



## PARKER GLOBAL STRATEGIES, LLC

APRIL 2012

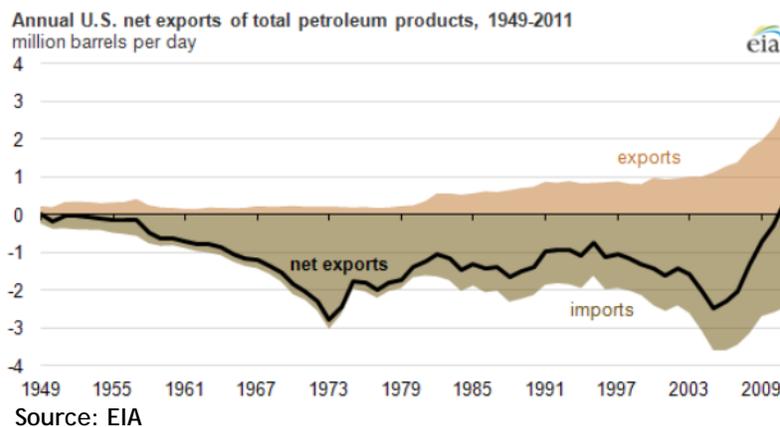
### THE MULTI-DECADE US ENERGY REVOLUTION: MLPs ARE STRATEGICALLY POSITIONED TO PROSPER

#### SHALE TECHNOLOGY IGNITES A REVOLUTION

The US is the fastest growing energy market in the world. Fracking has been around for over 60 years, but the technology has become very advanced over the past 5 years and changed the entire landscape for the discovery, development and production of crude oil and natural gas ("NG") in the US. Industry experts suggest that the technology continues to improve and the next 5 years may be as revolutionary as the past 5 years. This change in the US energy sector has brought unprecedented opportunities for MLPs whose pipelines represent the primary transportation system in the US.

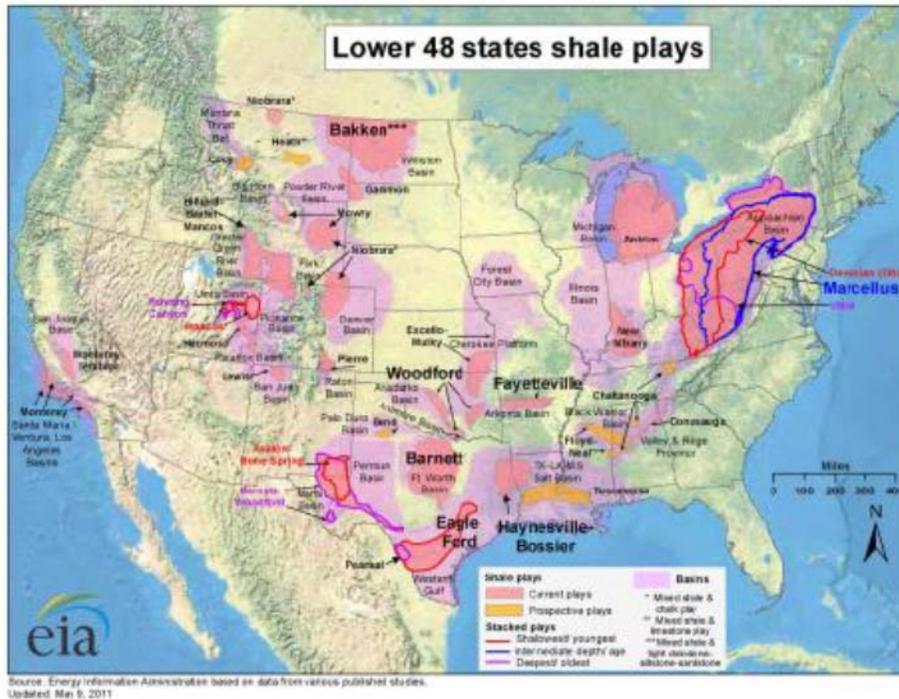
In October 2011, the US became a net exporter of oil for the first time since 1949. Energy experts suggest that this is a trend destined to continue. The export of crude oil represents a reversal in the direction of transporting energy product with broad ramifications for logistics throughout the US. In fact, the change that shale plays have brought to the US energy landscape is driving the "replumbing" of major portions of the US pipeline system. Northeast growth (Marcellus and Utica) is rearranging gas flows. The production is estimated to grow by 6-7 bcf by 2016. This suggests that flows may decrease from the Gulf to the northeast and also to the mid-west. Pipelines are being converted from northbound (the Gulf) to southbound (from the northeast) and eastbound from the Rockies to westbound from the northeast. The glut of NG and surge in production of natural gas liquids ("NGLs") has pipeline operators converting gas pipes to NGL pipes. Today, there is tremendous advantage to regional pipelines with flexibility for "bolt on" capability (adding additional pipe to an existing system to serve a new market). Some long haul pipelines are currently less desirable, as low NG prices have crushed the basis between markets.

#### US Net Exports of Petroleum



Shale technology has opened up an extraordinary supply of natural gas. Studies indicate over 100 years worth of natural gas is now available to meet US energy needs and help the US become energy independent. The US government is beginning to recognize the potential power of the US energy revolution - US energy independence, a growth industry with strong exports helping US balance of payments, a large source of new jobs helping relieve US unemployment, and natural gas as the bridge to cleaner energy.

### US Shale Formations



Source: EIA

### IMPORTANT THEMES FOR MLPs

The US energy revolution has created some important opportunities for MLPs specializing in the transportation, processing and storage of energy product. Current themes driving the profitability of well positioned MLPs include:

- ... NGLs (natural gas liquids)
- ... Gathering & Processing ("G&P")
- ... Port Terminals
- ... E&P for crude oil and liquids rich gas (wet gas)
- ... Regional infrastructure build outs and services: Marcellus, Utica, Eagle Ford, Bakken

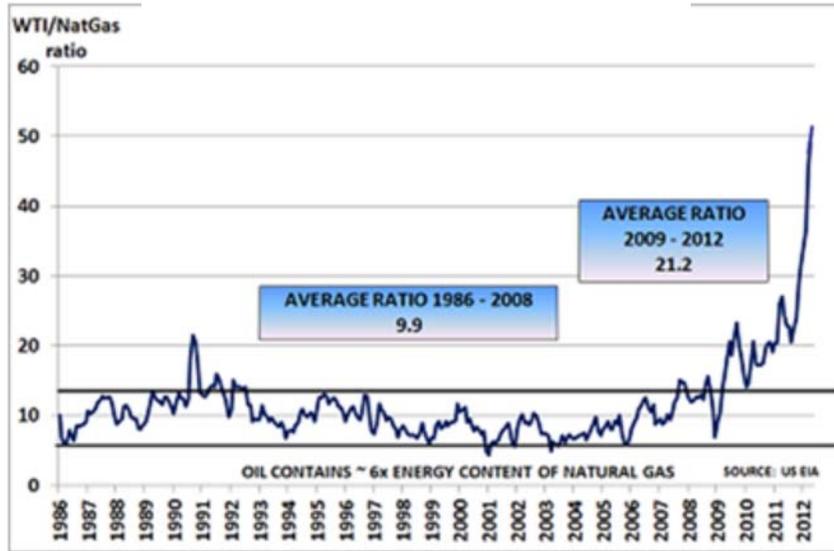
Current issues in the energy space that impact some MLPs include:

- ... Low dry gas prices have decreased the basis with potential to adversely impact long haul pipelines
- ... NG glut has created pressure for NG storage pure plays
- ... Ethane (component of NGLs) and propane have seen price pressure in 2012
- ... Some MLPs may face pricing pressure for renewals for NG pipeline contracts that rollover this year or next

## PRODUCTION IS BOOMING

Some of the biggest shale areas have the least amount of infrastructure and the biggest need: Marcellus, Utica, Bakkan, and Eagle Ford to name a few. The difference in the price of crude oil and NG drives the profitability of natural gas liquids (NGLs).

Ratio of WTI Crude Oil to NG Prices

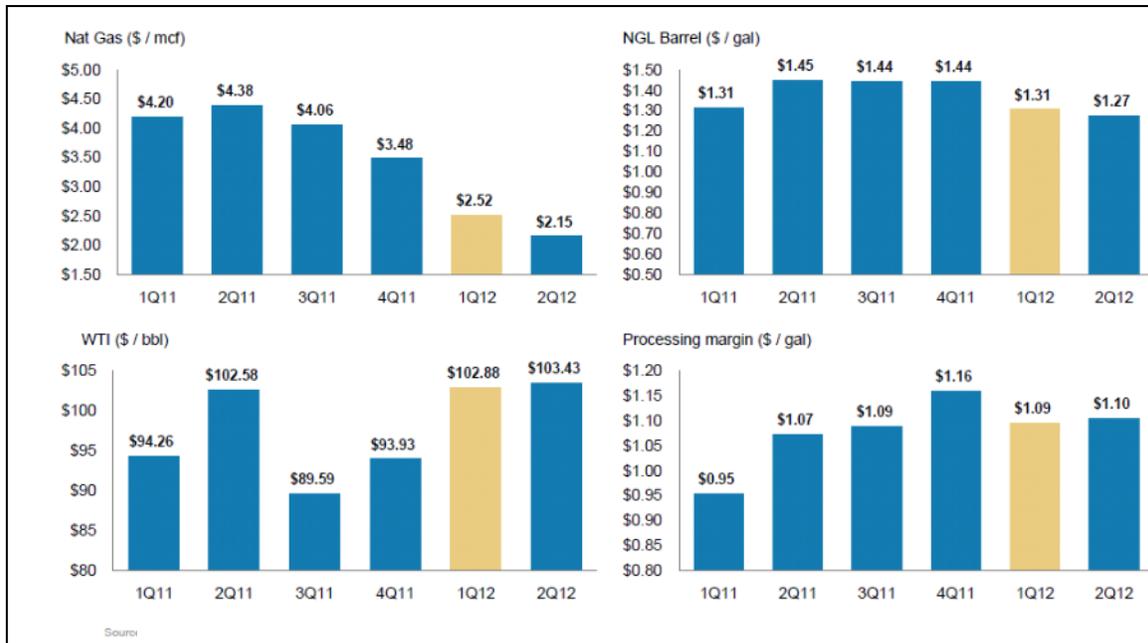


Source: ICIS.com

NGLs are very profitable today; NGLs require gathering & processing (G&P) services. Many of the shale areas lack sufficient G&P services. This is an important growth area for MLPs.

Gas Prices Remain Weak, While Oil is Strong

NGL Prices Have Dipped, but Frac Margins Are Wide

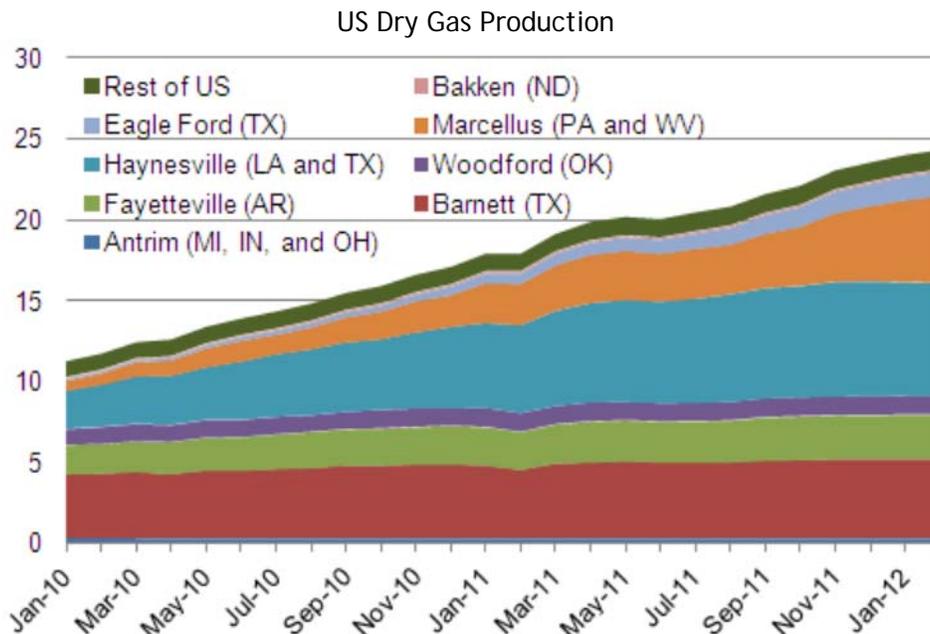


Source: Morgan Stanley, Bloomberg

MLPs with strategically located assets are at a clear advantage. G&P MLPs are making moves now to secure a footprint in the most attractive, growing regions. These shale areas also lack sufficient pipeline infrastructure for transporting oil, gas and NGLs. Energy product is being moved out of some areas by trucks and trains. The dynamics of North American and Gulf Coast crude and gas logistics are changing. This creates growth opportunities for MLPs. The Marcellus may become the primary source of NG for New York, but significant infrastructure is needed. Plans of new US energy infrastructure projects are being announced daily in April 2012.

Shale development has dramatically altered logistical needs:<sup>1</sup>

- ... Broad spectrum of infrastructure: field, transport, storage, distribution to market
- ... Product flow has changed: record exports of propane, refined products, and coal
- ... MLPs are gaining market share in the build out: lower cost of capital, operational advantages
- ... Breadth and duration of the cycle is unprecedented
- ... Shippers are committing to long-term capacity



Source: EIA

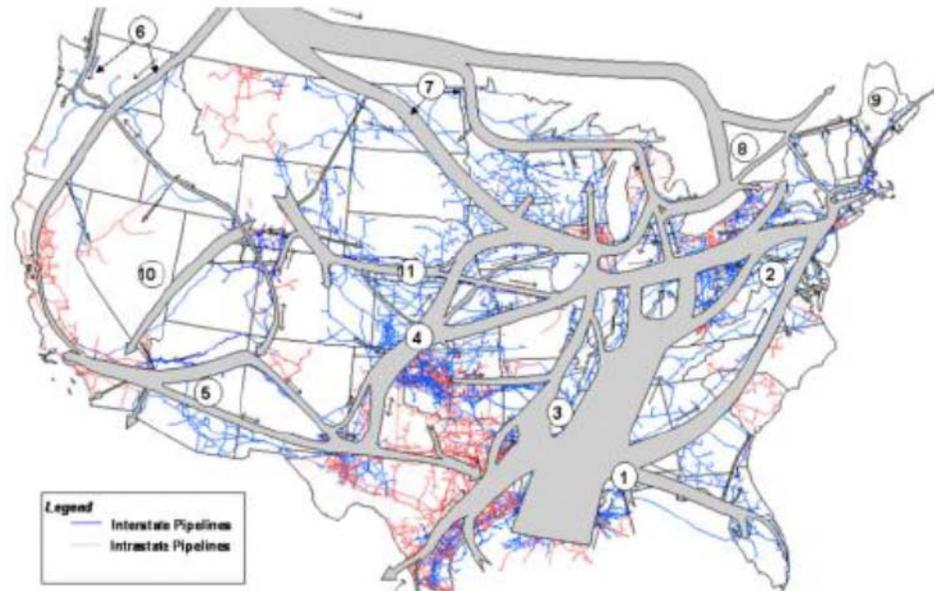
#### POWER COMPANIES: SHIFTING FROM COAL TO NG

There are two segments of the US power market: the regulated utilities and the unregulated utilities. The unregulated utilities are sensitive to their own price paid for energy. Many of the regulated power companies began shifting from coal to NG several years ago. The regulated utilities are not so sensitive to their cost of energy - regulations allow them to pass price on to the consumer. Both regulated and unregulated power companies are very sensitive to the new regulations they must follow requiring cleaner energy. These forthcoming regulations are prompting many utilities to shift from coal to NG; this shift will likely accelerate over the next few years. Many east coast utilities built

<sup>1</sup> Source: Barclays Capital

NG infrastructure in the 1970s which has remained idle for decades. These utilities should have an easy migration to the new fuel. Power companies will be the largest consumer and growth market for US NG over the next several years. The east coast power market is one reason producers and MLPs are eager to have sufficient NG infrastructure to move northeast NG along the eastern seaboard.

#### US NG TRANSPORTATION CORRIDORS



Source: EIA

#### EXPORTS: THE NEW GROWTH MARKET

The US has been decreasing its use of domestic crude oil (replacing with NG) as production has been increasing and price decreasing. Additionally, the price of US NG is significantly below the global market. The demand for oil and gas outside the US is growing. This creates opportunity for increased exports. The US has significant need for additional infrastructure and services to support this export growth. Marine terminals, port operations, processing and storage for export are an important focus and growth area for the MLP market. In recent years, LNG terminals were being used primarily for import of LNG and regasification.

Today, NG producers have their eye on the world market and exporting cheap US NG to Europe and Asia. South Korea, Japan and Spain are the world's largest NG importers. There is a large arbitrage opportunity to buy NG in the US and sell it on the global market. On April 16, 2012 Cheniere Energy Inc. won approval to build the largest US NG export terminal valued at \$10 billion. The terminal will be in Cameron Parish, La, next to its Sabine Pass gas-import terminal. Its MLP, Cheniere Energy Partners LP will build out and operate the terminal. Korea Gas committed to 3.5 million metric tons/year from the Cheniere facility. US NG is 30% cheaper than from Asian sources like Indonesia. Cheniere is awaiting approval for another LNG export facility in Corpus Christie, TX to go on-line in 2017-2018. Cheniere will become the largest NG exporter in the US. They will be hiring 3000-4000 people for the construction phase. The facility will have capacity for 2.2 bfc/d which represents 3% of the US daily supply. Cheniere secured long-term take or pay contracts from Europe, India and South Korea worth \$2.5 billion of revenue per year. On

April 17, Mitsubishi Corp and Mitsui & Co. announced plans to help Sempra Energy develop a \$6 billion NG export facility in Louisiana. In return for helping fund design, permitting and engineering work, Mitsubishi and Mitsui will each have rights to one third of the facility's export capacity for 20 years.

**MANUFACTURING: NG HELPS THE US BECOME COMPETITIVE ONCE AGAIN**

There is a renaissance of manufacturing returning in the US, and cheap NG as a replacement for coal is the driver. The US steel industry is once again able to compete on the global market. Manufacturing shifted decades ago to cheap labor markets overseas. Today, with US NG at approximately \$2.00 per BTU, US manufacturers are able to decrease their energy production costs by switching from coal to NG. Chemical companies and fertilizer companies are considering returning manufacturing back to the US as well. Overseas companies are bringing manufacturing to the US because our energy is cheap.

**DYNAMICS OF THE US NATURAL GAS MARKET**

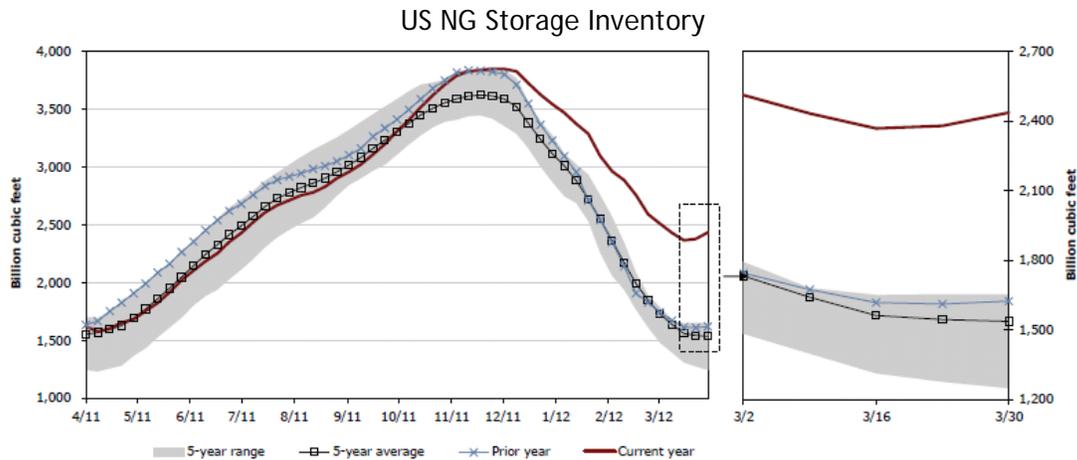
The spot price for US natural gas closed below \$2 on April 11, 2012 for the first time in 10 years. The US has a serious glut of gas, and production is not slowing down for the foreseeable future.

Historical & Forecasted US NG Prices



Source: EIA

Producers prefer to store, rather than sell, their NG at such low prices. US storage facilities are estimated to be completely full by September or October of 2012, unless the US has a very, very hot summer. Then full capacity may be delayed. In March 2012, the US had 700 bcf more natural gas in storage than in 2011; this is 530 bcf higher than ever before. These conditions create a difficult scenario for MLPs that are pure NG storage plays. Nonetheless, these very low NG prices will not last. Supply will return to balance with demand, but the situation will get worse before it improves.

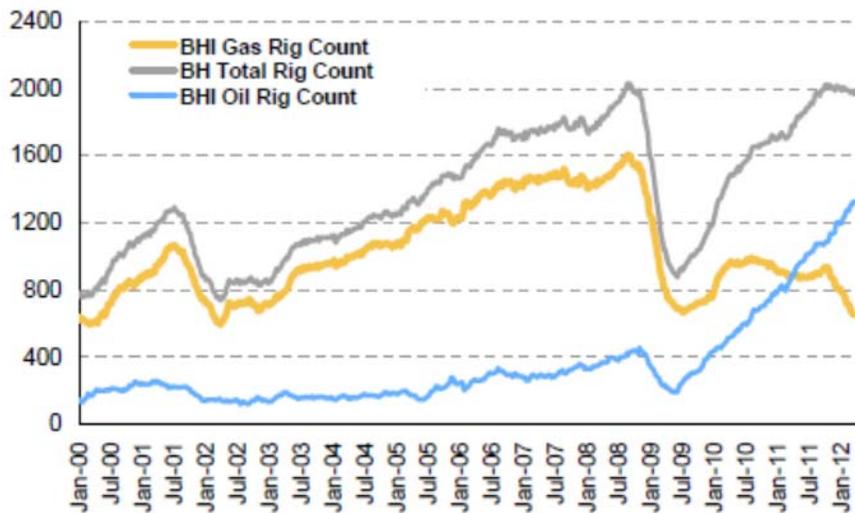


Source: EIA

Over the last 2 years, as previously mentioned, the US use of NG for power generation has increased significantly, but not enough to keep up with the robust production. Although producers of dry gas have begun shutting in wells, those fortunate enough to have wet gas (NG and liquids) or oil and natural gas, continue to pump. For the Q4 2011 year over year production of NGLs contributed 61% of the incremental volumes for natural gas. Liquid rich plays are attractive when oil is over \$65. By March 2012, only 5 major natural gas producers had reduced rig count. Rigs are moving from dry gas wells to crude oil and wet gas wells.

### US Rig Count

Source: Morgan



Source: Morgan Stanley

High crude oil prices make both crude oil and NGLs (driven off the ratio of crude oil to NG) very profitable business. Production of dry gas was up over 6% for 2011. The unusually warm US winter added further pressure to the problem. Some industry experts predict that NG prices may fall below \$1.50 by summer.

One impact of low natural gas prices is that the basis (price differential in various markets throughout the US) is very low to flat across the US. Therefore, long haul pipelines are at a disadvantage. The best opportunities today are regional pipelines and “bolt on” opportunities. Over the short term, the MLPs mostly likely to be impacted by the NG market are those with primarily NG pipelines. Generally, these pipelines have long-term take or pay contracts, protecting revenues for NG pipeline MLPs. Nonetheless, these MLPs run a risk when contracts turn over that the terms may not be as favorable. Those MLPs with NG pipelines are looking at several strategies: converting some pipes to be suitable for NGLs, becoming active in the crude oil area, or developing/increasing exposure to G&P. We have seen two major transactions from General Partners trying to position strategically for the changing energy landscape: ETE’s takeover of Southern Union (“SUG”) and Kinder Morgan Inc’s (“KMI”) takeover of El Paso (“EP”). Both acquisitions represent extensive natural gas pipeline networks and LNG operations. When the KMI merger is completed, KMI and its MLPs: KMP and EL Paso, will represent the largest NG pipeline company in the US. ETE with the SUG assets and ETP will be the 2<sup>nd</sup> largest NG pipeline system in the US. Although the price of NG is currently low, both KMI and ETE believe the NG will play an increasingly important role in US energy, in the domestic and export markets. Each has positioned accordingly.

The price outlook for NG is bleak for the rest of 2012. But the EIA projects that prices may rebound to \$4 by 2014. Price risks include continued high production (from oil and NGL rich shales), US and/or global recession, and weather. For MLPs, the sectors with the biggest risks include natural gas pipelines with contracts turning over in the next one to two years, propane and coal MLPs. Those MLPs with the best opportunities include: crude oil pipeline companies, NGL pipelines, gathering & processing MLPs, Marine Terminal operations and/or LNG facilities, Exploration & Production MLPs with oil and wet gas properties. We view the natural gas supply glut as a short term issue. Demand will catch up with supply. Most energy consumers are sensitive to price. We anticipate that the US NG market will come back into balance in 2014. Analysts are projecting a price target at that time in the \$4.00 to \$5.00 range. Over that period, demand from the power industry, residential and commercial, transportation and industrial will increase. But the big driver will be the utilities. The utilities are very important customers of the storage MLPs.

#### SUMMARY

Going forward, NG will capture share in existing and new markets. The biggest growth opportunities are: power market (replacing coal), residential and commercial (replacing oil and propane), exports, transportation and industrial. The current situation in the US provides a window to prepare for the resurgence in the price of NG - building infrastructure to prepare for new and existing markets.

Despite the current situation in the NG market, MLPs are generally well positioned and continue to be an important growth story:

- ... Shale production is growing and will further accelerate; producers are desperate for sufficient infrastructure
- ... The US needs another \$250 billion of natural gas infrastructure built over the next two decades; MLPs have important cost advantages
- ... US exports are likely to grow; there is need to appropriate services and infrastructure
- ... MLPs are growing market share in build out

MLPs have been weak since early March. As we approach the Q1 earnings season, we expect many of the best positioned MLPs to report strong earnings and distribution growth.

Some of 2012's best performers are this year's laggards. We see attractive value, growing and secure distributions and strong fundamentals throughout many of the sectors. MLPs are committing to projects today that will have them strategically positioned to serve the new US energy revolution.

*Virginia Reynolds Parker, CFA*  
*Chief Investment Officer and Portfolio Manager*

*April 2012*