

Antero Resources: Classic Market Bottom Finally Appears

Long Player

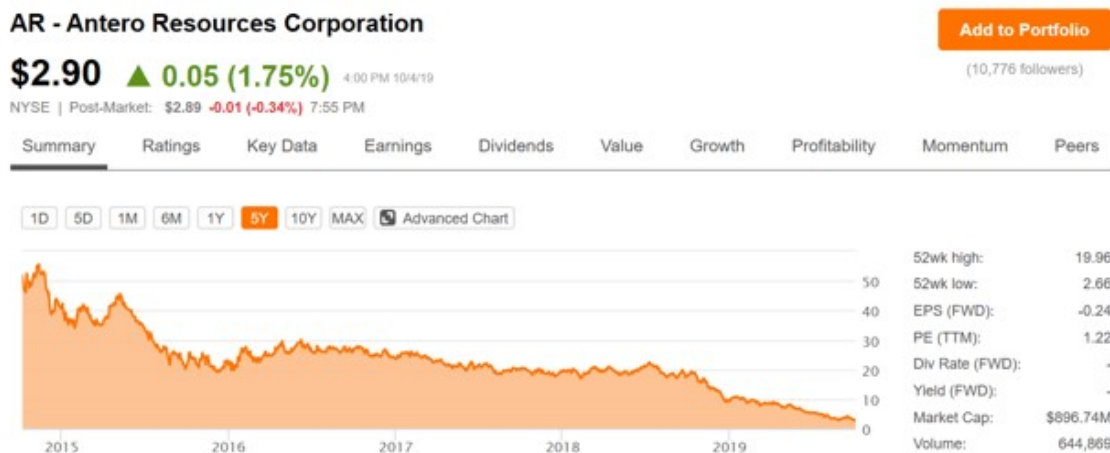
15-19 Minuten

Antero Resources (NYSE:[AR](#)) went public at a price that management felt was good for the current shareholders. The price action since that initial sale of stock to the public should have surprised no one. After all, if management felt they received a good price for the shareholders, then it is very likely that long-term buyers overpaid for the stock. Therefore, the only buyers of the initial public offering should have been short-term traders and people that hedge professionally for a living.

Oftentimes, though, there are purchasers at that initial stock price that blame management for the subsequent pricing action. This happens despite a large block of research that shows that long-term stock prices do not behave in the favor of investors about 95% of the time after the sale of stock. There are significant exceptions to this general rule. But those exceptions do not happen often enough for the average investor to worry about. Most investors can save a lot of money on average by not purchasing a new issue or even a sale of stock by an existing company until that stock has declined on average (at least) 50% within the first 18 months of the stock sale.

Antero Stock Price Specifics

True to most research predictions, the Antero Resources stock price has behaved exactly as one would expect after a going public stock price auction.



Source: Seeking Alpha Website October 6, 2019

Initial long-term investors could have saved a lot of money by waiting that 18-month period. At that point, the current gas pricing weakness should have become apparent enough that more waiting was advised. Just because gas prices were weakening back then, there was no reason to jump in until the gas production market showed some discipline.

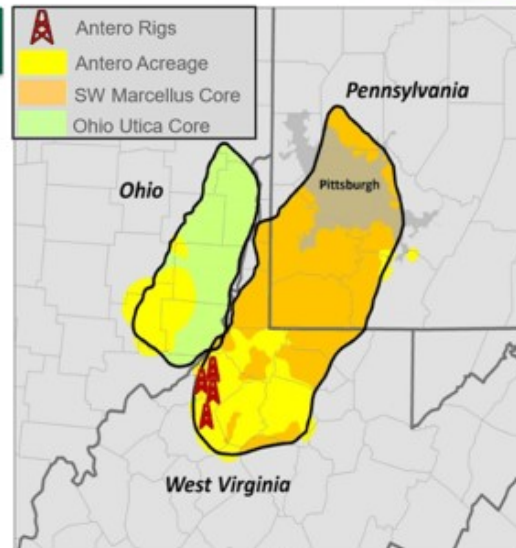
The market has become upset because all the stock price has done is decline. Now, the price-earnings ratio borders on the ridiculously conservative end. Admittedly, the earnings will not have another hedging liquidation gain next year. But operational improvements are on the way as well as revenue improvements from higher liquids production ratio wells. This management has done an excellent job of keeping Antero Resources in good financial condition during the current downturn. Management has also adroitly shifted gears to higher profitability prospects.

The Size and Scale to Capitalize on the Resource



Antero Resources Profile

Market Cap.....	\$1.0 B
Enterprise Value ⁽¹⁾	\$4.6 B
LTM EBITDAX	\$1.6 B
Ownership in AM (31%).....	\$1.1 B
Leverage ⁽²⁾	2.3x
Corporate Debt Ratings.....	Ba2 / BB / BB+
2019 Net Production Guidance ⁽³⁾	3.2 Bcfe/d
Liquids/Condensate.....	149 MBbl/d
Proved Reserves.....	18.0 Tcfe
Liquids ⁽⁴⁾	1.1 BBbls
Net Acres.....	584,000
Core Undrilled Locations.....	3,013



AR
LISTED
NYSE

Note: Equity market data as of 6/30/19. Reserves as of 12/31/2018. See 2019 Guidance page for production guidance details. Rig locations as of 6/30/2019. Net acres as of 6/30/2019.
 (1) Market cap plus net debt. Includes ownership of \$1.1 billion of Antero Midstream.
 (2) Leverage is net debt divided by LTM Adjusted EBITDAX at 6/30/19. See appendix for details.
 (3) Midpoint of guidance.
 (4) Proved reserves contain 498 MMBbls of C3+ NGLs, 554 MMBbls of ethane, and 46 MMBbls of condensate/boil. Assumes approximately 415 MMBbls of additional ethane are left in the natural gas stream.

Source: Antero Resources Barclays CEO Energy Conference
September 2019

[The financial strength ratings](#) remain slightly below investment grade. Those ratings are an improvement since the company has gone public. Management remains focused upon increasing those financial strength ratings in the future.

Financial leverage has decreased as management has paid off billions of debt over the last few years. The current holdings of Antero Midstream (NYSE:[AM](#)) and the hedge portfolio continue to provide a ready source of liquidity that gyrates around a \$2 billion value. In addition, there is a very generous and wide-open bank line for even more liquidity. This company faces very few financial hurdles in the immediate future.

The Industry

But as is typical at market bottoms, the rumors are flying about

counter-party problems and bankruptcy in a few years despite a slew of competitors with a far weaker financial condition than this company. Such talk is typical at a market bottom. Increasingly pessimistic forecasts are the order of the day as the market extrapolates the past into the future. Management probably has other ideas rather than sitting and taking a beating.

After all, the stock went public at what was probably near the peak of the latest market cycle. Therefore, no one should have been surprised at the downward trend since the public sale of common stock. All that stock price trend proves is that management did its proper job of getting the owners a good price for their stock at the right market time (or at least close to the right market time).

Overpriced stocks tend to decline even as operations improve, as is the case with Antero Resources.

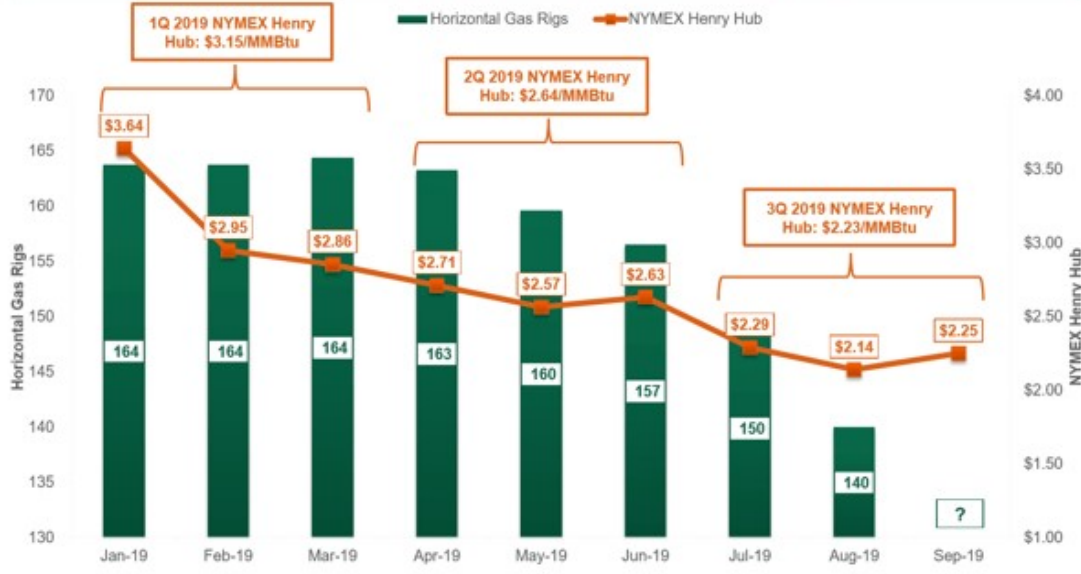
The growth of unconventional production made this downturn longer than usual. But downturns end sooner or later. This time, it appears to be a whole lot later. However, market bottoms always seem to happen when the market gives up hope and "everyone" either sells or goes short. Absolutely no one of any reputation wants to recommend a company whose stock has only gone down for years.

Natural Gas Rig Count is Responding to Price



Gas rig count is responding to lower natural gas prices with a 14% reduction in horizontal gas rigs since March

Horizontal Gas Rig Counts vs NYMEX Henry Hub



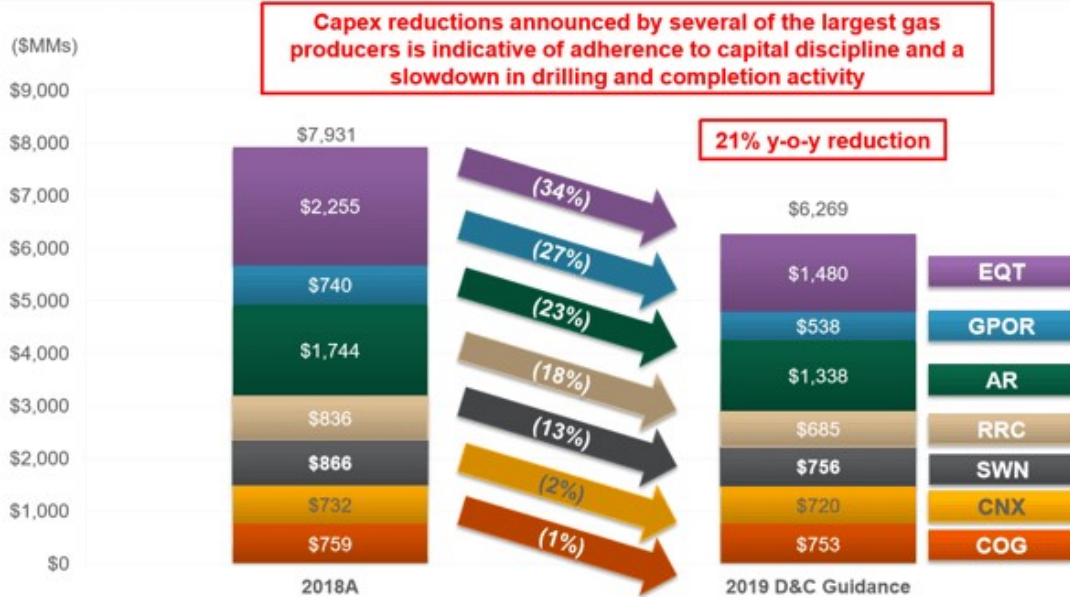
Source: U.S. Rig Counts from Baker Hughes 8/30/2019
Note: NYMEX Henry Hub price represents natural gas front month futures settlement history

D&C Capital Reductions...



Appalachian peers announced an average 21% reduction in their 2019 drilling and completion capital spending relative to 2018 levels, moderating supply growth expectations

Appalachian Peer D&C Capital Guidance Comparison (2019 vs 2018)



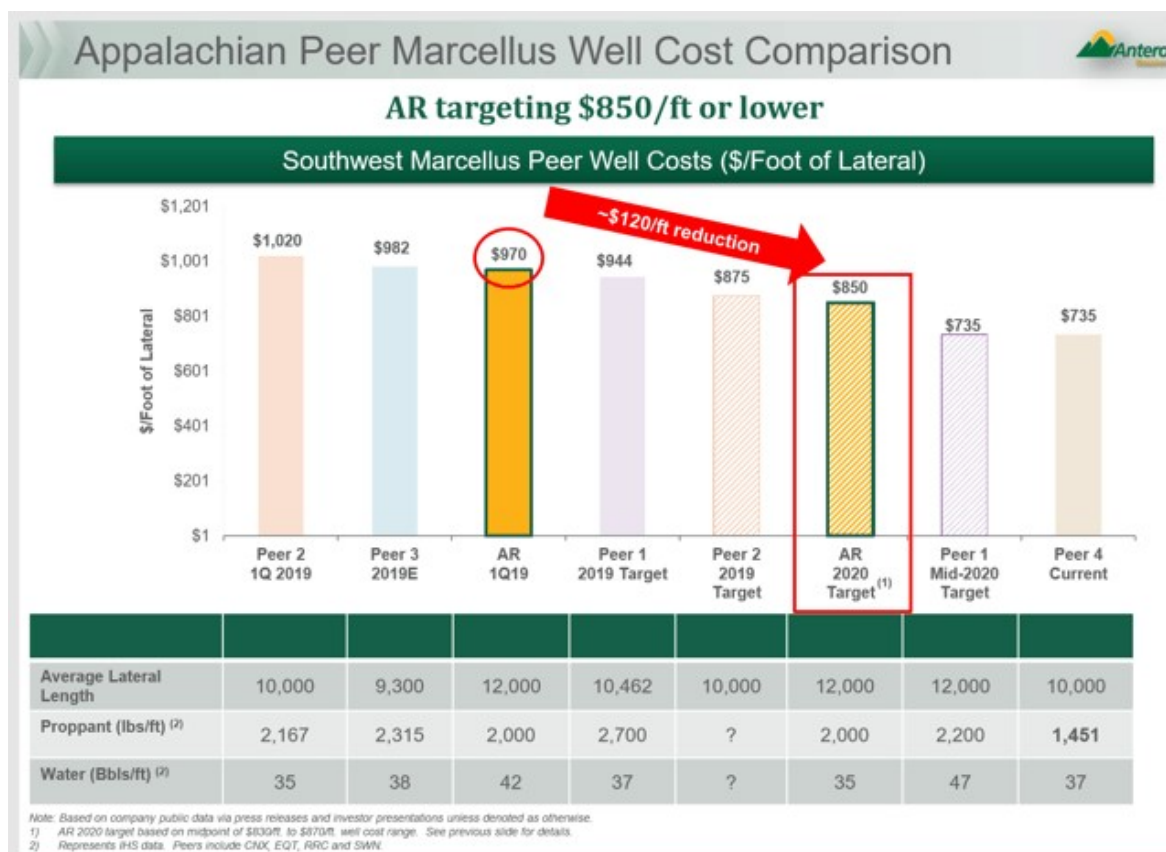
Note: COG 2018 actual D&C capital percent contribution to total capital applied to 2019 total capital on a pro rata basis. CNX D&C capital percent contribution from original 2018 guidance release applied to 2018A total capital spend on a pro rata basis.

Source: Antero Resources Presentation Of Natural Gas Fundamentals September 2019

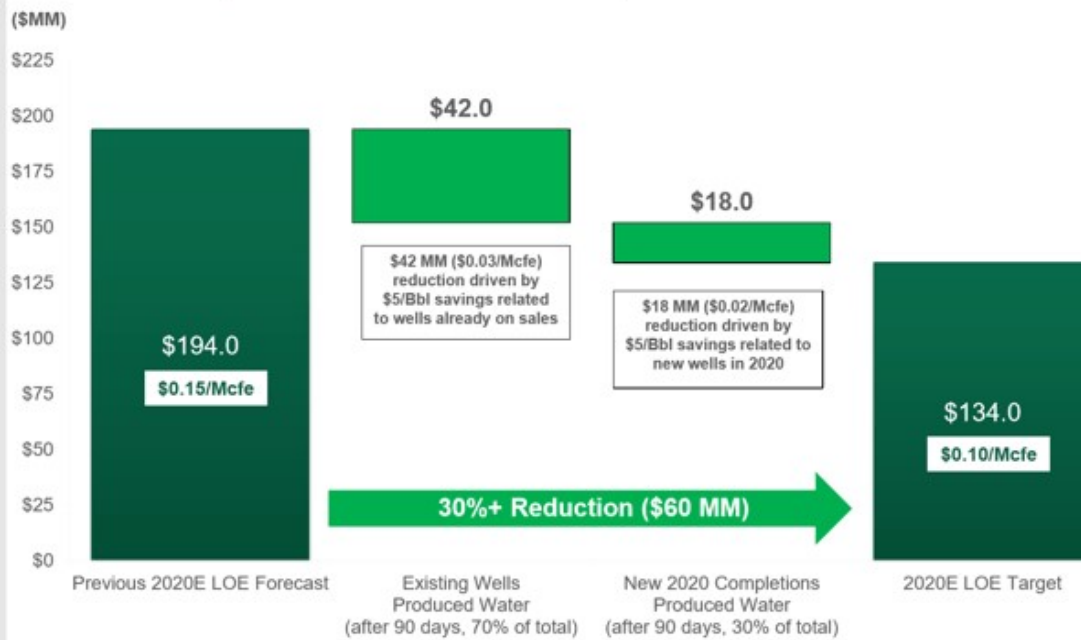
[Rig counts and capital budgets](#) are finally beginning to decline in

anticipation of the continuing over-production. The production from places like the Permian will continue to increase because those wells depend far more upon oil and corresponding liquids pricing than they do on gas prices. But, as noted many times before, the large oil-producing basins are not the main determiners of supply. Most of the production and supply growth comes from the dry gas areas of the country.

Offsetting the budget declines will be continuing cost reductions from operational improvements and well design improvements that lead to greater production per well. But the overall trend is clear. The gas supply market is finally beginning the necessary contraction needed to stop the long-term fall of gas prices.



AR is targeting ~\$60 MM or at least 30% reduction in LOE unit costs through its water savings initiatives for 2020, driven by local treatment of flowback water



Source: Antero Resources Barclays CEO Energy Conference
September 2019

The key here is that this company has always brought its costs in line with the competition. Timing of improvements can cause short-term cost variations, but overall costs need to remain in line with the lower cost producers in order for any commodity company to survive long term. Antero Resources is not an exception to the rule.

Peyto's Profitable Business

Competitive In The North American Marketplace

"2018 was a good year for most, Peyto included, but can the industry generate repeatable profit every year? Peyto has for 14 years straight."

	100% Montney VII 2018*	60% DB/40% Mont. TOU 2018*	100% Deep Basin PEY 2018	100% Montney AAV 2018*	10% DB/90% Mont. ARX 2017*
PDP FD&A \$/mcfe	(\$2.67)	(\$1.52)	(\$1.18)	(\$1.51)	(\$1.28)
Cash Costs \$/mcfe	(\$2.81)	(\$1.45)	(\$0.92)	(\$1.11)	(\$2.16)
Supply Cost	(\$5.11)	(\$2.97)	(\$2.10)	(\$2.62)	(\$3.44)
Sales Price \$/mcfe	\$6.42	\$3.69	\$3.27	\$2.75	\$5.09
Profit/(Loss)	\$1.31	\$0.72	\$1.17	\$0.13	\$1.65

	Permian PXD 2018*	Permian FANG 2018*	Marcellus Cabot 2018*	Marcellus/Utica RRC 2018*	Marcellus/Utica AR 2018*
	(\$1.98)	(\$4.45)	(\$0.42)	(\$0.40)	(\$0.57)
	(\$2.17)	(\$1.50)	(\$0.93)	(\$1.88)	(\$1.86)
	(\$4.15)	(\$5.95)	(\$1.35)	(\$2.28)	(\$2.43)
	\$7.12	\$7.46	\$2.56	\$3.55	\$3.69
	\$2.98	\$1.51	\$1.21	\$1.27	\$1.26

Source: IHS CERIA

*Source: BMO from Company Financials
Costs and revenues left in US\$ or CAD\$ as applicable to show relative margin

Source: Peyto September 2019, Corporate Presentation For Investors

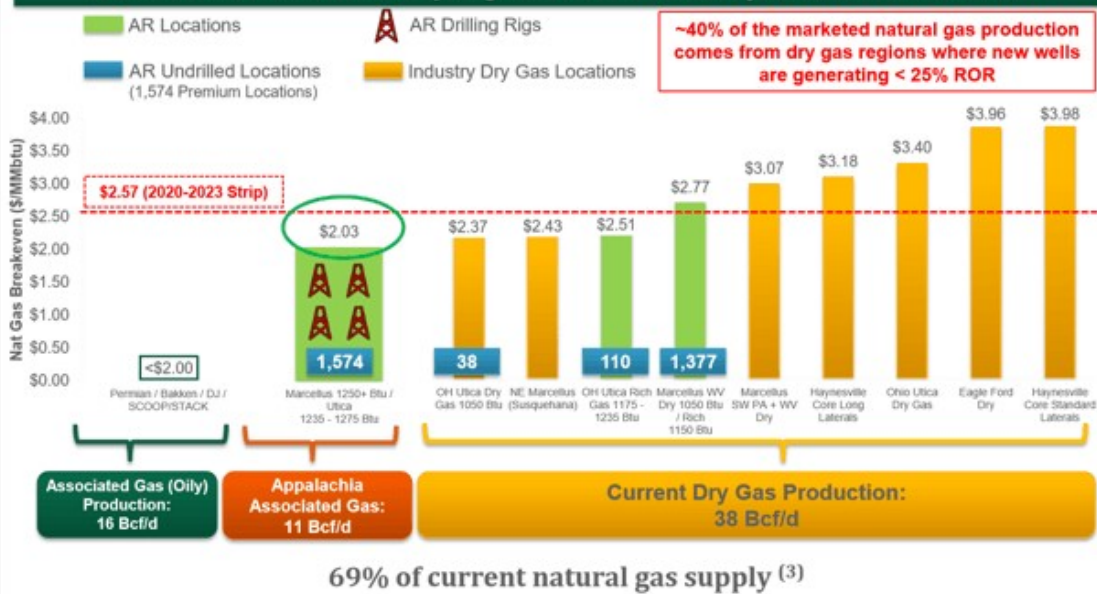
[One of the proofs that costs](#) are in line is shown when a known low-cost competitor uses the company as an example of margins for a basin. Not only does the superior margin appear to persist over time, but that margin does not include the periodic liquidation of hedges for one-time gains. Should those liquidation be included in a presentation such as this, then the margins shown above for Antero Resources would be larger still.

Superior Well Economics vs Dry Gas Producers



Liquids producers with associated gas have superior well economics in the current commodity price environment

Natural Gas Breakeven Price by Region – 25% ROR Half Cycle Breakeven Prices⁽¹⁾⁽²⁾



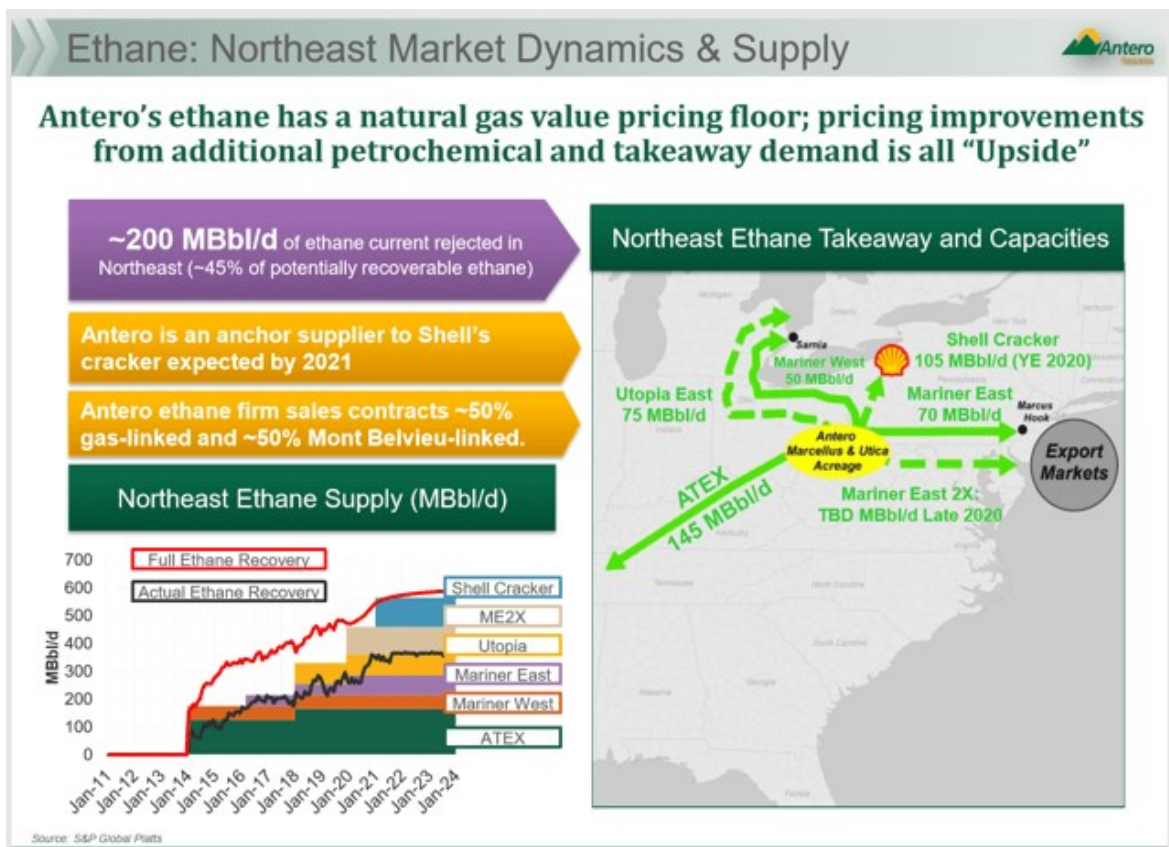
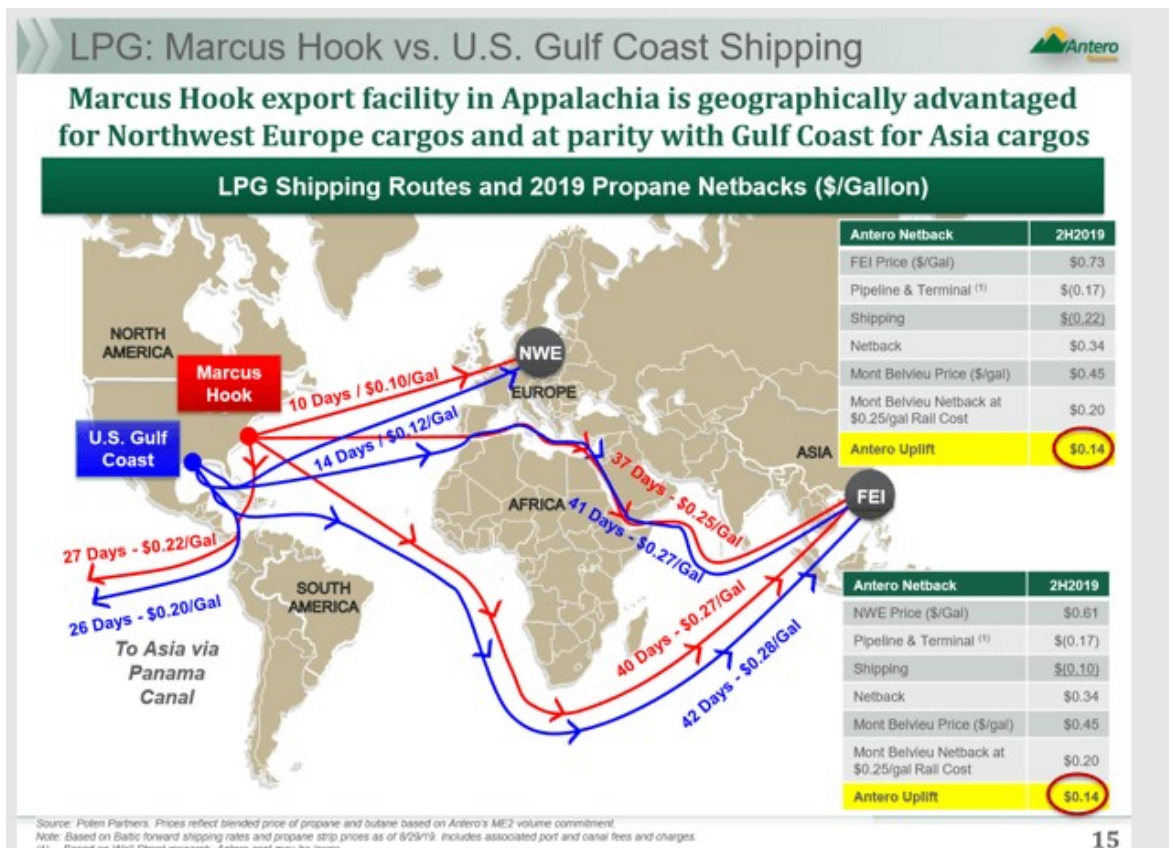
JP Morgan Equity Research breakeven analysis for best industry dry gas drilling locations as of January 2019. Excludes associated gas inventory with >50% liquids. Breakeven analysis for AR prepared by management and excludes AR hedges. AR drilling inventory as of 12/31/18. Assumes midpoint of well cost savings target range at \$550/foot of lateral.
 (1) Breakeven price is defined as half cycle pre-tax ROR of 20%. Assumes average 2020-2023 strip WTI oil price of \$54.42/BBbl as of 6/30/2019 and C3+ NGL pricing of \$29/BBbl. Assumes 12% lower well costs than 2018 budgeted Marcellus costs and 20% lower LDE per unit costs.
 (2) AR half cycle well economics assume 12,000' lateral lengths and 89% of AM gathering and compression fees paid by AR to AM to account for AR's midstream dividend stream from AM (based on 31% ownership of AM).
 (3) Based on Platts current lower 48 dry marketed natural gas production of 90 Bcf/d at 6/30/2019.

Source: Antero Resources Barclays CEO Energy Conference September 2019

Note that Antero has plenty of low cost locations to grow in a relatively hostile environment. Continuing industry improvement should continue to lower that cost basis further in the future. As shown above, there is a long list of competitors that are going to suffer far more than this company.

One of the more interesting discussions is the cost basis for gas production in the Permian. Some would argue that there is no cost basis. However, even though the profitability is usually determined by the larger oil and liquids contribution from the Permian wells, there is at least a further processing basis to make the gas production marketable. Some transportation costs are also certain while allocations of administrative overhead and finances charges are debatable. The key here is that Permian wells are not the main determinant of the gas supply. As long as that is the case, then the cost of that gas is probably not relevant as a determinant

of the gas supply. The more dominant dry gas basins would be the main determinants of weak gas pricing or strong gas pricing.



Source: Antero Presentation Of Natural Gas Liquids Fundamentals September 2019

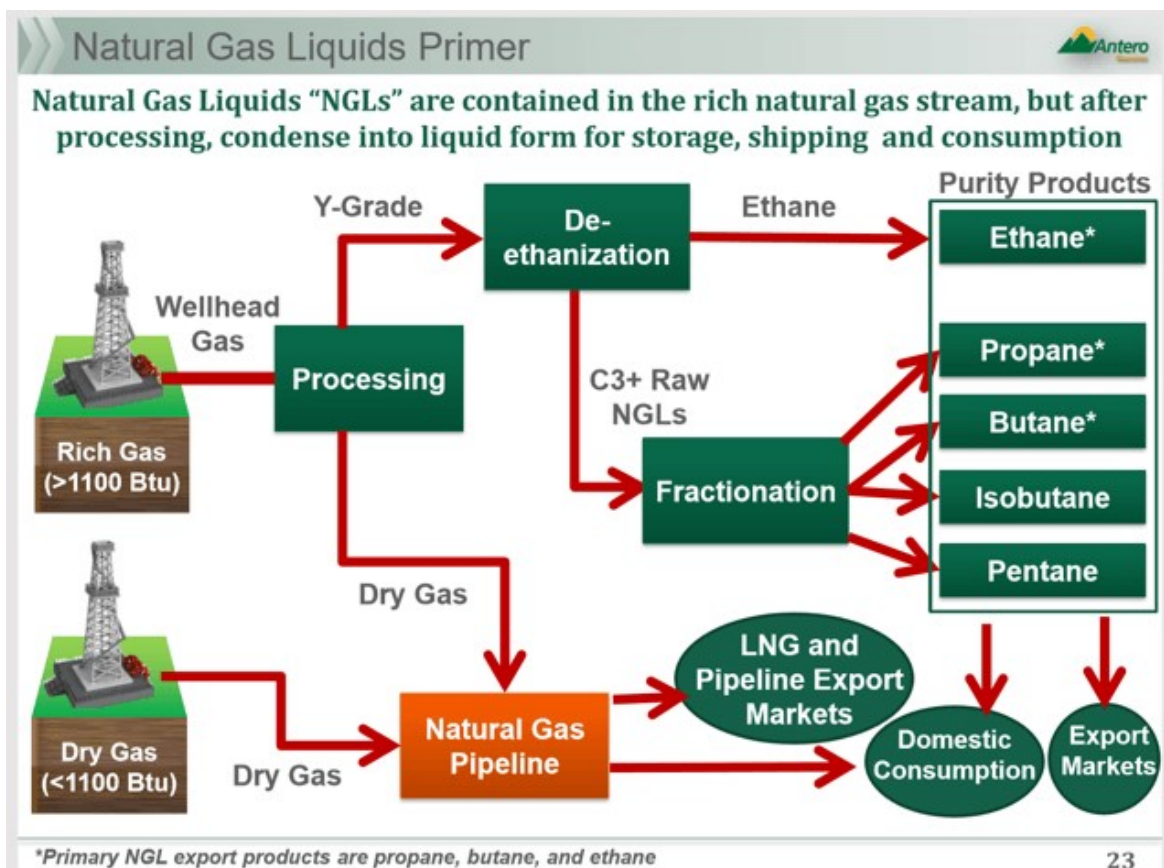
The company [maintains](#) incredible flexibility to maximize product pricing. More importantly, the pricing of production will be fixed by long-term contracts, so that less is exposed to short-term pricing swings. Antero Resources has a significant contract to supply a new Shell ([RDS.A](#)) plant with ethane when operations begin. Those kinds of contracts limit the company's exposure to the more volatile aspects of product price swings. Ethane use is experiencing very rapid growth. Probably, the most visible ethane use to the average consumer would be as a raw material for various plastics.

Another visible short-term growth is the use of natural gas and liquids products to generate electricity. However, the growing exports of the associated production products has led to stronger pricing in North America than would be the case without exports. That strength should continue for the near future.

Chart Industries (NASDAQ:[GTLS](#)) another company followed by the author has noted that large increase in storage capacity demand for natural gas availability during peak demand periods of electricity when the pipelines simply cannot meet the demand for natural gas to generate that peak period demand (summer heatwaves, for example). Plus, the low gas pricing is generating demand (for uses in trains, for example) in places that previously never used natural gas. This is one of the reasons it is so hard to accurately gauge the growth and balance of these commodity products.

Processing

New technology has enabled much better and lower cost recovery of valuable aspects of the production stream.



Source: Antero Presentation Of Natural Gas Liquids Fundamentals September 2019

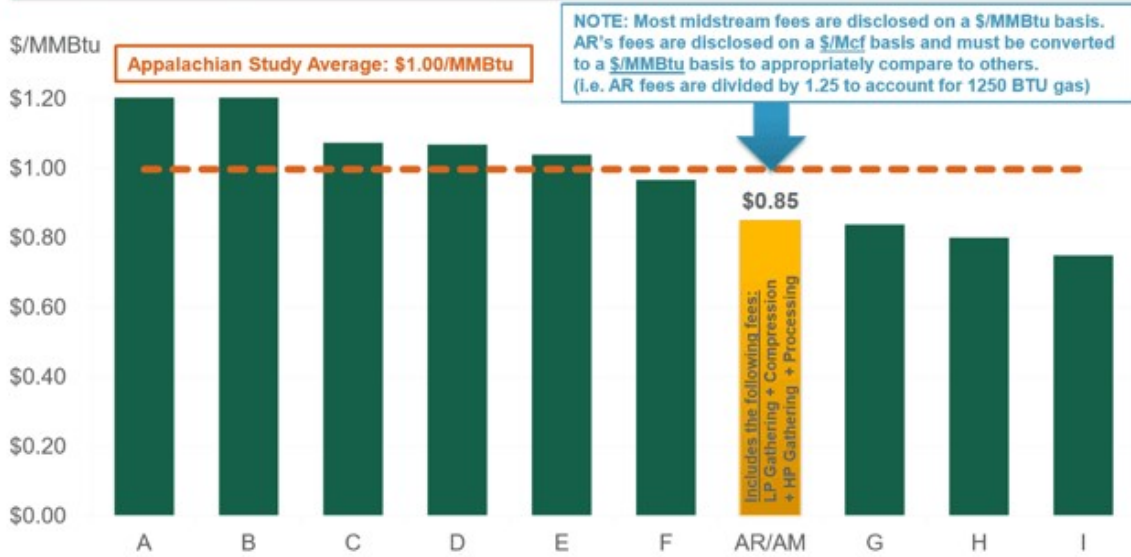
The company has long been [involved](#) in the further processed part of the business. In any commodity business, the further processed products to some degree offer limited margin protection in the event of pricing declines. Antero Midstream has long been near the first of midstream companies to embrace the continuing developments of new manufacturing processes to help increase the overall sales value of the produced products shipped to it. This is part of what has led to the superior margins shown in a slide before.

Summary

Antero Resources has thrived as a company despite years of declining natural gas prices. There is absolutely no reason that profitability should not continue into the future.

Liquids-rich development requires integrated gathering, compression, and processing infrastructure and requires additional midstream services compared to dry gas development

Appalachia Liquids-Rich Gathering Through Processing Fee Analysis (\$/MMBtu)⁽¹⁾



Note: Excludes dry gas gathering agreements that do not require liquids-rich natural gas processing services. All gathering & compression fees normalized to 1,250 Btu gas, two stage compression and CPI adjusted based on individual contract specifications. Analysis based on public and private company disclosures for Appalachia midstream contracts. Peers include EQT, CNX, MR and private operators.
1. AR's \$1.93/Mcfe GP&T costs in 2Q19 includes costs above plus fractionation, liquids transportation, and long-haul gas transportation on an Mcfe basis over total production (vs. MMBtu basis above for only processed volumes).

Source: Antero Resources Barclays CEO Energy Conference
September 2019

The further processing fees have long confused the market into thinking that Antero Resources is a high cost producer. The reality is that this company keeps its costs in line with the competition while maximizing the sales value.

Further processing fees enable management to enhance margins. They can be readily discontinued should the market indicate that further processing does not add value. Oftentimes, the assets involved have relatively fast paybacks unless the opportunity to make extra money is reasonably certain for the long term.

High cost operators, such as Denbury Resources ([DNR](#)) and California Resources ([CRC](#)), have poor margins compared to their competitors. The result is that overall cash flow does not come close to servicing the debt load under many future market scenarios. Their bond pricing and other debt pricing reflect this reality. Antero Resources has a very different debt pricing and

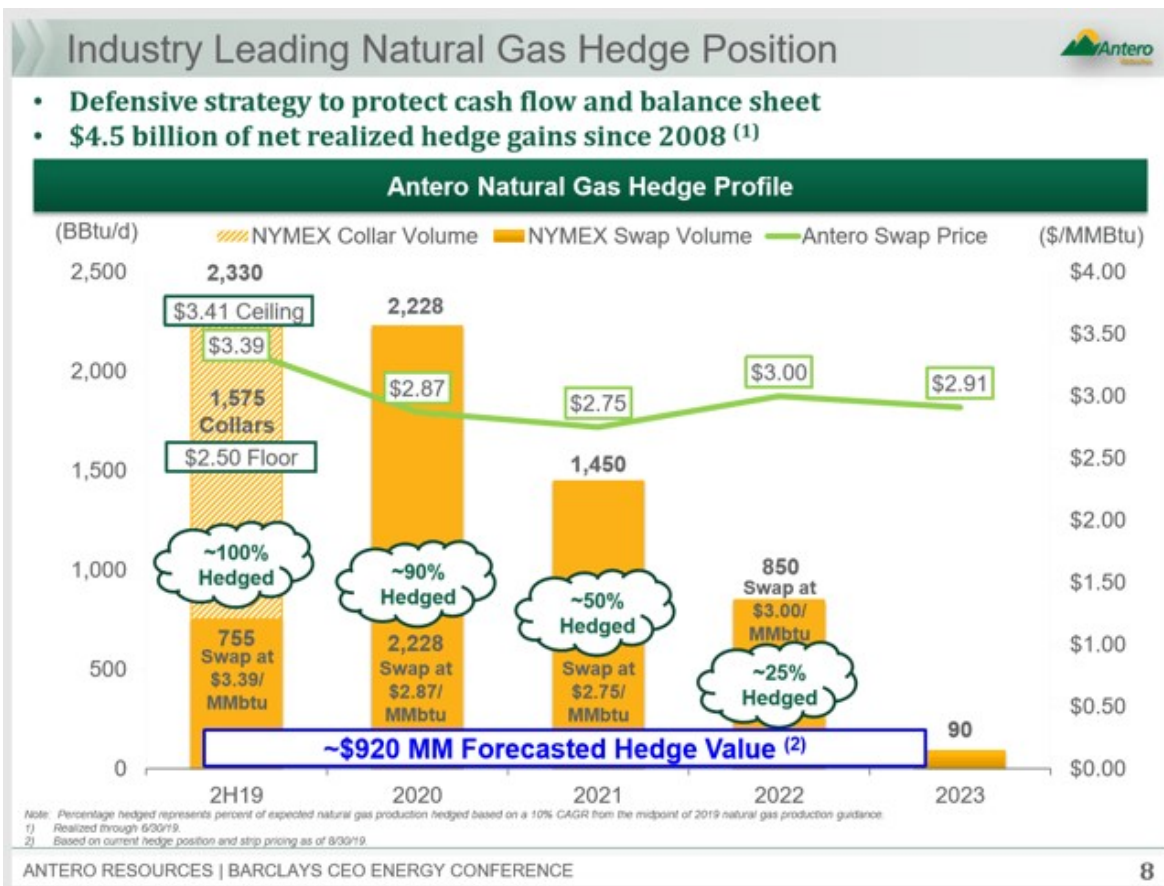
financial strength scenario.

Like any other management, this management devotes both sales price increase resources and cost reduction resources according to the maximum benefits first. That may involve a cost or two slipping out of line from time to time. Any management will conquer the maximum benefits first (and that may not always be cost reduction). But the key is always the total picture as shown by the margin. In order to survive, even a value-added producer must keep costs reasonably in line with the lowest cost producers.

Peyto ([OTCPK:PEYUF](#)) has demonstrated in its presentation that the margin is very much a margin to be reckoned with nationwide when looking at primarily gas producing basin areas. Other well-regarded low-cost producers such as ARC Resources ([OTCPK:AETUF](#)) use Antero Resources in their presentations to compare costs. This belies any argument that Antero Resources is a high cost and poorly managed producer. Those type of "bad" companies are simply not in reputable comparisons.

Whenever further processing (or incremental costs) are involved, then the revenue stream and the cost stream need to be reviewed at each step rather than overall. That is a very difficult and time-consuming analysis for many.

The problem is that, some companies, notably dry gas producers, do not have certain costs that rich gas producers have. This is "made up" by the larger exposure to natural gas pricing that often causes the margins to fall faster (when natural gas pricing is weak) without the limited protection of some liquids and oil in the production mix.



Source: Antero Resources Barclays CEO Energy Conference
September 2019

The periodic liquidation of hedges and sales of Antero Midstream stock are likely to continue as needed to keep the company in good financial condition. There is plenty of value in both to assure that Antero Resources will not be running into any financial trouble for the foreseeable future.

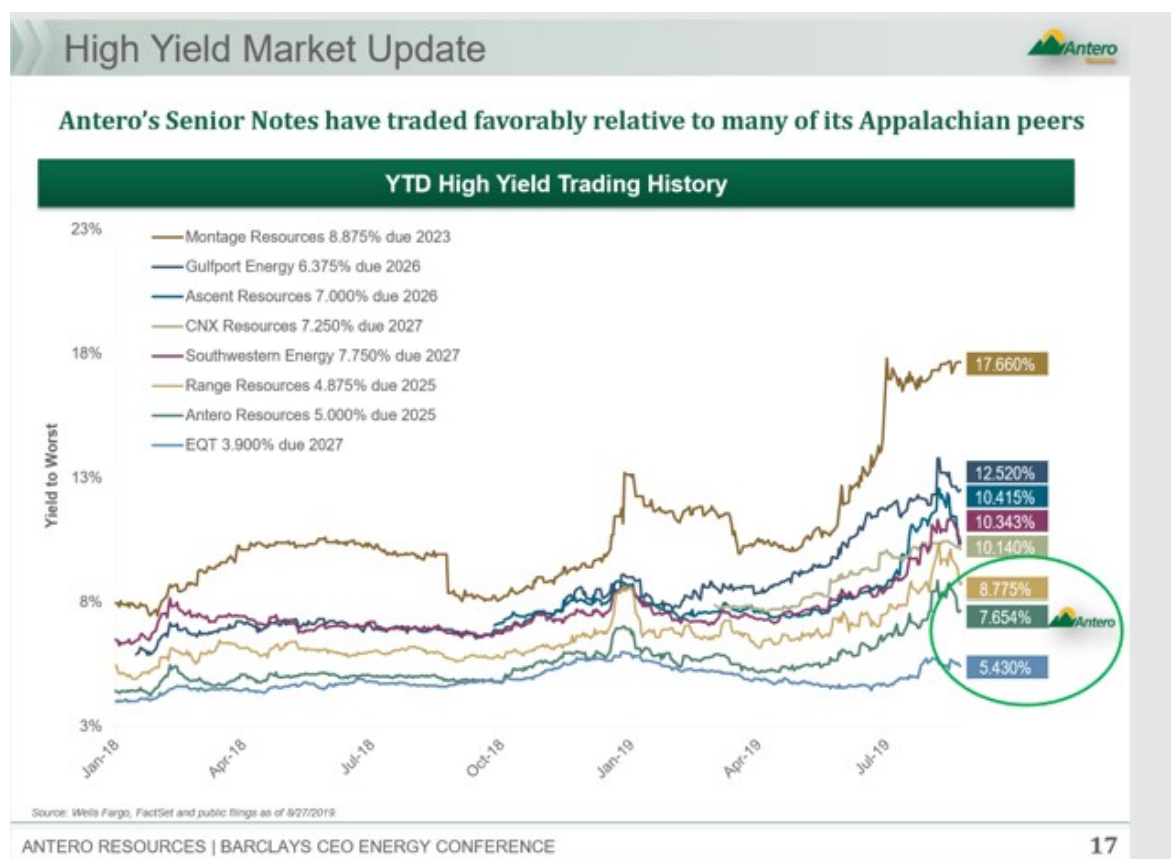
This company does make calls to liquidate hedges. Those calls (right or wrong) are a bullish call on the future price of natural gas when a liquidation for cash occurs. It also adds an element of risk to this investment as most companies simply hedge to fix the sales pricing of the products involved.

On the other hand, this management has added considerable long-term value by opportunistically hedging and then cashing in those hedges. The overall profitability of the company is far higher than the margin alone would indicate, because this company has

raised hundreds of millions of dollars through periodic hedge liquidations.

More than once, the hedging program has allowed the company to escape the ravages of weak natural gas pricing until operational costs caught up with the new reality. That trend is likely to continue in the future. This management could be tied to lower gas pricing as a result of the hedging, should an unexpected gas pricing rally occur. That currently appears to be unlikely.

The income forecast is extremely hard to predict and very lumpy. But the long-term profitability is there as well as the long-term climbing financial strength (since going public).



Source: Antero Resources Barclays CEO Energy Conference
September 2019

The bond market likewise sees no sign of financial trouble for the foreseeable future as indicated by the pricing above. Much of the current scare talk about shorting the stock and bankruptcies is typical "bottom-of-the-market" talk by a market frustrated by the

long-term downward trend of the stock price.

That is usually the time for long-term investors to consider an investment in a good sound cyclical stock. Commodity markets often come into balance when the market least expects that balance. Clearly, the balancing process has finally begun. Dry gas production appears to be finally poised to decline until the supply balances the demand.

Antero Resources has the substantial liquid holdings of Antero Midstream as well as the value in the hedging portfolio. The bank line offers the company still more flexibility to take advantage of weak competition, while gas pricing remains in the doldrums. This company will most likely be a consolidator and a survivor. A purchase during a time of weak gas pricing should reward long-term investors handsomely.

I analyze oil and gas companies like Antero Resources and related companies in my service, Oil & Gas Value Research, where I look for undervalued names in the oil and gas space. I break down everything you need to know about these companies - the balance sheet, competitive position and development prospects. This article is an example of what I do. But for Oil & Gas Value Research members, they get it first and they get analysis on some companies that is not published on the free site. Interested? Sign up [here for a free two-week trial](#).

Disclosure: I am/we are long AR, AM, PEYUF, GTLS, AETUF. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Additional disclosure: I have 2 long dated CRC calls.

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