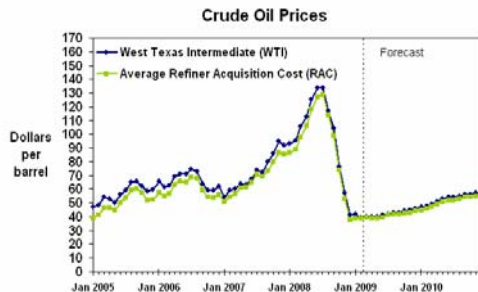


Oil & Natural Gas Outlook

After a precipitous fall during the Q4 2008 period, crude prices have stabilized and are expected to remain stable through 2009. With the global economic recovery, crude prices are expected to see an upturn in 2010. EIA's (Energy Information Administration) 10-Mar-09 'Short-Term Energy Outlook' projects 2009 and 2010 average crude-oil prices at \$42 and \$53 per barrel, respectively – marginally lower than last month's forecast. This projection is based on the underlying assumption that US real GDP and oil-consumption-weighted global GDP will decline by 2.8% and 0.8% Y/Y, respectively (in 2009) before rebounding to +1.9% and +2.6% Y/Y, respectively (in 2010). While non-OPEC supply remained flat, EIA's latest estimate of OPEC crude oil production in Feb-09, ex-Iraq, shows a decline of ~3 million bbl/d from the Sep-08 level. This represents almost 70% of the 4.2 million bbl/d cut in OPEC's production target. Estimated OPEC crude oil production fell by 1.1 million bbl/d during Q4 2008 to 30.6 million bbl/d and is estimated to fall by an additional 2 million



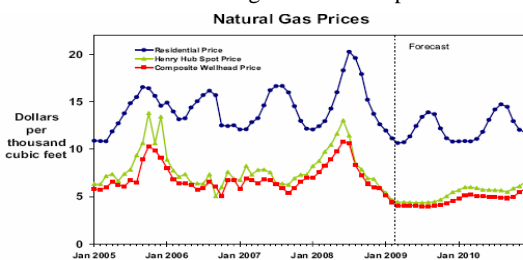
Short-Term Energy Outlook, March 2009



bbl/d in Q1 2009 to 28.6 million bbl/d. This would be the lowest Q1 level since 2003. OPEC crude oil production in 2009 is expected to average 28.9 million bbl/d versus 31.3 million bbl/d in 2008; for 2010 the projection is 29.8 million bbl/d. On the demand side, EIA projects (*Short Term Energy Outlook, 10-Mar-09*) that average annual world oil consumption will decline by ~1.4 million bbl/d in 2009, with consumption in the OECD countries falling by ~1.6 million bbl/d. Crude futures, however, indicates a market expectation of a marginal near-term price recovery. The Light Crude Dec-09 Futures at NYMEX (CL Z9) is currently quoting higher at \$61.38/ barrel than the May-09 Futures (CL K9) at \$52.51/ barrel.



Both coal and natural gas have underperformed oil in Q1 2009. Though rig counts have dropped and coal producers have lowered productions, these adjustments were not enough to offset the faltering demand and the oversupplied market. In addition, the US import of liquefied natural gas is expected to increase slightly due to increased volume supply in Qatar, Indonesia, and Yemen. EIA projects that natural gas consumption will decline 1.3% Y/Y in 2009. The sharpest decline will be in the industrial sector where the drop in consumption is expected to be ~ 6%. However, switching from coal to natural gas among electricity generators is expected to partly buffer the blow from the domestic consumption, particularly in the industrial sector. EIA in its latest report projects the Henry Hub natural gas spot price to decline from an average of \$9.13 per Mcf in 2008 to about \$4.70 per Mcf in 2009 and then to increase in 2010 to an average of almost \$5.90 per Mcf. Natural Gas futures indicates a market expectation of a marginal near-term price recovery. The Natural Gas Dec-09 Futures at NYMEX (NG Z9) is currently quoting higher at \$5.55/Mcf than the May-09 Futures (NG K9) at \$3.80/Mcf.



Short-Term Energy Outlook, March 2009

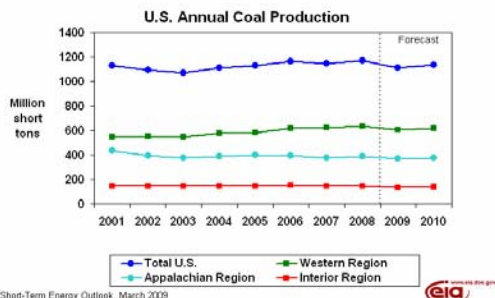


2009 is expected to be one of the worst years in a decade for the land drillers, due to the frozen credit situation, low natural gas and crude prices and over-leveraged customers. The Baker Hughes US rig count has seen one of the steepest falls lately. The number of US rigs has come down from 2,031 at the end of Aug-08 to 1,043 on 3-Apr-09. These large numbers of cold and warm stacked rigs are expected to pull down the day rates by more than 30% from the 2008 peak. However, day rates and drilling activity will eventually reach a floor and rebound. Due to lower costs and steep declining rates from natural gas wells, it will be economic for customers to drill many new wells. Currently, the customers have significantly cut their drilling budgets because of the lower commodity prices and frozen capital markets and it is expected that there will be a further decline in the industry wide rig count as well. Of late, there have been improvements in drilling technology which have led to many marginally profitable wells being drilled. In order to maintain natural gas production at the current level, more wells and rigs are needed in North America. One of our portfolio companies in the oil exploration segment, **Patterson-UTI Energy** (PTEN) is one of the largest North America centric land rig drilling contractors. PTEN is expected to suffer particularly with its essentially US centric footprint and a virtual absence from the other high activity zones (e.g. Middle East, Africa and South America). PTEN's highly unusual practice of taking up business on a spot basis might also turn out to be unfavorable, given their inability to lock the customers at high prices during the calm days of last summer. Given the local business concentration, PTEN's clientele has a large number of smaller players who are most vulnerable to the credit squeeze. On these counts, our other portfolio company in this segment, **Parker Drilling** (PKD), is relatively well hedged. PKD is well-diversified across all major drilling centers. PKD's customer mix is also skewed towards large oil and gas companies, global engineering and construction companies and national oil companies; liquidity is no concern for most of these customers. PKD's Gulf of Mexico centric barge drilling business, however, is facing a near- to mid-term strain given the commodity price points where these expensive sources are nearly unviable.

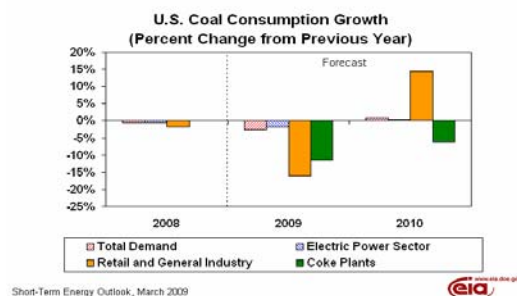


Coal Outlook

The global economic recession has led to contraction in industrial activity and energy demand, resulting in lower electricity consumption and steel production. Coal is hit hard in both of its consuming segments - electricity and steel. Consumers are delaying their expansion projects and trimming production levels. The demand contraction - expected to be ~ 50 million tons

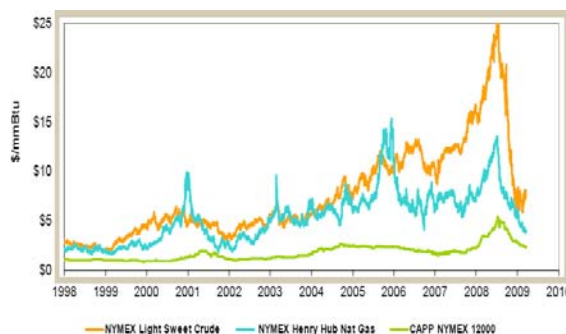


in 2009 – is primarily due to lower electricity generation and diminished steel production levels, and also because of the switching of fuel from coal to natural gas. EIA projects coal consumption for electricity would decline 1.7% in 2009 due to the projected decline in electricity consumption and the projected increase of other fuel sources. This demand contraction (and the consequent under-investment in supply and supply rationalization) is likely to spur the next upturn. Thanks to the credit



squeeze, the supply of coal, however, is currently very tight which provides a strong support to the current coal price and ensures a good rebound when the economy recovers.

Obama administration's emphasis on reducing the carbon footprint through carbon cap-and-trade poses a long-term threat to the coal industry. Under this policy, an entity would have to purchase allowance units through an auction from the government which is estimated to be ~ \$20 per ton of carbon emission. Starting in 2012, the administration's cap-and-trade policy envisions a reduction in emissions by 14% below 2005 levels by 2020, and 83% below 2005 levels by 2050. It is expected that through this 2009 federal budget plan the government will raise ~ \$80 billion per year from selling carbon allowances which in turn will be used to fund carbon sequestration research and other 'green' projects. The \$20 per ton of carbon cost is estimated to result in additional costs of ~ \$0.015/kwh of electricity and approximately \$0.22 cents of additional cost per gallon of gasoline. This level of incremental cost, in our view is not enough for the consumers to switch fuel sources away from coal. However, if the carbon cost goes up substantially, this may pose a serious threat to the coal industry.



One of our portfolio companies in the coal mining sector, **Arch Coal** (ACI) is the second largest coal producer in the US, providing for ~ 6% of the US electricity generation. The company has shifted its focus away from higher cost mining assets in Central Appalachia (CAPP) to lower-cost mining in the Powder River Basin (PRB) in the West. It has also entered into low-sulfur coal mining in the Illinois Basin. PRB is also low in sulfur content, but has lower carbon content versus CAPP and therefore produces less heat. The transportation cost of PRB coal is also high versus CAPP which is mined closer to the consuming centers. The low carbon content also makes it less attractive for exports. However, the inexpensive over-ground mining makes PRB attractive for domestic use. The demand for PRB has increased by ~ 80 million tons in the past five years. Our other portfolio company in this segment, **Massey Energy** Company (MEE) has dominant share in the Central Appalachia. CAPP is expensive to mine because of the difficult topography and its depleting reserves. CAPP is very high on carbon heat content. However, it is also high on sulfur content making it less attractive to the emission sensitive electricity generators. MEE locked in a major part of its current contracts at the near peak levels from last year. This will help the company maintain margins in the near-term. However, the margin contributions from its metallurgical coal last year will not be sustained given the steep decline in steel production levels and the consequent demand contraction for metallurgical coal. The proximity of CAPP to consuming centers should remain an advantage over *Western coal*. The high carbon CAPP is viable for export. So with the eventual recovery in emerging markets (e.g. China and India), we expect to see MEE benefiting in the long-run.

Renewable Energy Outlook

According to EIA estimates, **overall consumption of marketed renewable fuels** -- including wood, municipal waste, and bio-mass in the end-use sectors; hydro-electricity, geo-thermal, municipal waste, bio-mass, solar, and wind for electric power generation; ethanol for gasoline blending; and bio-mass-based diesel **is expected to grow annually by 3.3% in 2007-2030**, much faster than the 0.5% annual growth in total energy use. The volume of bio-fuels consumed is sensitive to the price of the petrol-based products against which they compete. The short-term outlook of bio-fuel may not appear exciting, as industry capacity exceeds the level of renewable fuels mandated through 2008 in the Energy Act.

The clean energy initiative has received a shot in the arm as President Obama unveiled a *New Energy for America* plan. The plan aims to ensure that 10% of electricity in the US will come from renewable sources by 2012, and 25% by 2025. It would help create 5 million new jobs by investing ~ \$150 billion over the next 10 years in order to catalyze private efforts to build a clean energy future. The plan also aims to place 1,000,000 plug-in hybrid cars with a comprehensive cap-and-trade program. Overall, the sector remains critically dependent on State renewable energy programs, technology improvements, access to transmission grids, smart metering programs, public concerns about environmental and other impacts, and the future of the Federal *production tax credit*. The scenario may undergo a paradigm shift if environmental concerns take the center stage in policy making in the US and worldwide.

The International Energy Agency's *World Energy Outlook* annual report is nearly 600 pages in length and contains estimates for future supply, demand, and price estimates. This year's outlook also included an eagerly-awaited study of 800 of the world's largest oil fields. The price of oil has collapsed from ~ \$150 to ~ \$50. The global recession is impacting demand and there are other factors pressuring oil prices downwards. As we have seen historically in financial markets, there is over-reaction to good news and bad news and this may be a case of the latter.

In a *Fortune* magazine article I read a few months ago that is not out-dated, the writer mentioned that **the IEA study makes clear that the long-term supply and demand picture for oil continues to favor higher prices.** The report estimates that energy demand will grow 1.6% per year on average through 2030, for a total increase of 45%. **To meet that demand, daily oil production will need to rise from today's level of ~ 85 mln barrels to (significantly) more than 100 mln barrels.** The study found high and rising depletion rates at existing oil fields that will make it increasingly hard for new supplies to keep pace. So, the IEA says, **the world needs to invest some \$26 trillion through 2030 in infra-structure and exploration.**

"Given what we know, just to stay flat in global oil production we'd have to add the equivalent of four Saudi Arabias between now and 2030," said Matt Simmons, chairman of Houston energy investment bank Simmons & Co. International. Simmons is also the author of *Twilight in the Desert*, the 2005 book that argues that oil-rich Saudi Arabia's petroleum production might have peaked. "It's a very, very scary study. It's hard to argue with the data and it's ghastly what the data says." **Over the next seven years,** the IEA predicts that the price of oil will average \$100 a barrel, and rise to more than \$110 by 2030. "The era of cheap oil is over," Nobuo Tanaka, IEA executive director told reporters at a press conference in London. If Tanaka is right, the vicious sell-off in the equity markets over the past couple of months makes this a good entry point for investors looking to grab oil-industry bargains.

We are currently equal-weight in this sector with 14 open recommendations (out of 98 net overall taking hedges into consideration). That is a 14.29% weight versus 13.25% in the S&P-500. Our industry over-weights are in Drillers; Exploration & Production; Equipment & Services. SLB, ACI, ESV, XEC and CGV were the higher performing stocks on our computer model from the current open recommendations in the sector. PBR is Brazilian and CGV is French.

		REVENUE	EARNINGS	ROE	PRICE	E'PRISE	% OF LT	P/E	
	MKT	5 YR HIST	5 YR HIST	5 YR	TO	VAL :	DEBT :	FWD	DIV
COMPANY NAME	CAP	GR RATE	GR RATE	AVG	BOOK	EBITDA	CAP	4 QT	YIELD
PETROBRAS PBR	153985	31.0%	18.0%	29.7%	2.1	7.94	27.0%	-	2.7%
SCHLUMBERGER SLB	53903	20.0%	45.0%	33.0%	3.2	5.95	18.0%	16.7	1.9%
DEVON ENERGY DVN	22168	11.0%	20.0%	17.9%	1.3	2.94	25.0%	24.8	1.3%
CHESAPEAKE EN CHK	12458	35.0%	21.0%	16.4%	0.8	4.04	47.0%	10.1	1.5%
ENSCO INT'L ESV	4266	32.0%	76.0%	19.9%	0.9	2.30	6.0%	4.5	0.3%
CNX GAS CXG	3897	N	N	18.0%	2.8	8.62	5.0%	20.3	0.0%
ARCH COAL ACI	2126	10.0%	60.0%	14.1%	1.2	4.76	44.0%	8.3	2.4%
CGG VERITAS CGV	2012	50.0%	64.0%	13.1%	0.5	2.80	30.0%	6.2	0.0%
CIMAREX ENE XEC	1747	28.0%	17.0%	17.1%	0.5	1.57	20.0%	19.8	1.1%
PATTERSON EN PTEN	1669	20.0%	26.0%	26.4%	0.8	1.90	0.0%	NM	1.8%
MASSEY ENERGY MEE	1008	11.0%	141.0%	8.1%	0.9	2.95	59.0%	4.7	2.0%
RPC RES	721	25.0%	27.0%	27.0%	1.6	3.41	28.0%	116.3	3.8%
PARKER DRILL PKD	241	19.0%	67.0%	24.1%	0.4	2.21	44.0%	70.7	0.0%
US NAT GAS ETF UNG	N	N	N	N	N	N	N	N	N

End of Report

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April 06: Energy-200
April 13: S&P-500
April 20: Dividends-200

May 04: Healthcare-200
May 11: ADR-200
May 18: Financials-200

June 09: Discretionary-300
June 16: Short Interest-1000
June 23: Technology-300

July 07: Russell-1000
July 14: Materials-100
July 21: Industrials-300
July 28: Staples-100

Mid-quarter updates are
available on request for all
reports.

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