Investment Management of Virginia, LLC
The Energy Portfolio
1st Quarter, 2013

The Energy Portfolio Composite was up 2.6%, net, for the quarter.[1] The S&P Energy Index was up 10.2% over the same period. The Philadelphia Oil Service Index (OSX) gained 11.9%, and the Philadelphia Exploration and Production Index (EPX) was up 8.5%.

The Portfolio[2]

The two stocks that dragged down performance in 2012, continued to weigh on the Portfolio in Q1 – Niko Resources and SandRidge Energy. After a dismal performance in 2012, Niko slid a further 40% in the first quarter. There have been two basic issues weighing on NKO. First and foremost, the Indian Government has yet to formalize a deal that would essentially double the price NKO receives for its gas from $4.00 to $8.00 per mcf. This decision has been "imminent" for the last 6 months. Second, the company's four recent high impact exploration wells have all been dry holes. This has been a prolonged period of extraordinarily bad luck, but we believe the worst is behind NKO and that the stock should do well from here. SandRidge declined 17% in the quarter. The company has reduced the Estimated Ultimate Recovery (EUR) from its Mississippian wells for the second time in six months. This is disappointing news and materially limits the potential upside in this stock. In a recently concluded successful proxy fight, we voted with the activists to remove the current board of directors. We believe that this result essentially puts the company in play, and that a take-out could happen at a 50% premium to the current stock price.

During the quarter, we trimmed our position in Cree, our only energy technology position. We initiated a position in Oasis Petroleum. Oasis is a very well-run company focused on the Bakken Shale. Its production and reserves are almost all oil.

The Global Energy Outlook

Oil prices remain relatively robust with West Texas Intermediate and Brent hovering in the mid-$90s and $110s per barrel, respectively. Of the two, Brent is far more important to global activity as many more classes of crude are benchmarked to Brent than to WTI. Given high Brent prices, and high global LNG prices (benchmarked to Brent), we expect global upstream spending to continue to increase at a moderate pace, as it did in the fourth quarter. Areas of strength include deep-water Gulf of Mexico, offshore Africa, and Asia/Pacific. Onshore hotspots include Russia, the Persian Gulf (Iran excluded), and Central/South America.

North American natural gas prices continued the recovery that began in the second half of 2012, with prices closing the quarter at just above $4.00 per mcf. On the heels of a 48% decline in the natural gas rig count in 2012, we have seen a further 8% drop in the first quarter of 2013; the gas rig count now hovers below 400 rigs, the lowest level since 1999. This drop finally has caused production to roll over. The January EIA 914 data showed the first year/year decline and the fifth consecutive month/month production decline. If this trend continues, the second half of 2013 could see production down 2-3% on a year/year basis. Industrial demand, the largest single component of total natural gas demand, continues to increase. The January data showed gains of 2.9% year/year – the 10th straight month of year/year increases. The combination of falling production, increasing industrial demand, and a smaller surplus of gas in storage sets the stage for a more constructive price environment in 2013 than we experienced in 2012. We do believe that the ability to bring production on-line quickly and the ability of power companies to substitute coal for natural gas will prevent prices from spiking

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[1] Past performance is no guarantee of future results, and no representation is made that results similar to those shown can be achieved. To receive a complete list and description of Investment Management of Virginia, LLC's composites and/or a presentation that adheres to the Global Investment Performance Standards (GIPS), contact Investment Management of Virginia, LLC at (804) 643-1100.

[2] The transactions/securities discussed in this section are generally portfolio-wide transactions for the accounts in this Portfolio and have not been selected by any performance criteria. It should not be assumed that all accounts in the Portfolio had the same transactions or that transactions in the future will be as profitable or will equal the performance of the securities mentioned.

above $5 per mcf. That said, the fundamentals appear to be in place to prevent another 2012-type collapse of gas prices.

We believe that continued strength in oil prices and strengthening gas prices, coupled with excess service capacity in North America, should create a strong operating environment for domestic E&P companies. While domestic service companies have reported stabilization in pricing, we think that the move to development drilling and greater capex discipline will continue to weigh on this sub-sector. International and offshore service providers are experiencing a much more robust environment.