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Natural Gas Outlook: Summary

Despite extended cold last winter, and unprecedented storage withdrawals, NYMEX peaked to only $6.10.

Despite an onslaught of hot weather this spring and summer, an early start to hurricane season, spikes in natural gas prices have been conspicuously absent.

Increased demand during 2010, due to increased power demand and industrial recovery (spurred by govt. stimulus programs) couldn’t raise prices either.

NYMEX peaked at $5.19 in June, and has trended down ever since.

Rig counts keep growing, in spite of low prices.

This lack of bullish price response is due to the rising supply of shale gas, combined with sluggish economic signals during the second half of the year.

Demand growth seen in 2010 is not likely to be sustained into 2011, given normal weather patterns, lack of economic stimulus and new coal fired power.

However, supply growth is likely to continue on into 2011, dominated by shale gas production.
US supply growth is expected to be driven by domestic shale gas production.

- **2010 Supply:** Est. 65.5 Bcf/d*, +1.4%, Canadian imports -0.2 Bcf/d* and domestic production +1.1 Bcf/d*.
- **2011 Supply:** Est. 65.3 Bcf/d* with
  - **Domestic Production:** (Positive) – 2011 natural gas domestic production is expected to be up 0.2 Bcf/d*, driven by continued shale drilling.
  - **Canadian Imports:** (Negative) – Canadian imports are expected to be down 0.7 Bcf/d*.
  - **LNG Imports:** (Neutral) – LNG is expected to continue to flow at slightly more than minimum contract levels, +0.3 Bcf/d*.

*Major Energy Research Groups Avg*
Natural gas rig counts hit a new high of 1,620, September 2008, then plunged to 675 in July 2009, as natural gas prices fell. To date, rigs have recovered only one third of the loss, to 996. Almost exclusively the growth has been in horizontal, shale drilling.

However, 2010 production is projected to be 57.9 Bcf/d*, up 1.1 Bcf/d or +2% * from 2009.

September 2010: Total drilling is up 40% y/y. Vertical (conventional) drilling is flat y/y, and horizontal (unconventional/shale) is up 77%.

Producers may be calibrating activity based on weather extremes ytd, leading to future over supply.

*Major Energy Research Groups Avg.
Natural gas storage inventories were at record highs from early June 2009 to January 1, 2010. Then, as severe cold gripped much of the nation for Dec'09 - Feb'10, inventory surplus was eliminated, as we drew more gas from storage than in any other year since NYMEX started trading in 1990.

- Extended extreme heat over spring/summer put additional pressure on storage fills.
- Projection of storage level at the end of injection season, 10/31/2010, ~3,672 Bcf*, 91% full, not at last year’s record.
- Assuming normal weather, storage could test record by end of winter, 3/31/2011.

*Major Energy Research Groups Avg.
The US economic recovery is likely to face headwinds in the second half of 2010, followed by continued slow growth in 2011.

The ongoing sluggish labor market and uncertainty surrounding future economic conditions are beginning to show up in economic data. Expiring government stimulus programs and weakening global demand is expected to pressure growth through 2011. US GDP Outlook: 2010= 2.6% & 2011=2.2%

- 2010 US Demand: Est. 65 Bcf/d*, +4%, with power demand @ 20 Bcf/d*, +6%, residential and commercial flat @ 21.7 Bcf/d* and industrial demand @ 18 Bcf/d*, +7%.
- 2011 Demand: Est. 64.5 Bcf/d, -1%, with
  - Power Demand : (Negative) – Est. -2.5%* in 2011 as new coal units come online and overall demand for electricity moderates with a slowing economy.
  - Industrial Demand: (Neutral) –Est. flat* to 2010 as the federal stimulus packages wind down amid a general slowdown in economic activity.
  - Res/Com Demand: (Neutral) – Will remain weather driven and continue to be a wild card going forward. Base case scenario assumes normal weather, and has residential/commercial demand flat.

*Major Energy Research Groups Avg.
Coal to natural gas displacement curve for Sept’10 has shifted up from ~$3.50*, last year, to ~$4.00* this year, where rapid displacement begins.

Drivers for higher displacement price include: coal prices are higher than last year; level of coal generation is up ~5% this year due to summer temps and economy; stockpiles have been reduced.

Could see 4 – 5 Bcf/d* displacement this month @ NYMEX = $3.60 where last year saw similar displacement in September @ $2.90.

*Major Energy Research Groups Avg.
Natural Gas Demand: Weather

Weather is Always a Wild Card

- Winter 2009/2010 was much colder than normal. Summer 2010 has been much hotter than normal. La Nina conditions have developed. Summer seasons that feature a swing from El Nino to La Nina conditions tend to average hotter and drier than normal.

- The longer-term weather forecast thru fall/winter is expect to average above normal, with normal/above normal temps Winter 2010/’11 in major heating regions.

- Latest NOAA Forecasts: August 16, 2010:

  - Hurricane season is progressing with 3 hurricanes to date, but none impacting the GoM. Drivers include transition from El Nino to La Nina and unusually warm tropical Atlantic sea surface temps.

  - Dr. Gray, Colorado State University, still forecasts a very active hurricane season with 18 named storms, 10 hurricanes and 5 Category 3 or higher.
Natural Gas Price Outlook: 2010/’11

- Continued economic recovery along with production/supply level are the primary drivers in 2010/2011.
- In 2010/2011 prices should trade in a relatively sideways pattern with additional production providing resistance at the high end and coal/gas fuel switching giving support at the low end.

*Major Energy Research Groups Avg.

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Further Questions?
Please contact

Susannah Hardesty
Manager of Strategic Analysis
ProLiance Energy
shardestry@proliance.com