Statement by Deborah Rogers
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Since the February 2013 publication of "Shale and Wall Street" (http://shalebubble.org/wall-street), a number of things have happened:

1. There have been significant asset write-downs together with sales of shale assets. Large independents wrote off billions in impairment charges as did the majors—approximately $35 billion in write-downs among 15 shale operators. This is not surprising given the decline in merger and acquisition activity and private equity capital investment. In the first half of 2013, private equity investment in shales declined over 90 percent. Assets at times sold for one quarter of the value companies had claimed a mere six to nine months earlier (Chesapeake Energy Corp.'s Mississippi Lime deal, for instance). Bankers claimed that investors were doing significantly more due diligence than they had in the past.

2. Although capital expenditures have been growing, free cash flow has been deteriorating since 2009, demonstrating a long-term pattern. I evaluated a universe of 22 shale operators and found that without exception, none had positive free cash flow cumulatively from 2010 through 2013 (see Table below). While free cash flow is a bit better this year thus far, it is due primarily to draconian cuts in capital expenditures which will, in turn, impact production volumes. This game cannot be played without continuous and prolific drilling programs. This inevitable drop in production could have implications for share prices in the next year due to production targets not being met.

3. Much of the activity has been financed with debt. This could prove highly problematic as a result of a shift in Federal Reserve policies or if rates begin to rise due to the quality of the debt. For instance, Standard & Poor's estimates that about 75 percent of the shale debt issued in recent years is rated junk.

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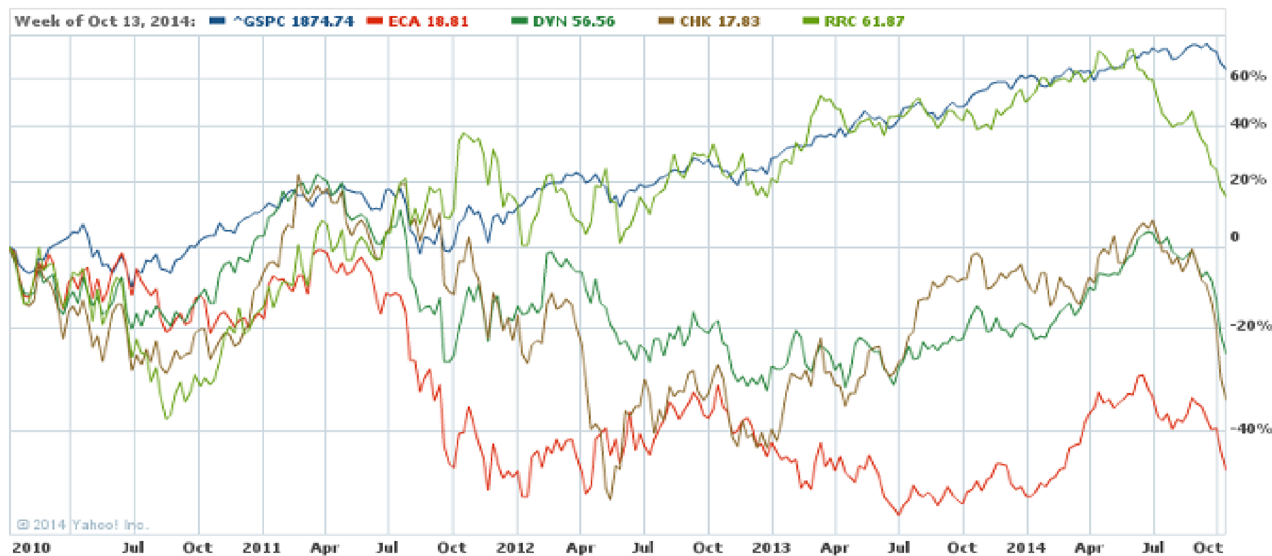
4. Share performance has not been stellar for many large independents engaged in shale production. The chart below shows performance for Chesapeake, Range, Devon, and Encana. Note that the only company to closely track the S&P 500 was Range and, in my opinion, there is very little justification for this. They are highly leveraged and free cash flow is non-existent. I think the market is beginning to wake up.



5. Externalities such as road damages are proving highly problematic. Severance tax and impact fee revenues are running much less than estimated costs to replace and repair roads due to drilling activities. North Dakota has taken in about $3.5 billion in severance tax revenue since 2010 and the North Dakota Department of Transportation estimates road damages to be about $7 billion; Arkansas has taken in about $182 million since 2009 and the Arkansas Department of Transportation estimates road damages to be around $450 million; Texas took in approximately $3.6 billion in severance tax revenue in 2012 for all drilling, onshore and offshore. The Texas Department of Transportation estimates road damages to be around $7 billion. In the Eagle Ford, the Texas Department of Transportation announced that in places they will be putting roads back to gravel because they cannot afford to repave them.

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Table: Major drillers' free cash flow is almost entirely negative

Many financial analysts regard free cash flow as the best measurement of what a company can earn for shareholders. Free cash flow is defined as cash generated by operations minus capital expenditures. Unlike conventional earnings which can be easily manipulated using perfectly legal accounting maneuvers, free cash flow is very difficult to manipulate. Negative free cash flow can indicate a period of heightened investment by a company—but this should be for a relatively short period of time. When the pattern turns long term, it indicates that the company is receiving a negative return on its investments.

Firm	Free Cash Flow (millions of dollars)			
	2010	2011	2012	2013
Noble	-66	-567	-881	-936
Anadarko	11	-3,408	804	737
Range	-556	-831	-1,072	-396
Devon	-1,279	-1,588	-3,593	-1,670
Chesapeake	-3,435	-1,459	-3,373	-3,398
EOG	-3,026	-2,539	-2,300	70
Continental	-430	-968	-2,486	-1,176
Cabot	-385	-402	-291	-195
Kodiak	-171	-495	-1,080	-1,232
Encana	-5,369	-1,271	-957	-824
Exco	-731	-1,343	-56	-990
Quicksilver	-311	-437	-272	-64
Hess	-1,093	-2,158	-2,306	-1,205
Sandridge	-687	-1,385	-1,600	-889
Newfield	-341	-1,055	-642	-650
Concho	-1,482	-546	-1,536	-517
PDC	-169	-314	-485	-235
Petroquest	23	-81	-66	-246
Carrizo	-225	-314	-497	-389
Bill Barrett	-1	-479	-577	-182
Diamond Back	N/A	-57	-52	-144
Pioneer	N/A	-397	-921	-493

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