“Motherfrackers” and Big Oil Hypesters

by Deborah Lawrence, originally published by Energy Policy Forum | TODAY

Forbe’s contributor Christopher Helman has always been an unapologetic supporter of shales. For instance, only last September he wrote a piece entitled “America’s Energy Outlook is Fracking Great, For Now”. Never mind that oil prices had begun their downward spiral three months prior to this statement. Never mind that every shale gas play in the US with the exception of the Marcellus had already tipped into decline. And never mind that reserve estimates had been repeatedly downgraded culminating with the colossal downgrade of the Monterey shale in California by 96% by EIA. You bet…fracking great!

Christopher Helman, however, is paid to hype Big Oil. And to his credit, he does occasionally mention a few problems as he tries to gloss over their implications. For instance, in this same article dated September 2014 he states:

“At the same time, they have to get their volumes up high enough that they can generate enough free cash flow to pay back their debt. If you can’t drill economically it all unravels.”

Yes, it does.

There's just one problem. Shale operators have never been able to get their volumes up high enough to generate free cash flow though Mr. Helman leaves one with the impression that they have. But they haven't…at least not since 2009! That's right, 2009.

Examining a universe of 21 shale operators including all the usual suspects, free cash flow has been overwhelmingly negative since at least 2009. Only three companies of the 21 have ever had positive free cash flow during that time frame. And even then it was nominal and not consistent.

Mr. Helman, however, glossed over this but went on to state with his usual hyperbole that:

"What is news is that the boom is showing no signs of slowing down."

Well, not exactly!

Shortly after Mr. Helman's statement, rig counts plunged. In fact, the plunge has been so precipitous that it is without precedent. Operations too are now being funded by massive amounts of additional debt. Never mind that there was too much debt already. Companies like Chesapeake and Range Resources would need between 15-20 years to pay off their debt if they used 100% of net income. Continental would need about 10 years. Further, Global Data conducted a review in April 2015 and found that debt and equity offerings from America's game changing shale revolutionaries had soared off the charts…again. There have been a total of 78 deals including private equity and venture capital which totaled $30.6B just in March 2015 alone. This was a tremendous increase over the prior month which saw deals valued at $12B. But perhaps most troubling is that the majority of the offerings in March were debt. A full 70% of the total or $21.4B in one month! Again this was a substantial increase from February which saw $7.5B in debt. Funding operations with this much debt is not a sustainable business model particularly when your wells don't cash flow. There seems to be financial disconnect here. At some point, you have to be able to pay this debt off. Or at least that is the way it used to work. Perhaps this gives a whole new meaning to shale operator claims of "game changer".

Going back to Christopher Helman's statement that "if you can't drill economically it all unravels", it should be noted that large investors and hedge fund managers are also starting to grouse about shale investments. At the the annual Sohn Investment Conference in New York this week, David Einhorn, manager of Greenlight Capital, one of the most successful hedge funds had this to say about the shale investments:

"We object to oil fracking because the investment can contaminate returns."

Yes, they can. Just ask KKR or Apollo or Carlyle …all private equity funds that have been singed by shales in the past 6 months. In the last quarter of 2014, Carlyle's profit declined about 68%; Apollo saw losses of about 79%; and KKR got smashed at 94%. All thanks to shales.

Mr. Einhorn went on to state that the large investment banks had helped the industry raise monies they would never be able to pay back. I actually wrote a report about this in 2013. Wall Street banks pushed shales hard after the economic downturn and shales became the number one profit center at many of these banks replacing mortgage backed securities in terms of fees generated. But the fundamentals of shales were shaky even then. Mr. Einhorn stated:

"The banks are clearly incentivized to help the frac-addicts."

Hey, the banks made a ton of money being financial pushers! But investors have not made money. The majority of shale company stocks have significantly underperformed the market during the self styled shale revolution. The only operator to match the index consistently was EOG while the majority turned in dismal share returns. And these were the operators who were considered the biggest and best in each play.

Mr. Einhorn's comments created quite a stir and the WSJ dutifully came to the rescue. The publication like Forbes has been very vocal in its support of shale operations. In an attempt to poke holes in Mr. Einhorn's assesment of the shale business model, the WSJ quoted Paul Sankey of Wolfe Research:

"Pioneer is the single most attractive takeover target to ExxonMobil, and the entire group Mr. Einhorn listed as short candidates based on a value-destructive business model, has takeover merits,"…adding the potential for a takeout is at least part of why the market is overvaluing Pioneer.'"

Really? Is that the best the WSJ could come up with? Well, Exxon Mobil will find Pioneer a much more attractive takeover target when its underlying assets are fairly valued rather than based on specious hyperbole.

There is a wonderful axiom which states that when nearly everyone holds the same opinion, that opinion is almost always wrong. This sums up shales. Too many people became intoxicated with the idea of shales and business as usual for the energy markets. But shales never performed up to expectations. In fact, shale companies have performed so poorly that Mr. Einhorn referred to one shale company, Pioneer Resources, as the "Motherfrackers".