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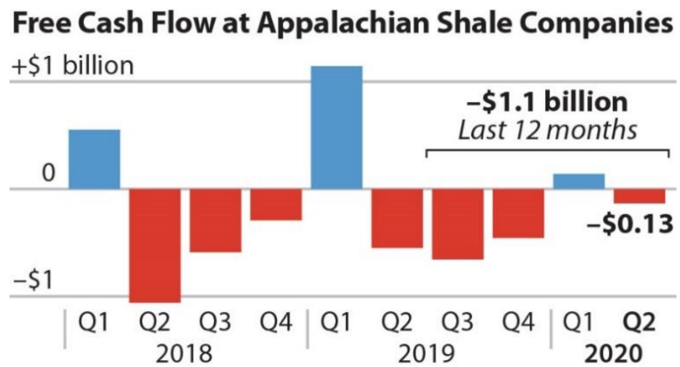
Despite Capex Cuts, Appalachian Frackers Report Negative Free Cash Flow in Second Quarter 2020

Red Ink Exceeds $1 Billion for Past 12 Months

An IEEFA analysis reveals that nine shale-focused gas producers in Appalachia continued their financial losing streak in the second quarter of 2020, collectively spending $134 million more on drilling and other capital expenditures (capex) than they generated by selling oil and gas. These disappointing financial results are in line with the Appalachian fracking sector's dismal long-term performance.[1]



Source: Company reports

The aggregate negative cash flows during the quarter came despite deep cuts in capital spending. The nine companies in IEEFA's sample spent $1.9 billion in the quarter on capex—a 35% year-on-year drop, and the lowest quarterly total in more than six years. Since mid-2017, these companies had averaged $2.7 billion in capital spending per quarter.

Rock-bottom natural gas prices hurt the sector's quarterly results, with monthly benchmark U.S. gas prices dipping in June to $1.63 per million British thermal units (MMBtu), their lowest level in decades.[2] However, several Appalachian shale producers used financial hedging strategies to soften the blow of low prices. EQT, for example, netted $315 million from commodity derivatives for the quarter, around 70 percent of its $447 million operational cash flows.[3]

Key Findings

- Nine fracking-focused gas companies in Appalachia reported $134 million negative free cash flow in Q2 2020.
- Over the past 12 months, these companies generated $1.1 billion negative free cash flow.
- In aggregate, capital spending was $1.9 billion in the quarter, a 35% year on-year drop.
- Capital investments during the quarter were the lowest in at least six years.

[1] IEEFA. In Extremis: Crisis Mounts for Appalachian Shale Producers. March 2020.
[2] EIA. Henry Hub Natural Gas Spot Price.
[3] EQT. Form 10-Q. July 27, 2020, p. 24

Meanwhile, cutbacks in U.S. gas output have helped lift prices by more than 50% since their June lows, modestly boosting stock prices for some gas-focused fracking companies. Yet these recent stock gains were overshadowed by a long-term collapse in the market value of Appalachia's top gas producers. The market capitalization of Antero Resources, for example, plummeted more than 90% over the last five years, dropping from $9.8 billion in 2015 to $790 million at the end of June 2020. And EQT, the U.S.'s largest gas producer, has seen its market cap drop 74% over the past five years, from $12.5 billion to $3.2 billion.

The shale revolution has propelled the U.S. into becoming the world's most prolific gas producer. Yet in financial terms, the gas production boom has been an unmitigated financial bust, with most fracking-focused companies, including major Appalachian gas companies, regularly reporting negative free cash flows. Free cash flow—the amount of cash generated by a company's core business, minus its capital spending—is a crucial gauge of financial health. Positive free cash flows enable firms to pay down debt and reward stockholders. Negative free cash flows, by contrast, force companies to fund their operations by dipping into cash reserves, selling assets, or raising new money from capital markets.

Negative free cash flows have made debt repayment an ongoing challenge for Appalachian gas producers. One of the nine companies in our sample, Chesapeake Energy, filed for bankruptcy during the quarter, counting on bankruptcy courts to lighten a debt load that the *Wall Street Journal* described as "immense" and "unsustainable."[4] At least 11 other Appalachian gas producers have filed for bankruptcy protection over the past five years.[5] Gulfport Energy retained a restructuring advisor in the first quarter and, in Q3 2020, warned that it may file for bankruptcy if it cannot restructure its debt, including a $1.5 billion revolving loan that matures in 2021.[6,7,8]

This financial distress seems far from over. In an apparent vote of no confidence in the future of the region's gas industry, international energy giant Shell sold its remaining Appalachian gas assets for $451 million to National Fuel Gas. Shell had acquired these assets, including more than 400,000 acres in Pennsylvania, as part of a $4.7 billion deal in 2010.[9]

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[4] Wall Street Journal. Chesapeake Misses Interest Payment, Starts Bankruptcy Countdown. June 15, 2020.

[5] The 12 shale producers focused on Appalachia that filed for bankruptcy between 2015 and 2020 are: Magnum Hunter (2015); Warren Resources, Penn Virginia, Stone Energy, and Ultra Petroleum (2016); Ascent Resources, Rex Energy, EV Energy Partners, and EXCO (2018); EdgeMarc, Arsenal Resources (2018) and Chesapeake Energy (2020), based on an several reports in Marcellus Drilling between 2105 and 2020.

[6] Reuters. Natural gas producer Gulfport Energy taps debt restructuring adviser: sources. March 18, 2020.

[7] Wall Street Journal. Gulfport Warns on Risk to Business if It Can't Refinance 2021 Debt. August 7, 2020.

[8] Gulfport Energy. Form 10-Q. August 6, 2020, p. 12

[9] National Fuel. National Fuel to Acquire Shell's Integrated Upstream and Midstream Assets in Pennsylvania. May 4, 2020.

Moving forward, Appalachia's gas industry may attempt to shore up its cash performance by cutting capital spending to the bone and using hedging strategies to cushion itself from volatile prices. Companies may sell off long-term royalty interests to raise short-term cash. Yet these moves would add to the pessimistic signals that industry insiders are already sending: As EQT's CEO said in its most recent investor conference call, "Based on the current price environment, we expect to run this business at a maintenance level for the next several years."[10]

Faced with an uncertain demand outlook and volatile prices, Appalachian fracking companies are reining in production, cutting drilling budgets, and touting capital discipline. They remain cautious, even skittish. Lenders and investors would be wise to do likewise.

[10] Fool.com. EQT Q2 Earnings Call Transcript. July 27, 2020.

Table 1: Cash Flows from Operations, 2018-Q2 2020, in millions

Eikon ticker	Mstar ticker	Company Name	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
AR	**AR**	Antero Resources Corporation	542	297	421	822	539	218	198	148	201	116
COG	**COG**	Cabot Oil & Gas Corporation	273	274	242	316	585	327	271	263	205	136
EQT	**EQT**	EQT Corporation	904	637	904	531	871	444	319	218	500	447
GPOR.o	**GPOR**	Gulfport Energy Corporation	226	185	220	155	240	160	218	107	131	116
RRC	**RRC**	Range Resources Corporation	371	175	229	216	261	185	104	132	125	79
SWN	**SWN**	Southwestern Energy Company	364	300	307	252	442	101	196	225	160	94
CNX	**CNX**	CNX Resources	259	192	239	196	309	252	305	114	267	144
CHK	**CHK**	Chesapeake Energy	588	363	444	335	456	397	329	441	397	376
NFG	**NFG**	National Fuel Gas	191	229	97	104	236	230	124	168	223	233
		Total, Selected companies	**3,718**	**2,652**	**3,105**	**2,927**	**3,939**	**2,313**	**2,064**	**1,816**	**2,209**	**1,741**

Table 2: Capital Expenditures, 2018-Q2 2020, in millions

Eikon ticker	Mstar ticker	Company Name	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
AR	**AR**	Antero Resources Corporation	(546)	(563)	(567)	(534)	(472)	(342)	(292)	(316)	(312)	(264)
COG	**COG**	Cabot Oil & Gas Corporation	(156)	(231)	(260)	(247)	(196)	(226)	(199)	(168)	(149)	(182)
EQT	**EQT**	EQT Corporation	(729)	(964)	(1,157)	(882)	(371)	(395)	(492)	(345)	(256)	(256)
GPOR.o	**GPOR**	Gulfport Energy Corporation	(306)	(280)	(198)	(123)	(245)	(267)	(139)	(74)	(114)	(161)
RRC	**RRC**	Range Resources Corporation	(334)	(290)	(209)	(190)	(214)	(199)	(178)	(157)	(142)	(129)
SWN	**SWN**	Southwestern Energy Company	(302)	(382)	(324)	(282)	(258)	(328)	(291)	(222)	(228)	(244)
CNX	**CNX**	CNX Resources	(232)	(264)	(297)	(322)	(299)	(329)	(336)	(228)	(152)	(135)
CHK	**CHK**	Chesapeake Energy	(440)	(595)	(501)	(461)	(530)	(575)	(593)	(565)	(518)	(349)
NFG	**NFG**	National Fuel Gas	(119)	(142)	(180)	(178)	(209)	(201)	(201)	(198)	(197)	(156)
		Total, Selected companies	**(3,166)**	**(3,711)**	**(3,694)**	**(3,218)**	**(2,794)**	**(2,862)**	**(2,721)**	**(2,273)**	**(2,067)**	**(1,875)**

Table 3: Free Cash Flows, 2018-Q2 2020

Eikon ticker	Mstar ticker	Company Name	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
AR	**AR**	Antero Resources Corporation	(4)	(266)	(146)	287	67	(124)	(94)	(168)	(111)	(148)
COG	**COG**	Cabot Oil & Gas Corporation	117	43	(18)	69	390	101	72	95	56	(46)
EQT	**EQT**	EQT Corporation	175	(327)	(252)	(351)	500	49	(173)	(127)	244	191
GPOR.o	**GPOR**	Gulfport Energy Corporation	(80)	(95)	22	33	(5)	(107)	79	33	17	(45)
RRC	**RRC**	Range Resources Corporation	36	(115)	20	26	46	(14)	(74)	(25)	(17)	(50)
SWN	**SWN**	Southwestern Energy Company	62	(82)	(17)	(30)	184	(227)	(95)	3	(68)	(150)
CNX	**CNX**	CNX Resources	27	(73)	(58)	(127)	10	(77)	(31)	(114)	115	9
CHK	**CHK**	Chesapeake Energy	148	(232)	(57)	(126)	(74)	(178)	(264)	(124)	(121)	27
NFG	**NFG**	National Fuel Gas	72	87	(83)	(73)	27	29	(78)	(31)	26	77
		Total, Selected companies	**553**	**(1,060)**	**(589)**	**(292)**	**1,145**	**(550)**	**(657)**	**(457)**	**141**	**(134)**

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About the Authors

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Kathy Hipple, a financial analyst at IEEFA, teaches the finance sequence at Bard's MBA in Sustainability and is the founding partner of Noosphere Marketing. Hipple has written extensively about sustainable, responsible and impact finance and investing. As Vice President at Merrill Lynch for 10 years, she placed fixed income securities with international institutional clients, and advised international life insurance companies and pension funds. She later founded Ambassador Media, a local search firm in New York City, and served as its CEO. She has served on several boards, including the national Local Search Association and Bennington County's Meals on Wheels.

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