Business Blasphemy
Intentionally Desiring No Growth

By Alan Lammey

No matter what type of business you're in, there's one hugely important commonality that all businesses share in order to thrive: the need for growth. But amazingly, there's one niche of business in the U.S., which has a large economic impact on the Texas economy, where various company shareholders throughout the industry no longer want to see any growth in their commodity.

The desire to be in business, yet intentionally not want growth sounds a bit like business blasphemy but the U.S. natural gas industry has now entered into that exact scenario. Quite frankly, it's maneuvered itself into a Texas-sized pickle. Over eight years of relentless drilling and fracking for the home-heating and industrial fuel has risen production so immensely and in such a relatively short-period of time that it has literally caused the industry to paint itself into a corner that sets up the very real possibility of widespread bankruptcies among many companies throughout the natural gas sector.

Smaller Commodity Price Means Fewer Jobs, Less Tax Revenue

This is a very serious situation for the Lone Star State because in addition to creating jobs, natural gas contributes more than $100 billion to the Texas economy each year, including product sales and royalties in addition to property, state, local, and severance taxes. In fact, natural gas companies pay five times more in state and local taxes on a per-job basis than the average company in Texas. The taxes help support state and local services such as first-responders and hospitals and provide funds that can be used to improve our schools, roads, and infrastructure. Workers, businesses, local charities, landowners, counties, cities, schools, and municipal services all share in the revenue.

Why Stockholders in One Industry Do Not Want Continued Growth of Its Commodity

Taxes on the natural gas industry also are key for the Texas Rainy Day Fund or Texas Economic Stabilization Fund. In fact, natural gas development in recent years has accounted for roughly 60 percent of the contributions to the Rainy Day Fund, which was created to cover state budget shortfalls in the event of an economic downturn. The Fund also is used to provide property tax relief, funding for public schools, teacher compensation and health insurance, Medicaid, foster child care and adoption services, and disaster recovery programs.

In terms of jobs, the Texas natural gas industry has supported nearly 12 percent of total employment in the state. That's nearly 1.3 million jobs that are directly and indirectly related to developing natural gas. To put this into perspective, that's more than the number of people employed in San Antonio, Austin, or El Paso, according to Bureau of Labor Statistics data.

Natural Gas Prices Collapse to Decade Lows

While the growth of the natural gas industry has been a blessing in recent years, it's now become its own liability. Throughout all of 2015, U.S. natural gas wellhead production has been oscillating near record highs between 81 to 82 billion-cubic-feet per day (Bcf/d), while natural gas storage at the beginning of November 2015 also reached record highs of 3,929 Bcf. The U.S. currently has a supply glut that has been the direct result of supply outpacing demand by a fairly significant margin.

As a result of the overabundance of natural gas supply, winter natural gas futures prices have recently collapsed down to lows not seen in over a decade with prices trading in a range of the $2.10 to $2.49 per million British Thermal Units (MMBtu). Cash or spot prices for natural gas throughout the U.S. have recently been trading for under $1 per MMBtu, which is well below many regional break-even costs for the fuel.

Despite natural gas prices being under break-even costs, gas producers ludicrously continue to announce even more production projects and more supply coming online, which is killing producer stock prices throughout the industry. For example, Chesapeake Energy (CHK), which is the 2nd largest producer of natural gas in the U.S., stock price has collapsed from a high of $64.00 a share in May of 2008 to a low as $6.00 in 2015, marking a 90 percent drop in the last seven years or so. It's not just Chesapeake that's down in the dumps. It's the same dreary story for a multitude of natural gas companies throughout the entire industry.

Mountains of Debt Must Be Serviced

For the first time ever, investors and stockholders are clamoring for publicly-traded natural gas producers to cool their heels on the growth of new production projects and new production in general. Stockholders simply want the big players in the natural gas industry to just cease drilling and let the magic of supply and demand do its thing to bring back some more favorable equilibrium to the market. The big problem is that producers can't stop growing for essentially one main reason: debt and lots of it.

Exploration and Production (E&Ps) companies in the natural gas industry have become so enormously over-leveraged in debt to the tune of hundreds of billions of dollars in the last eight years that they must continue to pull as much natural gas molecules out of the ground as possible in order to sell it and have funds available to service its debt.

The Mother of Negative Loops

This has created a seriously negative loop for the natural gas industry because if producers continue to grow production in an already hugely supply-glutted market, it will only result in a perpetually lower commodity price when there's no equal amount of demand available to absorb the excess supply. This sets up a situation where the commodity price falls unceasingly lower, so in order to maintain debt payments, companies have to produce even more of the commodity. Not only does this situation reduce company stock prices, but it also notably lowers the value of the gas reserves still in the ground that have yet to be produced.

In the near to medium term, about the only saving grace that the U.S. natural gas industry has is the hope of a very cold upcoming winter to create enough heating demand to consume large amounts of supply. Then there's the launch of new liquid natural gas (LNG) export facilities, which are presently under construction throughout the nation. The first LNG export facility to go online in early 2016 will be Cheniere Energy's Sabine Pass plant in Louisiana. Others will start to go online shortly thereafter. Then they will be exporting natural gas to destinations outside of the U.S.

There is one positive to this scenario. For consumers of natural gas such as electric utilities and industrial plants, this is a dream situation that couldn't be better because natural gas costs and power rates are at never before seen lows in Texas. Unfortunately for natural gas producers, it's a financial nightmare that isn't easily solved. **N**

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