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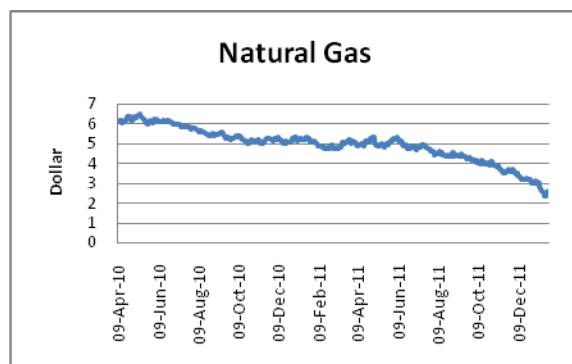
Natural Gas : A Value Buy



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Natural Gas Below Cost of Production:

Natural Gas producing companies are curtailing production and cutting down the drilling activities due to the mere existence of the vast gas reserves. The price of natural gas has already declined to the decade low levels. Limited production would automatically balance the gas market resulting into improved market price.



Source: Bloomberg, NB Research

The cost of production of natural gas varies from \$2.9-3.5 per thousand cubic feet of gas depending on the drilling technologies. The current price of natural gas is well below the production level and it is trading around \$2.56. Historically, we have seen that the commodity trading below its production cost represent lots of value.

Production Cuts due to gas trading at a decade-low price:

Natural gas is trading at its decade-low levels which have forced many producers and drillers to shutdown down their production and exploration in order to reduce a massive surplus that has pushed down the gas prices to 10-year lows.

Recently, Chesapeake Energy Corp, US second largest gas producer announced that it plans to cut its current daily production by 8 percent due to lower revenues and profits for drillers. Gross Production at wells it operates will be cut by as much as 1 billion cubic feet a day. It will also immediately curtail output of 500 million cubic feet a day. Chesapeake accounts for about 9% of the total US gas production.

This move follows recent announcements by Canadian producers such as Talisman Energy Inc. and Encana Corp. that they are cutting back drilling in their dry shale gas plays and shifting resources to develop natural gas liquids or tight oil fields.

Looking at the current scenario of gas market, we may see more production cuts across the major gas producers if the gas price continues to fall further.

Weather Concerns:

Generally, extreme weather for winters and summers keep natural gas prices high, due to boost in demand for home heating and power generation. However, this season's mild winter weather especially in the Northeast and Upper Midwest, has crimped demand and ultimately resulted into lower prices.

The initial few weeks of January have witnessed snowfall in most of the mid- west areas signaling that winters could improve after unseasonal warm weather. In February, we may see again stronger winter resulting in good demand of natural gas which would lead into drawdown in inventories.

Exports may boost prices:

Recently, EIA reported that eight companies are seeking permission to liquefy and export natural gas to the tune of 19 percent of the total production. Producers want to export some of the excess natural gas to higher-priced markets in Europe and Asia. Exporting natural gas would automatically help the markets to reduce the excess inventories which have continuously seen a built-up and would also ease the pressure on producers who are currently facing a loss as prices are trading below production cost. EIA also reported that the consumers and industry could spend 3 to 9 percent more each year over a 20-year period on natural gas because of expanded exports.

Technical Outlook:



Source: NB Research

Natural gas (Feb) have tested the previous bottom at 118 and witnessed buying interest, one can enter long around 130 with a stop loss of 115 for the target of 153 and 160. Oscillators are turning positive.

Conclusion:

We are of the view that you buy a commodity when prices are depressed, natural gas prices eventually kissed a decade low, but such times represents great opportunity for the long term investors. Looking at the massive inventories, huge ongoing production one may not justify the reasons for going long but we think lots of negative news have been factored in and decline in February contract of Natural gas should be used as good opportunity to go long. We would not be surprise to see natural gas again trading at Rs.160/mmbtu in months to come.

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