SEA OF RED: Majority Of U.S. Shale Companies Took A Beating Q1 2019

Description

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The overwhelming majority of U.S. shale companies were hit hard due to lower oil prices in the first quarter of the year. Just about every shale company that I keep track of suffered negative free cash flows in Q1 2019. This was quite a surprise as Rystad Energy claimed that the breakeven price for U.S. tight oil (shale oil) was the second lowest in the world at $46 a barrel, right behind Saudi Arabia at $42.

According to the U.S. Energy Information Agency (EIA), the average West Texas Oil price in Q1 2019 was $54.82, down from $60 in the last quarter of 2018. However, even with receiving nearly $55 a barrel, the majority of U.S. shale companies posted negative free cash flows. I was quite surprised when I researched the data.

As we can see in the chart below, sixteen of the leading U.S. shale companies posted a total of $3.2 billion of negative free cash flow:

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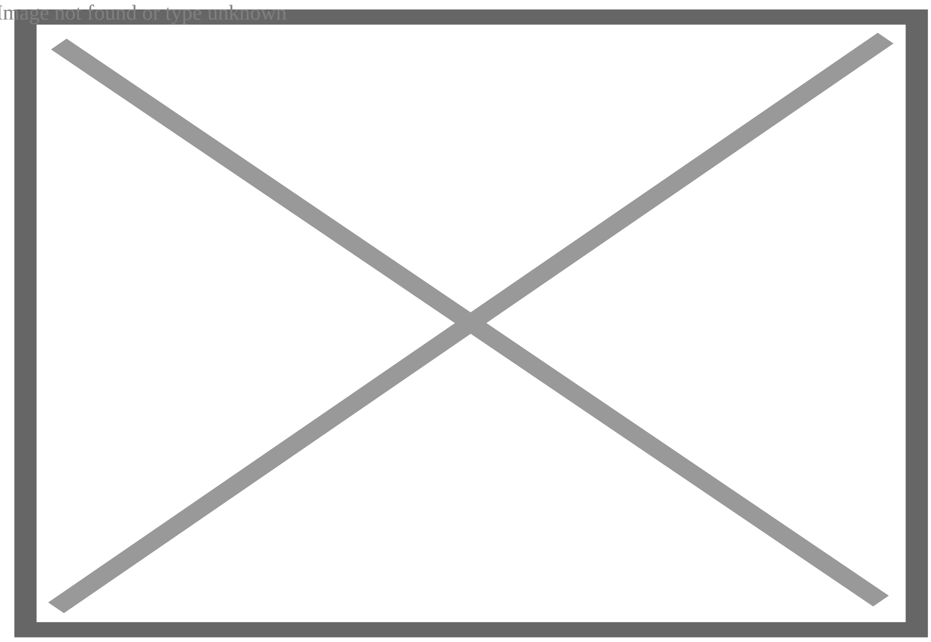

Hess suffered the largest negative free cash flow at a negative $433 million, while Continental Resources was the "best of the worst" at -$32 million. Here is the list of the companies shown above:

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While it’s true that I did not include every shale company in the list above, it’s a pretty extensive group. Furthermore, I did not include the free cash flow from the big three U.S. oil companies, ExxonMobil, Chevron, and ConocoPhillips as they still produce a lot of conventional and offshore oil. However, one shale company that I did not include in the list above was APC – Anadarko Petroleum. Anadarko posted a negative $260 million in free cash flow in Q1 2019.

Regardless, we can clearly see that even at $55 a barrel, the majority of U.S. shale companies were still spending more money than they received from operations in the first quarter of the year. Again, the total free cash flow of the group was a negative $3.2 billion.

NOTE: For those who don’t understand the term Free Cash Flow, the companies calculate that figure by subtracting total capital expenditures from cash from operations. It’s important for companies to show “positive” free cash flow as they need the funds to grow their business, pay dividends, or buy back stock. However, many shale companies listed above have suffered negative free cash flows for many years, which forced them to increase their debt or issue stock to fund business or grow production.

Unfortunately, due to the U.S. shale oil industry’s rapid decline rate, and negative free cash flows, many of these companies added a great deal of debt to their balance sheets to grow production over the past decade. To service this debt, these companies pay a quarterly interest expense. According to the data taken from GuruFocus.com, these sixteen shale companies paid nearly $900 million of interest expense in just the first quarter of the year:

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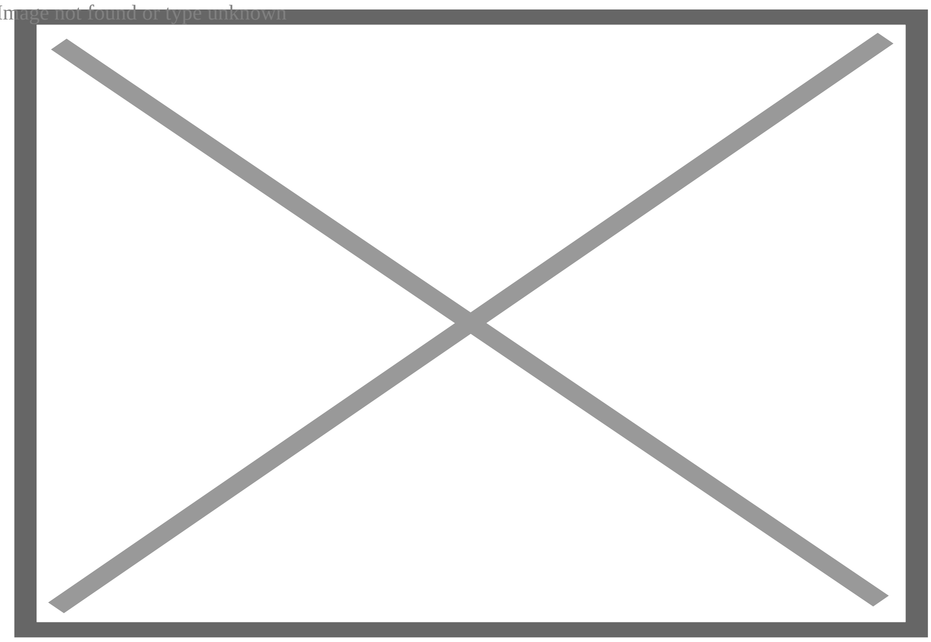

Thus, for the entire year, these shale companies will pay roughly $3.6 billion only to service the debt. How much is $3.6 billion of interest expense in one year? Well, that would purchase 65 million barrels of oil at $55 a barrel. But, of course, these companies only pay a portion of each oil barrel to pay for the interest expense. If we assume $5 for each barrel for their interest expense, that will take 2 million barrels per day of oil production. That’s correct. These shale companies need to produce 2 million barrels of oil per day for an entire year at $5 a barrel just to pay their interest expense.

It will be interesting to check the financial data from these companies in Q2 2019 as the oil price has recovered a bit and is up $7 a barrel more than it was in the first quarter. So, the higher oil price should provide these companies more cash from operations. I will do an update when the earnings are released at the beginning of the summer.

Lastly, higher oil prices will certainly allow the U.S. Shale Oil Ponzi to continue longer than lower oil prices. However, if the U.S. and global economies head into a recession, then all bets are off as lower prices will likely pull the rug out from under the Shale Industry.