

July 8, 2013

Natural Gas Trends

Highlights

Berry deal in jeopardy as Linn faces SEC probe

Shares in Denver-based Berry Petroleum and Houston-based master limited partnership Linn Energy plunged Tuesday after Linn announced that the Securities and Exchange Commission has launched an informal inquiry into its accounting and hedging strategies. A unique MLP that invests in exploration-and-production assets and then hedges 100% of that production for four to six years out, Linn is supposed to close its all-stock purchase of Berry, a Rockies oil and gas producer, this quarter. But Tuesday's drop in value of the currency Linn was going to use to buy Berry – stock in its C-Corp affiliate LinnCo – could derail the deal, according to some analysts. Linn and LinnCo both affirmed their intentions to go through with the \$4.3 billion acquisition, while Berry stayed silent all day.

Kevin Kaiser, an analyst with investment research firm Hedgeye Risk Management, thinks any deal will have to wait until the SEC issues Linn a clean bill of health. "It's likely that Linn and Berry will not close the merger while the investigation is ongoing, and Berry will be free to terminate the merger without paying the \$83.7 million termination fee if the merger does not close," Kaiser said Tuesday in a note to clients.

The regulator is examining Linn's use of financial measures that are not part of generally accepted accounting principles to calculate how much cash it can distribute to unit holders. Units in the parent MLP lost 19% of their value to close the market at a new 52-week low as \$27.05/unit on 14 times the normal volume of trading. Shares in LinnCo, a holding corporation made up of Linn Energy units and whose stock would be exchanged with Berry shareholders if the deal closes, lost 16.5% to close at \$30.90/share in heavy trading – an all-time low for the new stock issued in the fall of 2012. Under the terms of the pending deal, Berry shareholders are to receive 1.25 shares of LinnCo for every Berry share they own. On Tuesday, Berry's stock dropped nearly 6% to \$39.86/share as investors lost faith that any merger would happen. When the deal was announced, Linn said it would boost its production by about 240,000 Mcf/d of gas equivalent, or about 30%."

Both Linn companies said Monday night after the market closed that the Fort Worth office of the SEC had begun an informal inquiry into the proposed merger, as well as Linn's use of non-GAAP financial measures and its hedging strategy. "The SEC has stated that the fact of the inquiry should not be construed as an indication that the SEC or its staff has a negative view of any entity, individual or security," Linn said. "Linn and LinnCo are cooperating fully with the SEC in this matter." An extensive user of hedging to lock-in cash flows, Linn has been criticized by Hedgeye and others for amortizing its hedging costs over the life of the hedge rather than in the quarter the money was spent for the swap, put, etc. That practice increases the amount of cash it is able to distribute to its investors. The company has used this non-GAAP accounting method for years. "The SEC shining a light on Linn's non-GAAP measures will likely show investors how far they are from economic reality," Kaiser said. He thinks the end result will be a cut in the Linn MLP's cash distribution, which at \$2.90/year/unit was one of Linn's selling points.

Source: Platts Gas Daily

Data

- August 2013 Natural Gas Futures Contract (as of July 5), NYMEX at Henry Hub closed at \$3.617 per million British thermal units (MMBtu)
- August 2013 Light, Sweet Crude Oil Futures Contract WTI (as of July 5), closed at \$103.22 per U.S. oil barrel (Bbl.) or approximately \$17.80 per MMBtu

Last week: Texas and U.S. warmer than normal

For the week beginning 6/30/13 and ending 7/6/13, cooling degree days (CDD) were higher than normal (warmer) for Texas and for the US. www.cpc.ncep.noaa.gov

COOLING DEGREE DAYS (CDD)				
City or Region	Total CDD for week ending 7/6/13	*Week CDD +/- from normal	Year-to-date total CDD	* YTD % +/- from normal
Amarillo	72	-16	701	49%
Austin	110	-22	1175	1%
DFW	114	-19	1020	7%
El Paso	123	-3	1286	36%
Houston	131	5	1271	9%
SAT	123	-10	1301	7%
Texas**	109	-13	1110	5%
U.S.**	77	10	485	12%

* A minus (-) value is cooler than normal; a plus (+) value is warmer than normal. NOAA uses 65° Fahrenheit as the 'normal' basis from which HDDs are calculated. ** State and U.S. degree days are population-weighted by NOAA.

-999 = Normal Less Than 100 or Ratio Incalculable

Last week: U.S. natural gas storage at 2,605 Bcf

For the week ending 6/28/2013 working gas in storage increased from 2,533 Bcf to 2,605 Bcf. This represents an increase of 72 Bcf from the previous week. Stocks were 491 Bcf lower than last year at this time and 30 Bcf below the 5 year average of 2,635 Bcf.

Source: <http://ir.eia.gov/ngs/ngs.html>

U.S. WORKING GAS IN STORAGE				
Region	Week ending 6/28/13	Prior week	One-week change	Current Δ from 5-YR Average (%)
East	1,191	1,043	148	-7.2%
West	443	433	10	10.8%
Producing	971	957	14	2.0%
Lower 48 Total	2,605	2,533	72	-1.1%

Lower 48 states, underground storage, units in billion cubic feet (Bcf)

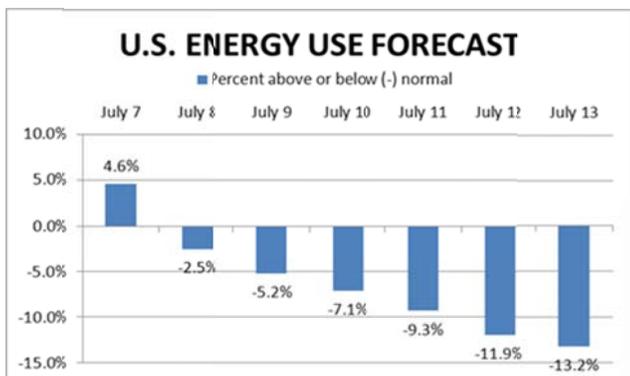
Last week: U.S. gas rig count increasing

The gas rig count for the U.S. was up two when compared to the prior week but was down 187 when compared to twelve months ago. The total rig count for the U.S. was up nine for the week and down 208 when compared to twelve months ago. The total rig count includes both oil and natural gas rotary rigs. Source: Baker Hughes

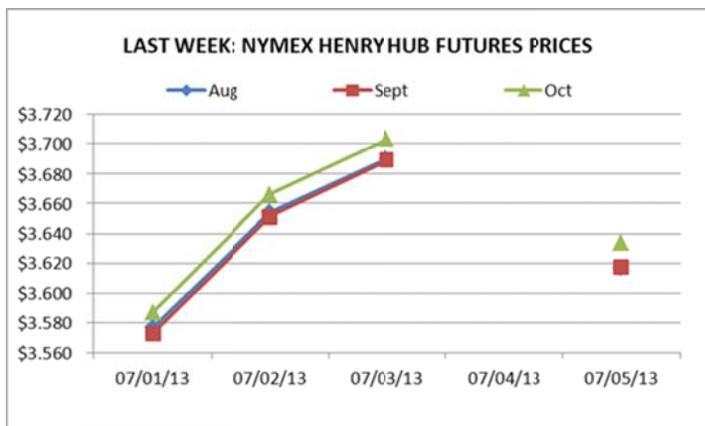
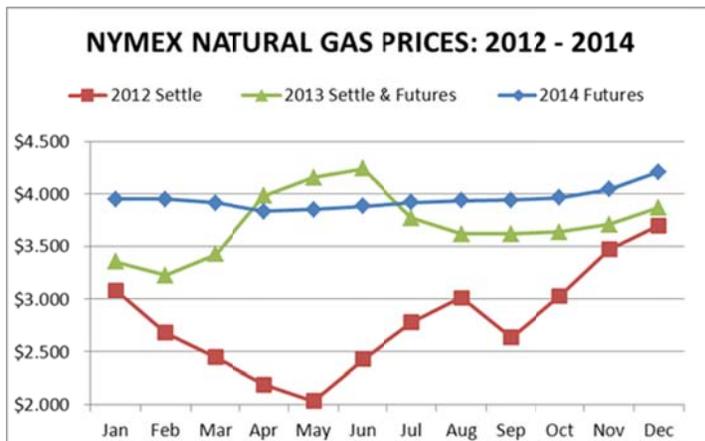
BAKER HUGHES ROTARY RIG COUNT				
	As of 7/3/2013	+/- prior week	Year ago	+/- year ago
Texas	835	3	927	-92
U.S. gas	355	2	542	-187
U.S. oil	1395	5	1419	-24
U.S. total	1757	9	1965	-208
Canada	214	8	264	-50

This week: U.S. energy use below normal

U.S. energy use is predicted to be below normal for most of the week, according to the Dominion Energy Index, as shown below. Dominion forecasts total U.S. residential energy usage, a component of which is natural gas. Source: Dominion Energy Index



2013 prices. Natural gas prices for 2013, shown below in green, are the NYMEX settlement prices for January-July and the futures prices for the remaining months of 2013.



NATURAL GAS PRICE SUMMARY AS OF 7/5/2013

	This Week	+/- Last Week	+/- Last Year	12-Month Strip Avg.
US August futures				
NYMEX	\$3.617	-\$0.039	\$0.843	\$3.811