SPECIAL REPORT

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FRANK JUNGERS VISIT TO FERGUSON WELLMAN CAPITAL MANAGEMENT July 2008

From left to right: George Hosfield, Frank Jungers, Helena Lankton, and Shawn Narancich

In light of the high price of oil and its increasingly significant effect on the worldwide economy and investment portfolios, Ferguson Wellman Capital Management hosted Frank Jungers, former chairman and CEO of Aramco (now Saudi Aramco) to discuss the oil markets and his outlook for prices. Jim Rudd, CEO of Ferguson Wellman, kicked off the discussion by highlighting Jungers' distinguished career. He worked at Aramco for 31 years, a career that began in 1947 following Jungers' graduation from the University of Washington, and culminated with him as CEO of the now state-run oil company.

Today, Saudi Aramco is the world's largest oil company and supplies more export barrels to the global market than any other producer. Production is currently 9.7 million barrels/day, accounting for more than one of every 10 barrels consumed worldwide. Saudi Aramco is our nation's second largest crude oil supplier, shipping approximately 1.5 million barrels/day to the U.S. During his time in Saudi Arabia, Jungers dealt extensively with the ruling King Faisal, who was later assassinated.

Jungers developed lasting relationships with the Saudi ruling family that continue to this day, having visited the kingdom twice already this year. Long since retired, Jungers and his wife now reside in Oregon. In addition to a storied and successful career at Aramco, he has been a board member of several leading corporations, spanning industries from Donaldson, Lufkin & Jenrette in investment banking to Georgia Pacific in the timber industry.

Following is the discussion between Frank Jungers and Ferguson Wellman's investment and client services team on Monday, July 7:

George Hosfield**:** "How accurate is the media in disseminating oil market news and providing meaningful commentary about industry developments?"

Frank Jungers**:** "The media gets pieces of it right, but they tend to take liberties in making conclusions that aren't always accurate." He used President Bush's recent visit to Saudi Arabia as an example where the press reported that Bush was unsuccessful in his attempts to get Saudi Arabia to increase oil production. In reality, Jungers points out that Saudi Arabia subsequently increased its light, sweet oil production by 200,000 barrels/day, which he reports is all the excess capacity the Kingdom had in this category. The world is not running out of oil, but capacity is tight for the easy-to-refine, low-sulfur varieties that most refineries worldwide are capable of processing. Jungers then cited several examples of new joint refining ventures that Saudi Aramco has embarked upon to increase its capacity to process this heavier, sour crude. In cases such as its joint venture with Shell in Texas, the refinery complex is being reworked to process these lower-grade crudes. Saudi Aramco is also working on refining joint ventures in China and within the Kingdom itself, the latter which is a joint venture with Total. In addition to boosting sour crude refining capacity, Saudi Arabia is investing in microbe-based processing technologies and other research to boost production.

***Jim Rudd*:** "What role do you think speculation plays in today's oil price?"

Jungers: "The market is speculative, and one could argue that this has an effect, but largely, I don't feel that there is a speculative bubble." He discussed the role of risk discounting in the markets, and opines that this at times may be overblown, but sees this as a transitory effect.

***Lori Flexer*:** "None of us in this room thought we'd see oil prices where they are today; what is the tipping point for prices?"

Jungers: "I don't see anything in the near-term that is going to change the current industry dynamics." In addition to the increasing scarcity of light, sweet crude, he cited inflation and the weak dollar as part of the reason for current prices. Nevertheless, he conceded to being surprised by how fast oil has risen recently.

***Shawn Narancich*:** "We have been hearing for sometime the former Saudi Aramco CEO and now minister of petroleum Ali Naimi comment about how oil prices are being inflated by speculators. Yet you cite increasingly tight supplies for the premium prices being placed upon light, sweet crude. How come the Saudis are blaming speculators when they should know better?"

Jungers: "Saudi Arabia is concerned about prices and matching buyers' needs. Thus, they are trying to calm the markets by emphasizing their abilities to meet changing demand."

***Marc Fovinci*:** "It seems as though the supply and demand equation in oil has been tipped on its head. How do we reconcile what we see in prices relative to new investment in oil production and the effect of pricing on demand at current levels?"

***Jungers*:** "Thirty years ago, Saudi Arabia believed that recoverability was limited to only about 30 percent of estimated reserves. Today, high oil prices and advanced recovery techniques such as directional drilling allow Saudi Aramco to extract as much as 60 percent of a field's estimated reserves." He went on to say that Saudi Arabia discovered major fields such as Khurais several decades ago, but is only now developing them, and gave an example of one such field in the South that is ramping production from 600,000 barrels/day currently to 1,000,000 barrels/day in the near future. In this field, recovery rates are estimated to be 50 percent. He reiterated his belief that there is still oil out there to be found and produced economically.

***Dean Dordevic*:** "What are your thoughts about the recent Wall Street Journal article highlighting the differences of opinion about oil prices and resource availability, as presented by two former Saudi Aramco insiders?"

***Jungers*:** "Both Sadad al-Husseini and Nansen Saleri are good people, but they approach the industry from opposite sides of the issue. Husseini was an explorationist and in upper management and Saleri was strong in oil reservoir engineering. They see the issue from different angles."

***Dordevic*:** "Who is right?"

Jungers: (laughter in the room) . . . ?

Flexer: "Where do you see oil prices in the next 12 to 24 months?"

Jungers: "I don't see the supply/demand equation changing much in the next five years. Price is going to increase. Conservation and wind power are good, but wind power can account for only an estimated 14 percent of demand at projected peak output; the wind doesn't blow all the time."

Rudd: "Who are Saudi Arabia's largest customers?"

Jungers: "China, the U.S., and Europe are all big customers." He allowed for the fact that developed economy demand is waning at today's prices, but observed that demand continues to increase in emerging markets. Russia's production is stagnant and as their economy expands, energy usage is increasing. As well, Saudi Arabia itself is developing rapidly and using more of its own production to fuel a growing economy.

Don Rainer: "How does Saudi Arabia perceive us?"

Jungers: "They know us well, perhaps better than we care to believe."

Rudd: "What is Saudi Aramco's capital spending budget?"

Jungers: "They have a $130 billion spending plan, which typically runs over a five-year period." He proceeded to say that this includes what are known as downstream investments in the oil refining and petrochemical sectors.

Narancich: "You have told us that production of light, sweet crude is increasingly hard to come by, and that infrastructure to process the heavier grades of crude is lacking. Has the nature of Ghawar (the largest Saudi Arabian oil field) and its oil mix changed materially over the years?"

Jungers: "Ghawar is an old reservoir, and it is increasingly being backed up with saltwater injection to stimulate production (pressure maintenance). Nevertheless, output at Ghawar is stable at current rates and in similar proportions of light/heavy output relative to years past."

Rudd: "How about the oil supply coming from Iran and Canada?"

Jungers: "Iran's oil production features fractured producing zones caused by formation movement, a phenomenon that limits its ability to increase production at competitive costs." He acknowledged the oil sands production in Alberta and Saskatchewan, but observed that Canada is using more natural gas to heat the oil sands, a key process used to produce the synthetic crude. As a result, he estimated that Canadian natural gas exports to the U.S. will suffer.

Narancich: "You mentioned the Khurais field earlier in your discussion about new fields that are coming online in the kingdom. We recently received confirmation that this field is on pace to begin producing over a million barrels/day by the spring of 2009. What kind of oil does Khurais offer?"

Jungers: "Oil from Khurais is a medium-grade crude." He observed that as with other new production coming on line, it will require a degree of specialized refining equipment to process. He circled back to a key theme by stating that there are "no simple answers" to the challenge that today's energy markets pose.

Rudd: "You participated in many OPEC meetings over the years. How does OPEC work?"

Jungers: "OPEC is an organization of oil producing and exporting countries currently comprising 11 nations." Not all OPEC nations are Arab, and he provided the examples of Nigeria and Venezuela. On the other hand, exporting nations in the Middle East, such as Egypt, are not part of the cartel. Tax issues were responsible for its formation, and Jungers observed that despite opinions to the contrary, OPEC is not a monopoly (he cited De Beers as the only true monopoly, that being in diamonds). He observed that despite OPEC's best efforts to unify production plans, nations in many cases produce according to their national interests, which usually means maximizing output. He acknowledges that there is some arm twisting and cajoling among members, but it is imperfect at best.

Narancich: "We have been hearing about a handful of Iranian oil tankers on the water, with no apparent buyers for their cargo. You mentioned earlier in your comments that Iran produces a mix of light and heavy crudes, so how do we interpret this paradox?"

Jungers: "Iran's oil company was run by a consortium of interest groups, who often operated relative to their own specific interests and their own crude requirements. Iran has not geared their production to the recent market needs, thus their buyers' requirements may have changed."

Rainer: "While working overseas for Aramco, in how many countries did you live?"

Jungers: "I lived in Saudi Arabia most of the time, for all but one year when I lived in Lebanon." He described the changes that have occurred in the Middle East because of oil wealth, indicating that as far as oil wealth goes, Abu Dhabi's is most visible.

Hosfield: "Can you foresee oil prices falling back materially from here?"

Jungers: "Prices could fall from here, and $100 is possible." He proceeded to opine that such a pullback would be temporary, with oil prices driven back up by increasing demand from emerging economies.

Narancich: "Do you think the advent of electronic trading and cash settlement for oil contracts has influenced the price gains we've seen?"

Jungers: "At times, you might get demand and supply surges not directly related to the oil industry, but rather political events that move prices by, say, $25/barrel, but these changes are temporary."

Rudd: "How does Saudi Arabia feel about the issue of political instability in the Middle East?"

Jungers: "Iraq is more stable than we think. The security situation there has improved. Saudi Arabia is politically stable, at least for the foreseeable future." In general, he feels that the Middle East is better off than most perceive. "Is there a push for democracy in the Middle East?" he asked rhetorically. "No."

While he would not be buying oil itself at these levels, Jungers thinks that opportunity remains in exploration and production companies and oil service providers, companies that stand to benefit from his thesis of high commodity prices for the longer term. Ferguson Wellman-managed portfolios retain a full market weighting in the energy sector, owning companies that continue to benefit from high petroleum prices.