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Mounting Negative Cash Flows Highlight Struggles of Appalachian Fracked Gas Producers

Companies Perform Poorly, Even Compared to Wider Industry Adversity

Faced with persistently low natural gas prices, exploration and production (E&P) companies with operations in Appalachia continued to struggle financially in the third quarter of 2019. An IEEFA analysis reveals that seven of Appalachia's largest producers collectively spent half a billion dollars more on drilling than they realized by selling oil and gas last quarter.

Appalachian Gas Drillers Struggle on Wall Street

Percentage change in stock prices since January 1, 2019, for selected companies.

Source: Nasdaq

Appalachian natural gas companies use unconventional techniques (hydraulic fracturing, or fracking) that have propelled the U.S. to become the world's largest producer of natural gas. Much of America's gas production is from Appalachia, primarily from the Marcellus and Utica shale basins. Among Appalachian states, Pennsylvania led the way, ending 2018 as the second-highest gas producer in the U.S., behind only Texas.

But production growth has not led to financial success. Despite booming gas output, Appalachian oil and gas companies consistently failed to produce positive cash flow over the past five quarters.

With prices of gas averaging $2.38/MMBtu in the third quarter, down 18 percent from the third quarter one year ago, only two of the companies in our sample, Cabot

Oil & Gas and Gulfport Energy, had positive cash flow during the quarter. The other five—Antero, Chesapeake Energy, EQT, Range Resources, and Southwestern Energy—all experienced negative cash flows, with Chesapeake and EQT leading the plunge, posting negative cash flows of $264 million and $173 million, respectively.

Analysts expect natural gas prices to remain depressed for the foreseeable future. IHS Markit forecasts that natural gas benchmark prices in 2020 will be the lowest level in decades, due to a persistent oversupply. Much of the supply glut can be traced to the Permian Basin in Texas and New Mexico, where gas is often an unwanted by-product of oil production. Permian gas has become so uneconomic that some oil producers simply burn their natural gas rather than selling it, with Permian flaring hitting an all-time high in the third quarter. Earlier this year, Permian gas prices briefly turned negative, as some oil producers actually paid to have their gas transported out of the basin. But since both gas and oil come from the same Permian wells, oil companies continue to overproduce gas, further saturating the market.

Negative cash flows among fracking-focused companies are just one sign of

challenges facing the industry. Layoffs, reductions in permits, wells, and rig counts also signal slowdown in the industry.

In 2019, Range Resources laid off employees in its Southpointe, PA, offices, and EQT fired nearly a quarter of its workforce. And Chesapeake continued to reduce its workforce after terminating 400 employees in 2018.

Shale gas producers have also drastically cut their requests for drilling permits in Pennsylvania as they seek to tighten expenses. For example, in October 2019, shale gas permits in Pennsylvania were only half the levels of the prior year.

Decreased rig counts are another signal of the financial slowdown. Ohio, for example, had only 12 rigs operating in early November, compared to 18 rigs one year ago.

The stock market decline among shale producers in Appalachia has been even steeper than across the U.S. fracking industry.

Production increases are no longer enough to mollify investors, who have severely punished the companies throughout the E&P sector. For example, the ETF XOP, which tracks oil and gas exploration and production companies, is down 33 percent over the past year, while the S&P 500 increased by 18 percent. The XOP ETF includes fracking-focused companies throughout the country. But the stock market decline among shale producers in Appalachia has been even steeper than the broader selection of U.S. fracking-focused companies. The market has signaled just how dire these companies' prospects are, with one-year stock declines ranging from 31% (Cabot Oil & Gas) to 83% (Antero Resources).

In response to investor concerns about persistently negative cash flows, E&P companies have promised to reduce their capital expenditures. Some have publicly stated capital cutbacks will continue throughout 2020. Over the last five quarters, these seven E&P have spent nearly $13 billion in capex, though their quarterly capex spending has dropped in 2019 overall, including a $943 million, or nearly $1 billion, drop from Q3 2019 compared to Q3 2018.

Even with the decline in capex, however, the seven Appalachian fracking companies spent over half a billion more in the third quarter than they realized selling oil and gas (primarily gas). Investors have concluded that these companies' prospects have become ever riskier as the glut of natural gas shows no sign of easing.

Even though Appalachian gas companies have proven that they can produce abundant supplies of gas, their financial struggles show that the business case for fracking remains unproven. Careful investors should view the entire fracking industry as a speculative venture with a poor track record and shaky prospects.

Data and Methods

This IEEFA analysis was based on the financial performance of seven US-focused oil and gas exploration and production companies with significant focus on the Appalachian shale basins, Utica and Marcellus. Two of the companies in the sample, Chesapeake Energy and Gulfport Energy, have operations in other shale basins in the U.S., such as the Permian and Bakken. This report excludes companies that have filed for bankruptcy since 2010, or lacked comprehensive income or cash flow data over the past five years.

Appendix

Free Cash Flow, Selected Fracking Companies ($US Millions)

Company	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	Total, 5 Quarters
Antero Resources Corporation	(146)	287	67	(124)	(94)	(10)
Cabot Oil & Gas Corporation	(18)	69	390	101	72	614
Chesapeake Energy Corporation	(57)	(126)	(74)	(178)	(264)	(699)
EQT Corporation	(252)	(351)	500	49	(173)	(227)
Gulfport Energy Corporation	22	33	(5)	(107)	79	22
Range Resources Corporation	20	26	47	(14)	(74)	5
Southwestern Energy Company	(17)	(30)	184	(227)	(95)	(185)
Total, Selected E&Ps	**(448)**	**(92)**	**1,109**	**(500)**	**(549)**	**(480)**

Source: Morningstar, company reports.

About IEEFA

The Institute for Energy Economics and Financial Analysis conducts research and analyses on financial and economic issues related to energy and the environment. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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