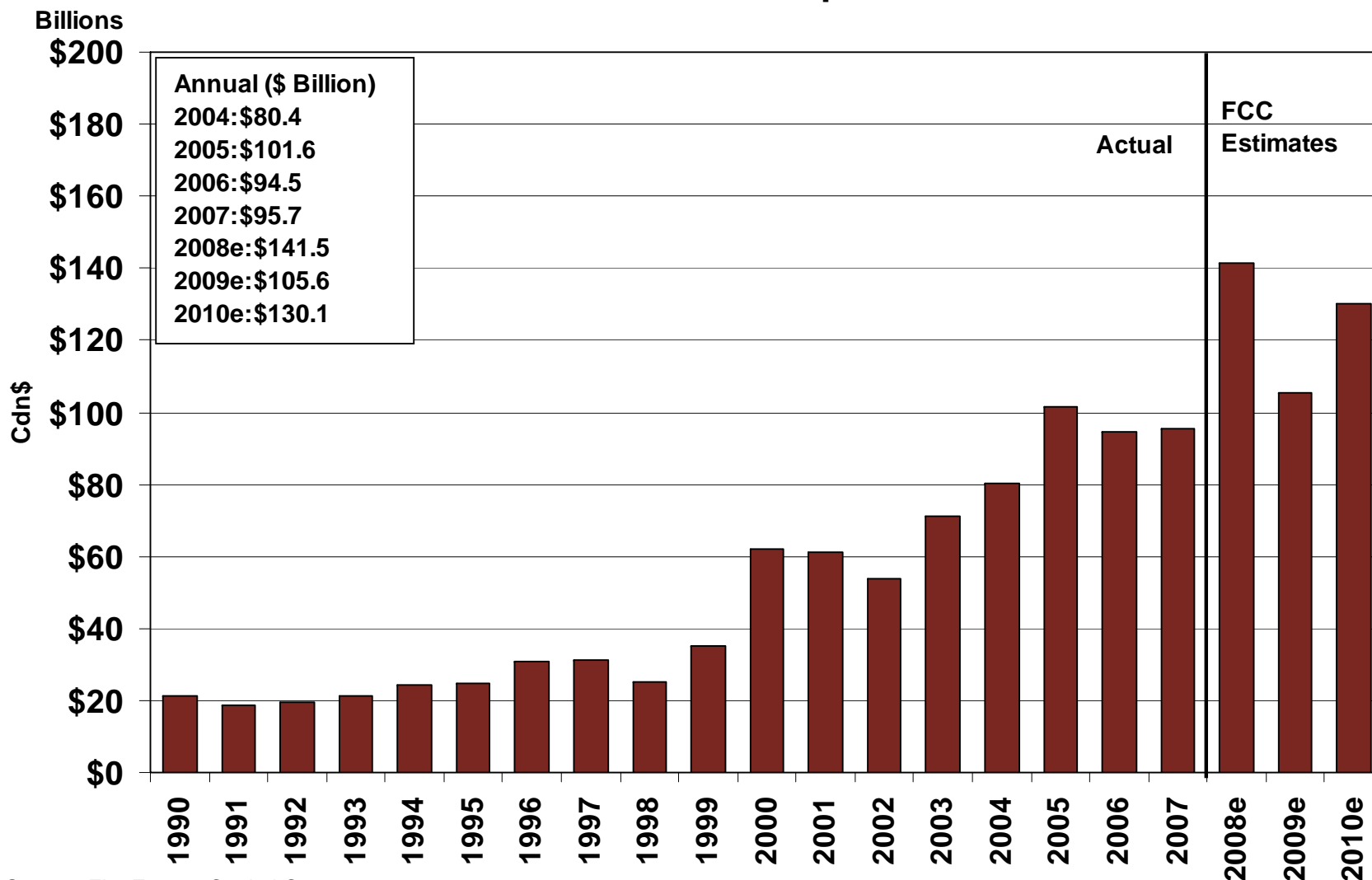


Canadian Annual - Natural Gas Revenues



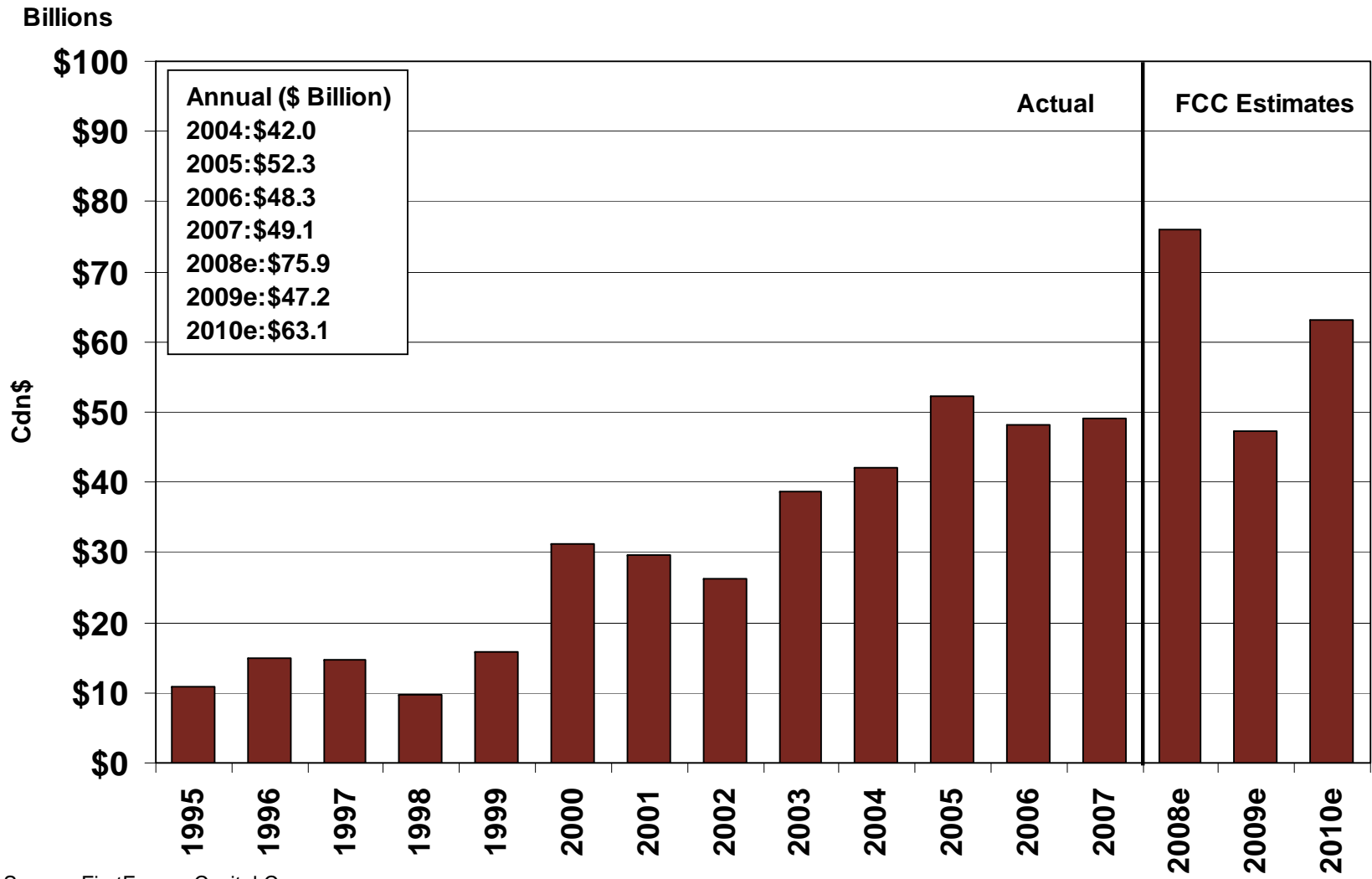
Source: FirstEnergy Capital Corp.

Canadian Annual Oil & Gas Total Upstream Gross Revenues



Source: FirstEnergy Capital Corp.

Canadian Annual Oil & Gas Total Upstream Cash Flow

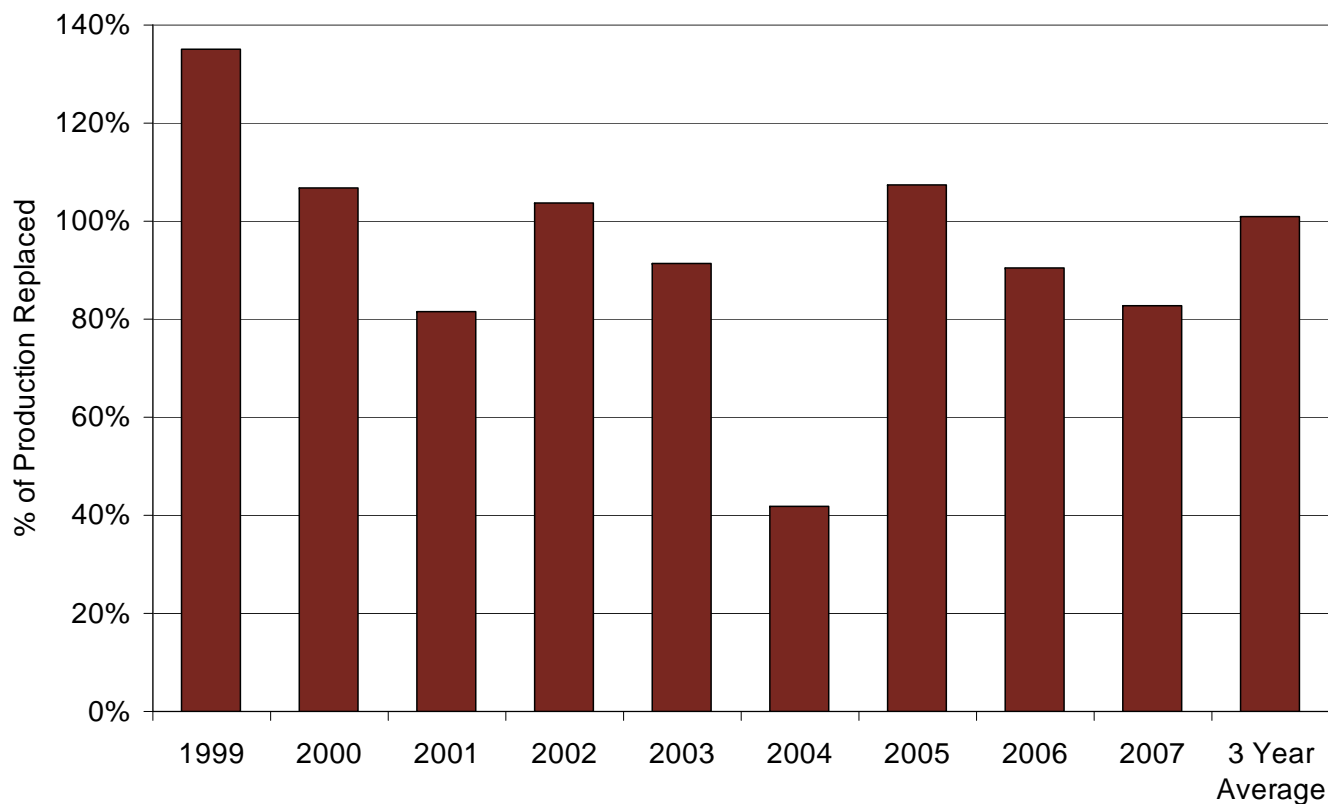


Source: FirstEnergy Capital Corp.

World FD&A

- Companies are challenged at replacing oil production.
- Oil production replacement has steadily dropped over the past three years.
- Insatiable appetite for crude oil becoming increasingly difficult to satisfy.
- Bullish sign for crude oil prices.

World Reserve Replacement (Crude Oil & NGL)

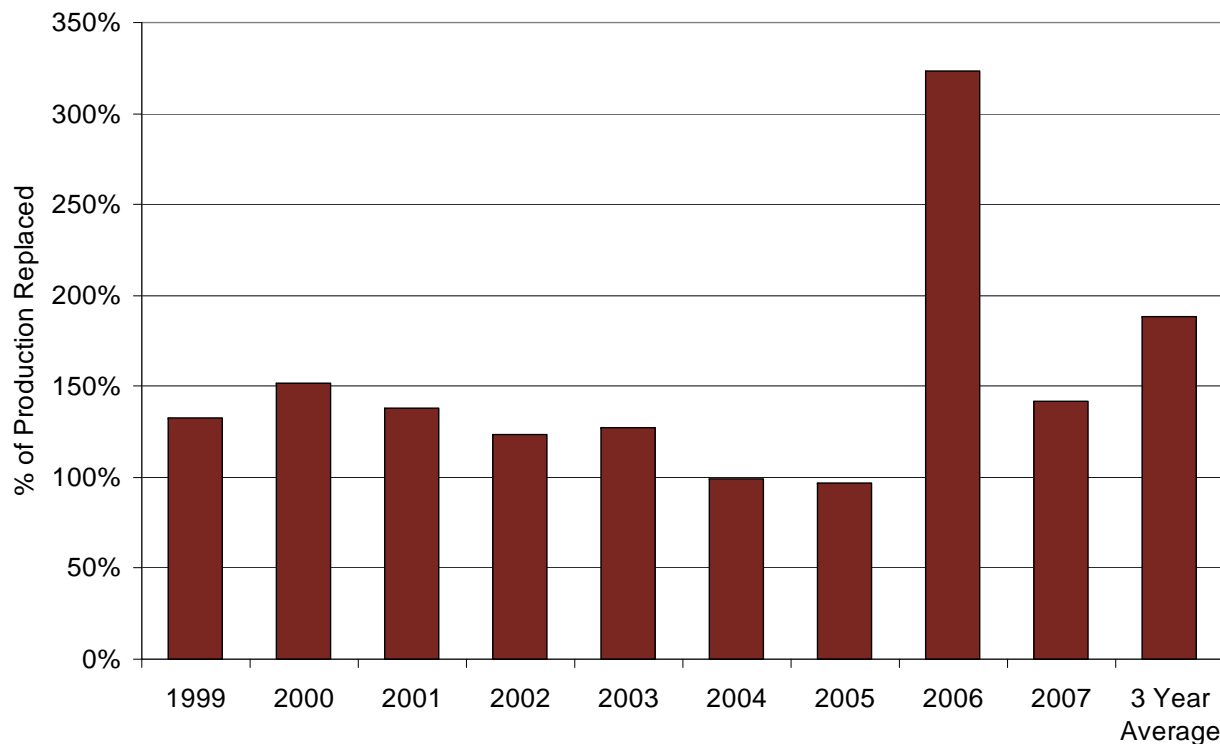


Source: FirstEnergy Capital Corp. and Evaluate Energy

World FD&A

- Companies doing a better job replacing natural gas production.
- The spike in 2006 is due to the sanctioning and development of significant projects.
- Expect natural gas replacement to continue.

World Reserve Replacement (Natural Gas)

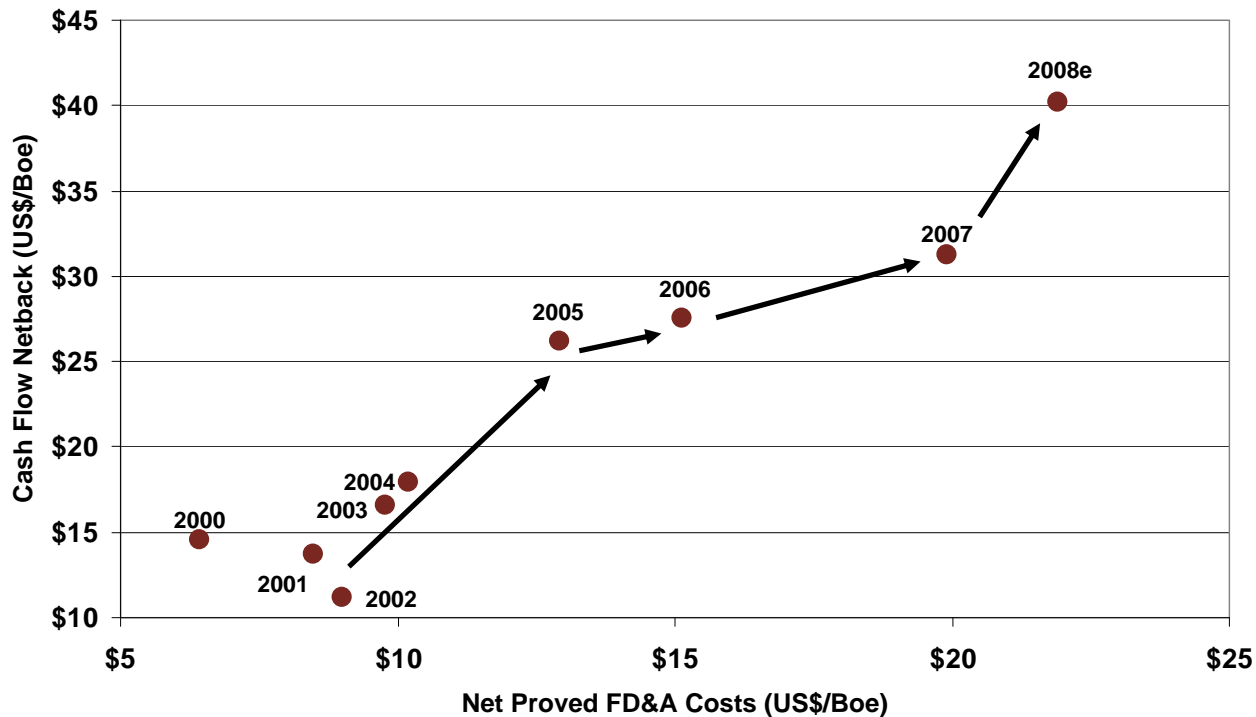


Source: FirstEnergy Capital Corp. and Evaluate Energy

2008 Outlook

- Expecting increased demand for equipment and services for the remainder of 2008.
- FD&A costs could increase by 5% to 10% to \$20.00/Boe to \$22.00/Boe in 2008.
- Given our commodity price outlook, this would imply robust recycle ratios of 1.6 to 2.0x.

Large Cap Sector
Cash Flow Netback Versus FD&A Costs

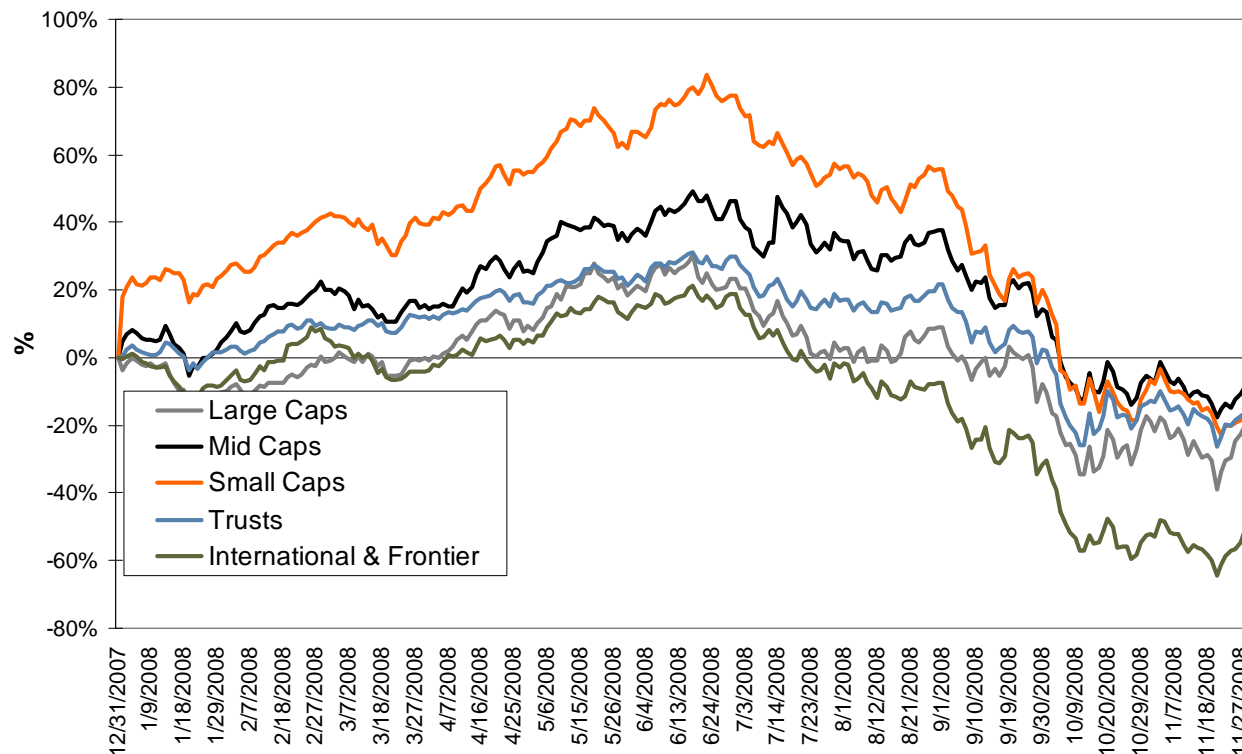


Source: FirstEnergy Capital Corp. and Company Reports

Sector Comparison: EV/Boe Analysis

International companies have lagged when compared to the other sectors and commodity prices.

Sector Comparison (EV/Boe)



Source: FirstEnergy Capital Corp., Bloomberg, Company Reports

Challenges For Producing Community

- Their challenge is managing energy enterprises in an environment of significant change in most if not all aspects of their operations e.g. commodity price expectations, capital and operating cost inflation, competition for intellectual capacity, government takes, labor availability, competition for services, delays in project execution, acquisition cost versus value expectations, all this topped off with a 30%+ decline in equity market valuations YTD and 50%+ from the peak etc., etc.

Challenges For Producing Community

- Capital has gone from plentiful to scarce.
- People retention and additions will be the differentiating factor going forward.
- Top performers will likely be those who can add the most value per share or unit. Ideas and flexibility are worth a lot!
- Challenge in 2009 will be redeploying cash flows while adding financial flexibility.
- Competition will remain intense, in every aspect of the business.

Questions?