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The Big Secret Behind T. Boone's Fortune

How to Buy the Best Resource Acreage in Texas at a Discount – Without Any Production Costs or Risks

California Energy Idiocy is Back – This Time, On Steroids. Now, You Can Supersize the Same Trade That Made T. Boone 9000%. "Like a Coin Where Both Sides Are Heads…"

"Why don't we fly to Aspen for lunch…?"

About 10 years ago, we visited T. Boone Pickens at his famous ranch, Mesa Vista.
The ranch, at 100 square miles, consumes a little over 10% of Roberts County, Texas. It has 18 miles of manmade lakes for duck hunting and bass fishing. There are more than 100 different fields for hunting quail and over 1,000 wild quail feeders.

There are also enormous homes. Several of them. T. Boone (everyone called him "T. Boone") was married five times… and each new wife got to build a house at Mesa Vista. The house T. Boone built for himself, The Lodge, is over 30,000 square feet. And in the living room, looming over an enormous fireplace is a life-sized, full-length portrait of… himself.

On the second day of our visit, a snowstorm ruled out quail hunting. Fortunately, T. Boone had his own airport at Mesa Vista and a nicely appointed Gulfstream V. The pilots circled the ranch as we took off. The landscape was covered in oil and gas wells.

> "It's the damndest thing, Porter… I spent most of the 1960s and 1970s looking for oil in Canada and Libya… if I'd only known how much oil I had right here, on my own ranch!"

Boone was, for most of his life, an ardent believer in "Peak Oil." He believed that oil production in the U.S. had peaked in the early 1970s and that, in only a few more years, all the oil would be gone.

He believed nuclear and wind power should be used to produce electricity for the power grid, so that all the remaining oil and natural gas could be conserved for use as a transportation fuel. He

was convinced that the country was heading for a disaster because we were going to run out of oil within a decade or so.

In 2008, Boone announced a major investment in wind power. He ordered 667 1.5-megawatt turbines from General Electric – a $2 billion turbine order. Boone was going to cover his Mesa Vista ranch in wind turbines.

> *"I lost my ass on that wind deal," Boone complained.*

By 2010, the entire project was scrapped. Among the hurdles and economic realities T. Boone didn't anticipate: It would have cost $5 billion just to connect Mesa Vista's windmills to the regional power grid. Worse, the entire premise of his massive investment into wind energy and his "Pickens Plan" was dead wrong.

We'd first met T. Boone because we were extremely vocal opponents of his "Plan" and had mocked Peak Oil as yet another nonsense Malthusian fantasy. At a 2014 Stansberry Research Conference event in Dallas, T. Boone conceded that he'd been dead wrong about Peak Oil and that his "Pickens Plan" would have been an economic disaster.

In a wonderful example of how truth is often stranger than fiction, a huge amount of oil and gas was discovered directly underneath Boone's own ranch. By 2014, oil and gas production in Roberts County exceeded 3 million barrels annually. Easing the sting of his losses in Wind Energy, even today – a decade after they were completed – several of T. Boone's new Mesa Vista wells (#008888 #008543, and #008991) are still among the most productive wells in the country. T. Boone's BP Operating Company LLC is still the third-most prolific producer in the county, even three years after T. Boone's death.

We learned much from T. Boone over the years, but the most important lesson he taught us was that commodity industries – like oil and gas – that require huge capital investments are fraught with risk. T. Boone very nearly bankrupted himself by investing heavily in an economic myth: Both Peak Oil and the idea that wind power can reliably and affordably produce baseload power are economic fallacies.

T. Boone also showed us the trick to avoiding 90% of those risks.

THE REAL STORY OF T. BOONE: A FORTUNE MADE ON A MYTH

Most people think T. Boone made his fortune developing Mesa Petroleum, which by the early 1980s was America's largest and most successful independent oil and gas company.

But that's not so...

Boone's unfailing belief in ever-higher prices for fossil fuels led Mesa Petroleum into serious financial distress in 1996. Legendary dealmaker Richard Rainwater bought it for pennies on the dollar in 1997, and turned it into one of America's best independent oil companies, Pioneer Natural Resources.

Boone, meanwhile, was forced out of the company. He was 67 years old and virtually broke. He took his last $8 million and raised another $30 million from friends to start a hedge fund, BP Capital.

What did he invest in? Natural gas, of course! He kept pyramiding leveraged bets on higher prices for natural gas, essentially same strategy that led to ruin at Mesa. Within 18 months, he'd lost more than 90% of his fund, which dwindled to under $3 million.

What happened next was the greatest speculative triumph in the history of the financial markets. T. Boone continued to bet on natural gas going higher, using the futures market. And in 2000, his commodity fund rose by $250 million, generating a 9,000%-plus return.

The gains came, in large part, because of the California state energy crisis and the subsequent spike in natural gas prices. It's worth understanding what happened, because the same thing is about to happen again – but on a much bigger scale – in Europe.

California "deregulated" electricity in 1996, creating a market structure that could have only been built by politicians. Baseload providers (Mirant, Reliant, Williams, Dynegy, and AES) were to supply power on a competitive basis to the California Power Exchange.

But to ensure competition, they could only sell power to the system the day before it was to be delivered to the customer by one of California's three retail electrical utilities. Worse, the regulators demanded caps on wholesale energy prices for a decade and based the caps on prices for energy that existed before deregulation began, on the theory that competition would increase efficiencies.

As a result of these caps, there were no additional power plants built in California between 1990 and 1999. Meanwhile, the population grew by 13%. Where did the state get the additional power it needed? All of the additional demand for power was supplied by importing electricity from Oregon and Washington, which normally came from hydro-electrical plants.

In 2000, the stage was set for a huge crisis when California finally deregulated wholesale prices – but continued to regulate retail prices. A drought led the hydro-sourced power to leave the market, causing a massive shortage. That, along with an absence of any long-term market for power, led to skyrocketing wholesale electrical prices, which the retail utilities had to pay because long-term contracts were not allowed.

The result? The power went out all over California with rolling blackouts as the retail utilities – which couldn't pass the price increases on to consumers – were forced to balance supply with demand by rationing power.

Eventually the governor, Pete Davis, resigned himself to the inevitable, signing long-term supply agreements with Enron and other major natural gas-based suppliers of energy. The crisis cost the state of California an estimated $40 billion, as natural gas prices soared on anticipation of increasing demand.

Where did all of that money go? A lot ended up at T. Boone's hedge fund, which had been buying natural gas futures throughout 1999 and 2000 and continued to do so through 2007.
By early 2008, as oil soared to around $150 per barrel, T. Boone's fund had earned more than $8 billion in profits, leaving him with a multibillion fortune.

T. Boone spent 40 years looking for oil and producing millions and millions of barrels of it. But what made him a billionaire wasn't producing anything. BP Capital didn't own a single oil field or gas well. It merely owned the rights to energy other companies had to produce.

As he told us, "I sure wish I'd thought of that earlier."

CALIFORNIA ALL OVER AGAIN

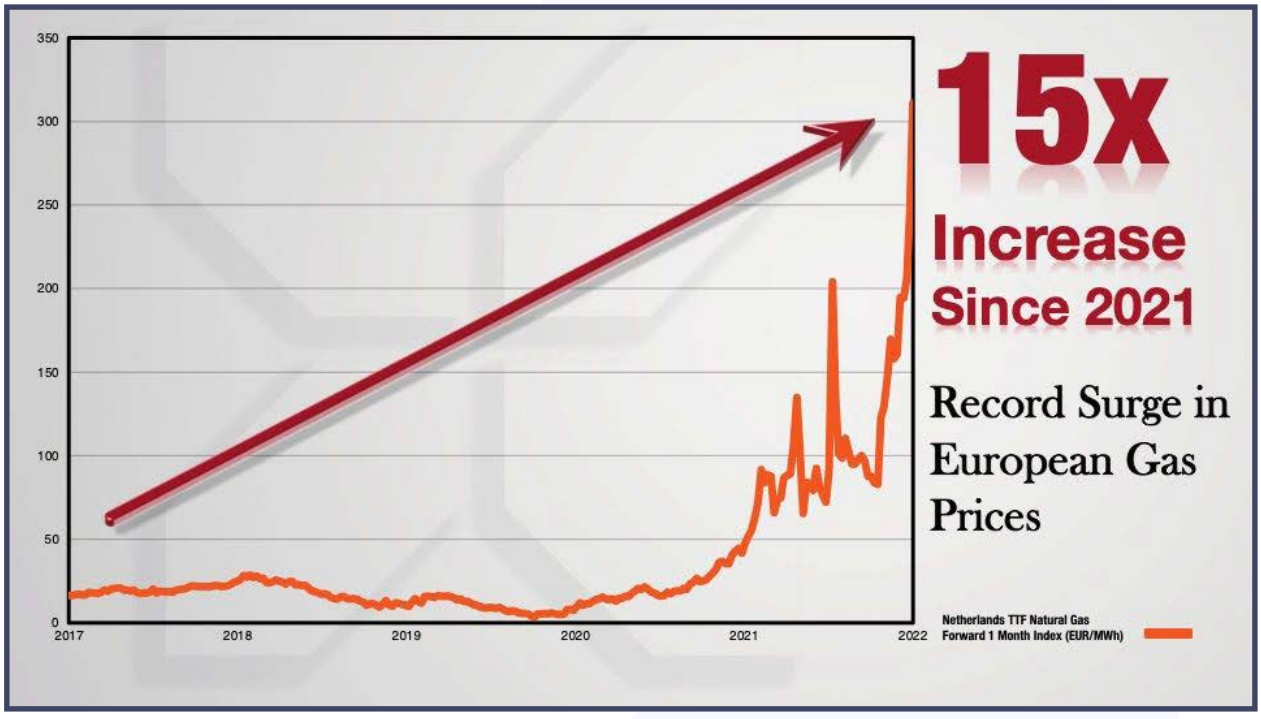
Just imagine what T. Boone would think of the opportunity being created by European politicians today.

Just like California in the 1990s, Europe has regulated itself into a severe energy shortage. Bans on hydraulic fracturing and political decisions to abandon nuclear power led to dependence on Russian natural gas.

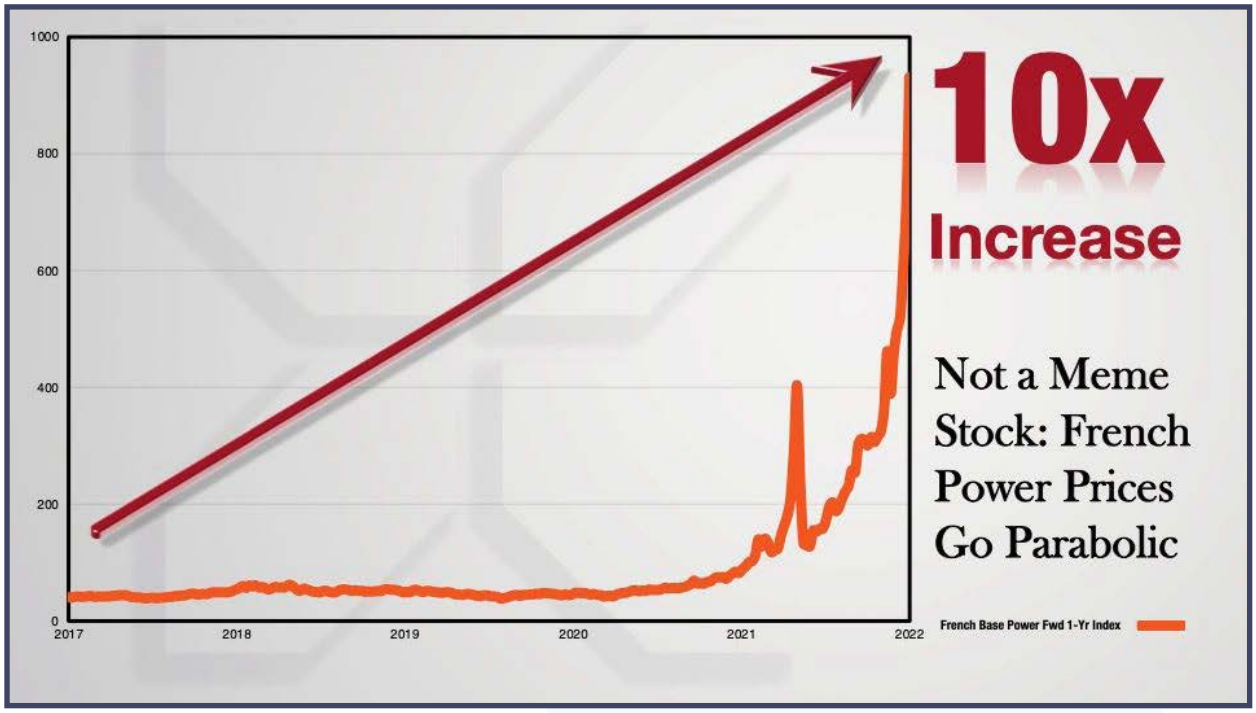
Then Russian President Vladimir Putin turned out to be even less reliable than wind and solar power. The result: Europe is spiraling into an economic collapse, with severe consequences for the entire global economy. The only solution: Much higher prices for natural gas.

Fears of a halt in Russian energy flows this winter have sent European natural gas prices spiking into previously unimaginable territory, approaching $272 per thousand cubic feet (mcf) this past summer. (For reference, U.S. gas prices traded around $3-$4 per mcf for much of the last decade.)

Without any easy or immediate replacement for disrupted Russian volumes, the market is pulling the only remaining lever to balance the market: a demand-destroying price rally.



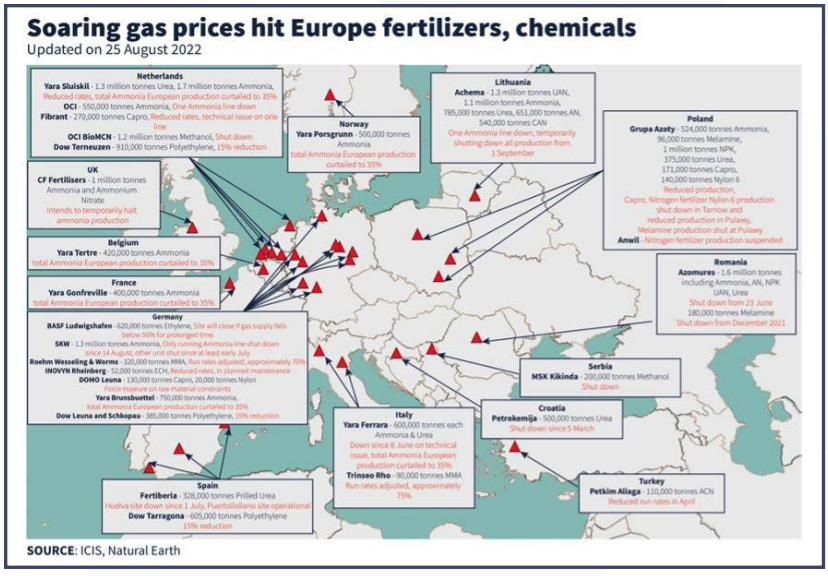
That's how Europe finds itself in a situation with power prices trading like a meme stock stuck in a short squeeze. This isn't only hurting consumer demand. Natural gas and electricity are the two key inputs for manufacturing in Europe.



We should note that the combination of mild weather and ample gas storage in Europe has caused spot natural gas prices to plunge in fall 2022. However, despite the short-term price weakness, the lack of Russian volume leaves Europe vulnerable. With the Nord Stream Pipeline shut down and no signs of a resolution in the Ukraine conflict, Europe's energy supply remains dependent upon the whims of mother nature.

The charts above show price spikes as they occurred in summer 2022. Even though prices have come back to earth since the 10x and 15x increases shown above, the threat of a shortage remains...

Absent a resolution in Ukraine and return of Russian gas supply, Europe will face the ongoing risks of a crippling gas shortage until new sources of LNG come online starting in 2025. The tight supplies of gas and soaring electrical prices will push the European economy into chaos. Each day, it seems we hear of another new announcement of production cuts or outright shutdowns in manufacturing plants.



For now, the wholesale power market is the focal point of the European energy crisis. But it's only a matter of time before wholesale prices hit consumers in the retail market. An executive director at one UK power company recently issued a shocking warning that "**more than half of UK households will likely be in fuel poverty by January**."

And yet, politicians show no signs of addressing the real problem – a rational approach toward energy policy. The political solution? Print more money and attempt to manipulate the market with price controls! (A recent series of UK parliament resolutions called for "energy price freezes, solidarity taxes, and social tariffs that lower bills for lower income households.")

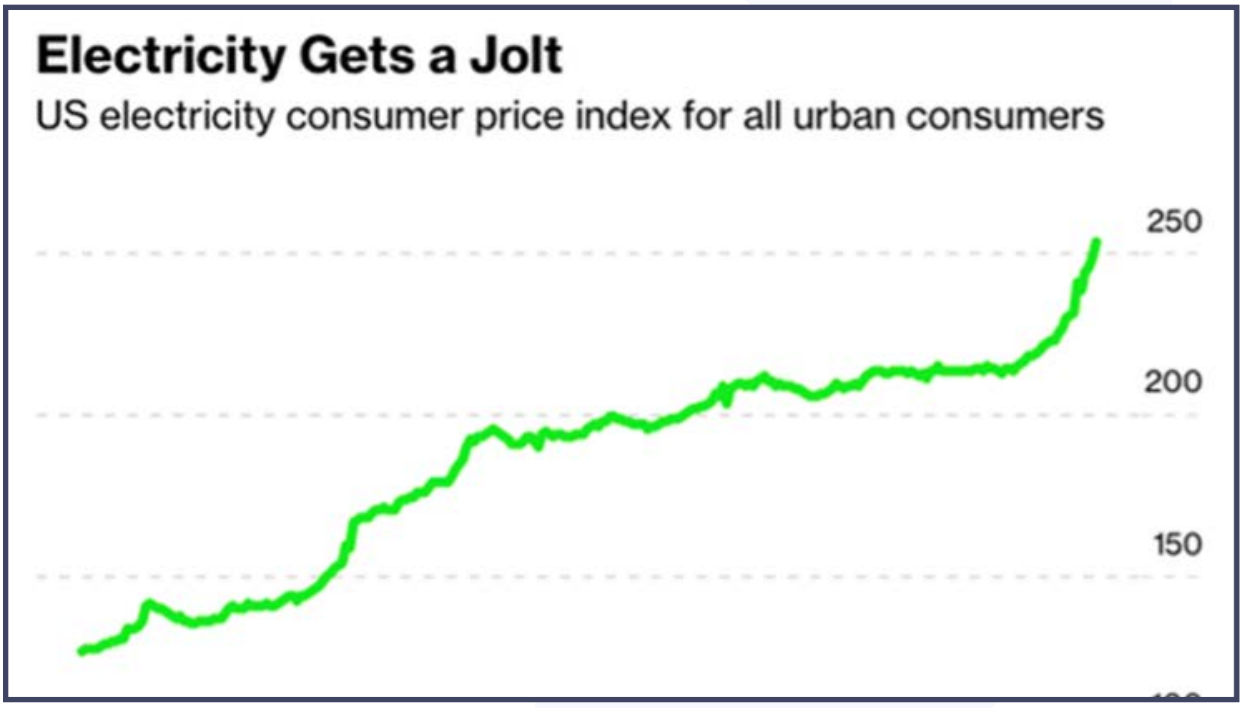
Likewise, across Europe, governments continue to regulate retail prices of electricity, while subsidizing utility companies (with printed money) that have been bankrupted because they cannot pass on the new, vastly higher cost of energy. These policies will cause a hyper-inflationary environment in Europe and, sooner than most people expect, fuel and electrical rationing there. The only solution is producing or importing a lot more natural gas.

BP Capital made $8 billion when these exact same things happened in California. How much will you make on Europe's crisis, which will be even bigger and last even longer? The situation is like a coin where both sides are heads.

WINTER IS COMING: THE U.S. WILL SEE VASTLY HIGHER NATURAL GAS PRICES TOO

As Russian energy supplies leave the world's markets, global demand for American energy will continue to grow, pushing up the price of energy that can be exported from America, like oil, coal, and liquefied natural gas ("LNG"). That will, in turn, lead to higher electrical prices here, too.

And in places like New England, which rely heavily on natural gas – but which lack new natural gas infrastructure – the price spikes will look more and more like Europe's:



The only cure to these problems is increases to baseload power generation.

And the fastest and quickest way to accomplish that in Europe is building natural gas-fired power plants. That will mean big increases to American LNG exports over the next decade. There's truly no other solution.

In America, that will mean more natural gas pipelines, more drilling, and more production. And that gives us tremendous confidence in the American LNG investments in our portfolio, EQT (NYSE: EQT) and Tellurian (NYSE: TELL).

But these companies have one problem: They require huge amounts of capital to grow. Natural gas production and LNG exports are highly capital inefficient. Tellurian will have to raise and invest between $6 billion and $10 billion in capital to build out its oil and gas wells, pipelines, and the Driftwood LNG export facility.

Likewise, eventually EQT will have to reinvest billions of dollars in drilling new wells and building new pipelines to expand its production. These investments will create a lot of risk, as natural gas prices are incredibly volatile. The capital required could also significantly reduce the amount of profit that eventually reaches investors if it is invested unwisely or even just at the wrong time. That's what happened to T. Boone at Mesa. He was about four years too early. It wiped him out. As Warren Buffett's longtime right-hand man Charlie Munger once explained:

> *"There are two kinds of businesses. The first earns 12%, and you can take it as cash. The other earns 12%, but all must be reinvested. It reminds me of the guy who looks at his equipment and says, 'There's all of my profit.' We hate that business."*

As T. Boone Pickens discovered the hard way, it's much better to simply own the hydrocarbons. Let other folks do the heavy of producing and distributing the energy. And what's the best way of buying a huge amount of energy in the ground?

OWNING THE ENERGY, NOT THE PRODUCTION COSTS

Once again, we owe an intellectual debt to T. Boone.

In 1979, T. Boone Pickens created the first publicly traded "MLP" – a publicly traded partnership – that would own only mineral rights. He took most of the proven assets of Mesa Petroleum – huge oil and gas fields in Kansas, New Mexico, Colorado, and Wyoming – and he spun them off into a separately listed partnership, the Mesa Royalty Trust (NYSE: MTR, $16).

The idea was to separate the income streams from proven and operating fields from the costs of finding and developing additional fields. Doing so was much more tax efficient, as partnerships are not taxed like corporations are. Creating the trust meant shielding most of Mesa's income from corporate taxes. Mesa Petroleum, meanwhile, could take the capital from selling the assets, and continue to explore and develop more fields, activities that would generate tax-losses.

This structural innovation turned T. Boone into a "corporate raider" – as he couldn't figure out why much larger oil companies, like Gulf Oil, didn't do the same thing: Create royalty trusts to shield their income from taxes. T. Boone bought nearly 10% of Gulf Oil and demanded these changes be made, or else. The company was "in play" and through a series of mergers became Chevron. T. Boone made over $700 million on the investment for his partnership in two years' time.

Since those days, MLPs (master limited partnerships) have become a major segment of the stock market. They provide tax-efficient income for energy investors, much like REITs do for real-estate investors. We think they are an outstanding investment vehicle for conservative investors who want income and exposure to higher energy prices and growth in production. Investing in the sector is tricky, however, as these partnerships normally have tax accounting requirements (a 1099) and because you have to avoid buying into a trust when it's trading at a value that's above the value of its proven assets.

Looking at the sector today, our top pick is **Viper Energy Partners LP (VNOM)**.

The company's assets were developed by Diamondback Energy Inc. and are in the heart of Texas' leading field, the Permian Basin. But now these proven assets are owned by Viper Energy Partners. If an oil company – Diamondback or anyone else – wants to produce oil from land that Viper owns mineral rights on, it must get Viper's permission. That means striking a deal where Viper extends a lease for the development of the resource in exchange for a cut of the profits.

T. Boone created the first energy trusts for tax reasons, but the advantages of these kinds of businesses go well beyond tax benefits. The key to understanding these businesses is that they don't have to pay any of the production costs or take any of the developmental risks: Viper just owns the mineral rights. The only cost Viper incurs is the upfront acquisition of the mineral rights. Once it owns them, all capital and operating expenses lie with the operator.

And that means, as inflation continues to drive energy prices higher, the rights that Viper acquired in the past become more and more valuable.

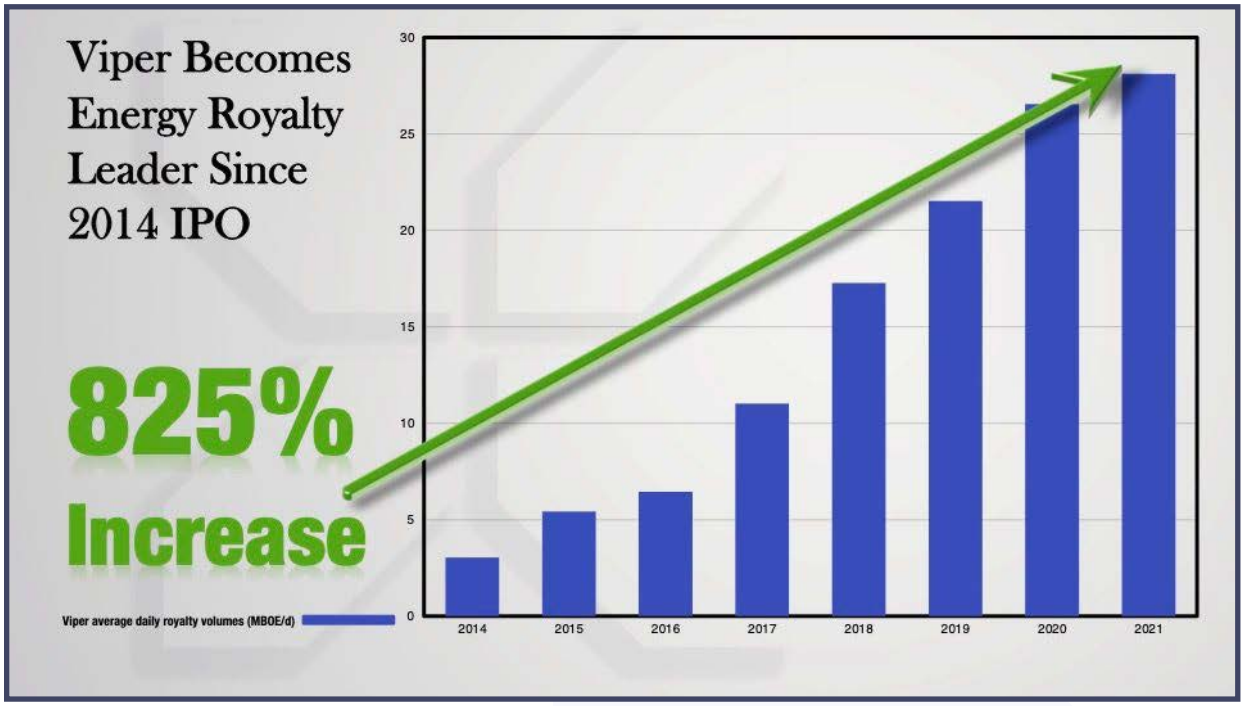
Viper transforms a capital-intensive industry into a capital-efficient business that's virtually guaranteed to produce increasing returns across time. In fact, Viper really isn't a business at all: it's mainly a legal fiction that generates enormous wealth. Well-run mineral rights businesses like Viper are truly one of Wall Street's greatest secrets.

Consider: our standard rule of thumb when seeking out capital-efficient companies is finding businesses capable of converting at least 10% of sales into free cash flow, or a 10% free cash flow margin. **Over the last five years, Viper has averaged an incredible 77% free cash flow margin.**

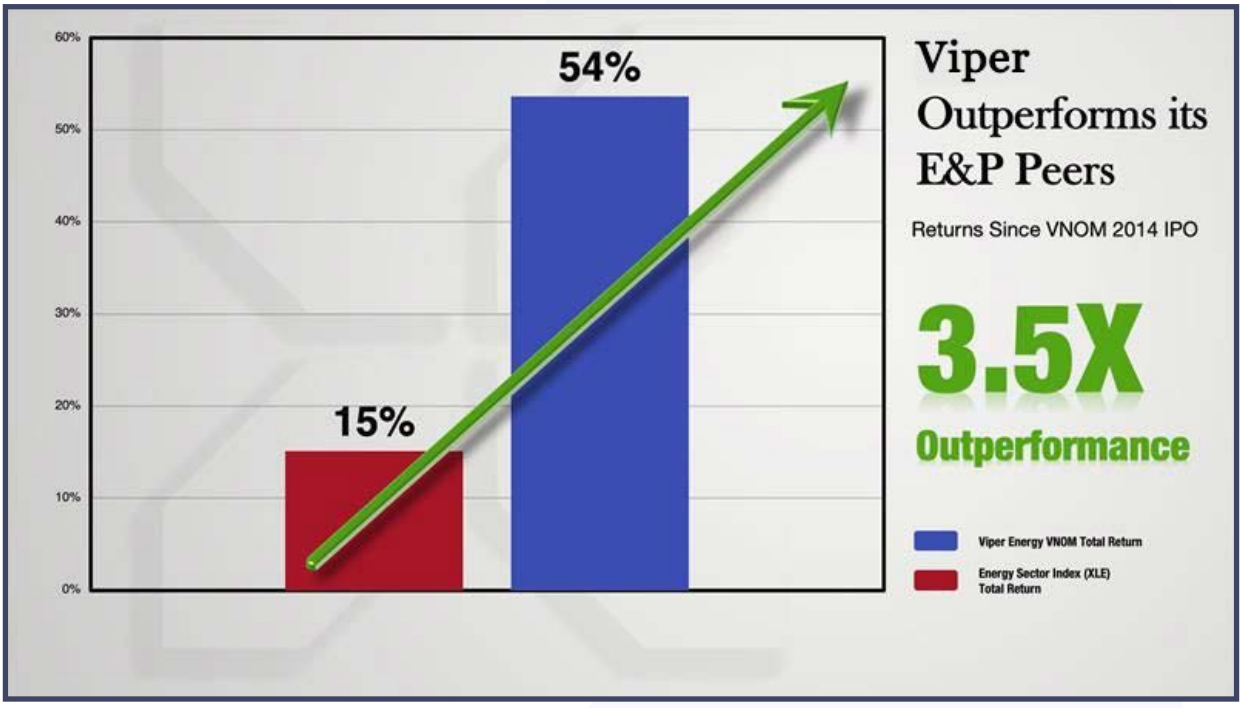
Another metric of capital efficiency we look for are businesses that can earn $500,000 or more in operating income per employee. Well, Viper pushes the theoretical limit here. **The company has zero employees. You read that right – zero.**

Zero capital expenditures and zero employees is how Viper offers one of the most capital-efficient businesses – not just in the shale patch – but in the entire stock market. But before explaining how this unique business model churns out gobs of cash with zero employees and zero capital expenditures, let's begin with the company basics.

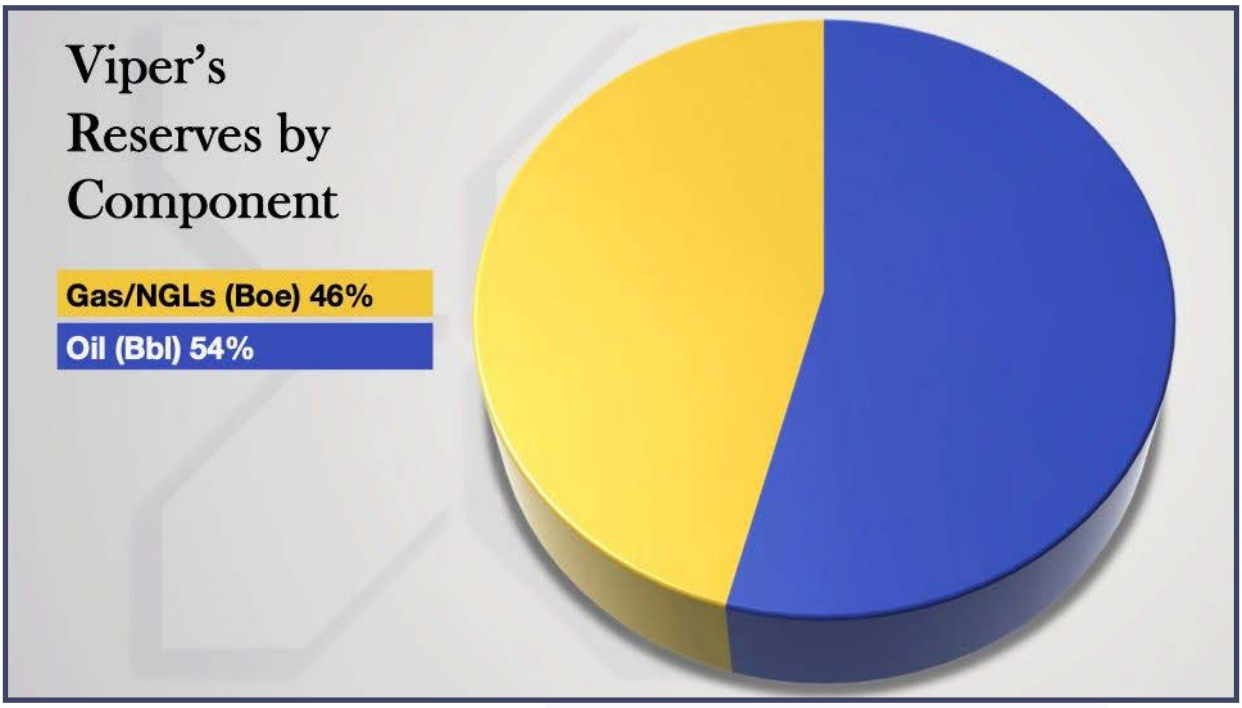
Viper was created as a spin-off from Diamondback Energy in 2014. Viper was one of the first pure-play energy royalty businesses in the Permian and leads the market in consolidating royalty acreage – investing over $2.5 billion acquiring mineral rights over the last several years.
Since going public in 2014, Viper's royalty volumes have grown nearly 10-fold, from average daily volumes of 3,000 barrels of oil equivalent ("BOE") eight years ago to 28,000 last year:



Investors have reaped the benefits, with Viper shares outperforming the broader energy sector by a factor of 3.5 to 1 since its inception as a public company:



Viper owns mineral interests spanning across 930,871 gross acres and over 9,000 producing wells, with net production of 31,359 barrels of oil equivalent per day ("BOE/d"). The company's total proven reserves stood at 128 million BOE as of year-end 2021, including 54% oil and 46% natural gas and natural gas liquids ("NGLs"):



This reserve mix provides us with hedged exposure to a general bull market in fossil fuels – including oil and natural gas.

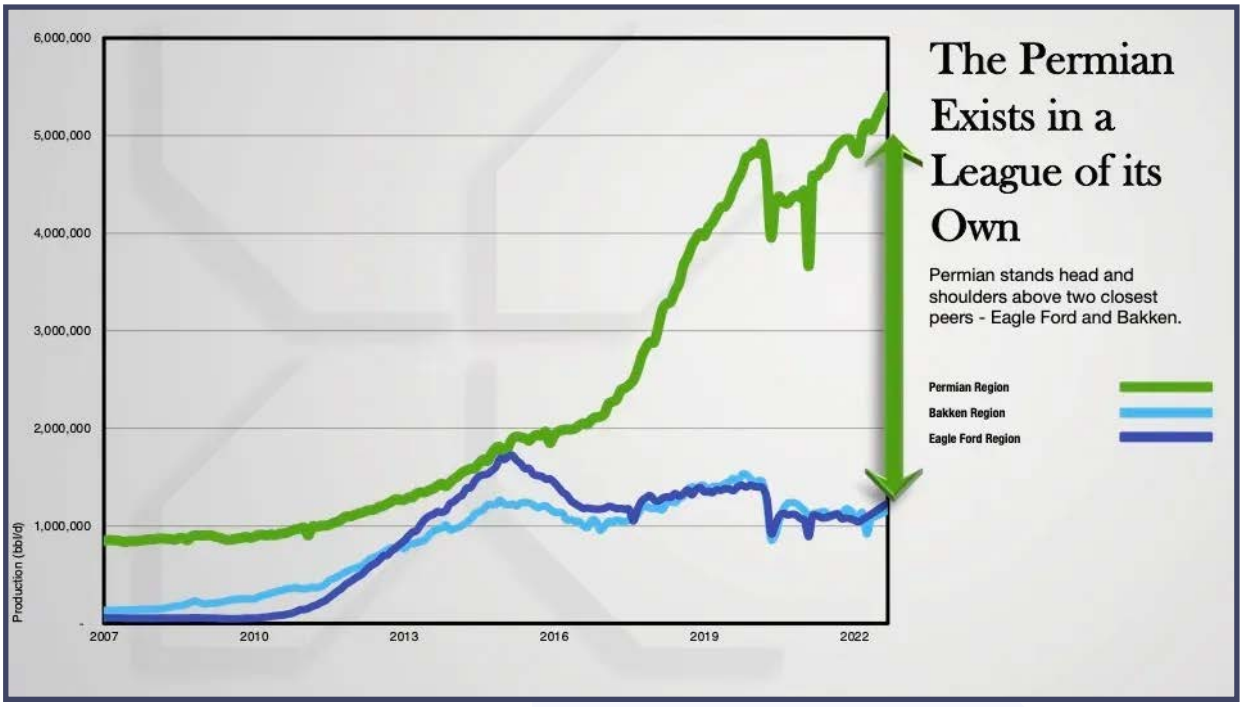
But more important than the what is the where. You see, the value of mineral rights goes beyond the cash flows that the existing oil or gas wells produce today. The real upside comes from buying the right acreage that has substantial upside from additional development in the future.

BUY THE PERMIAN, NOW

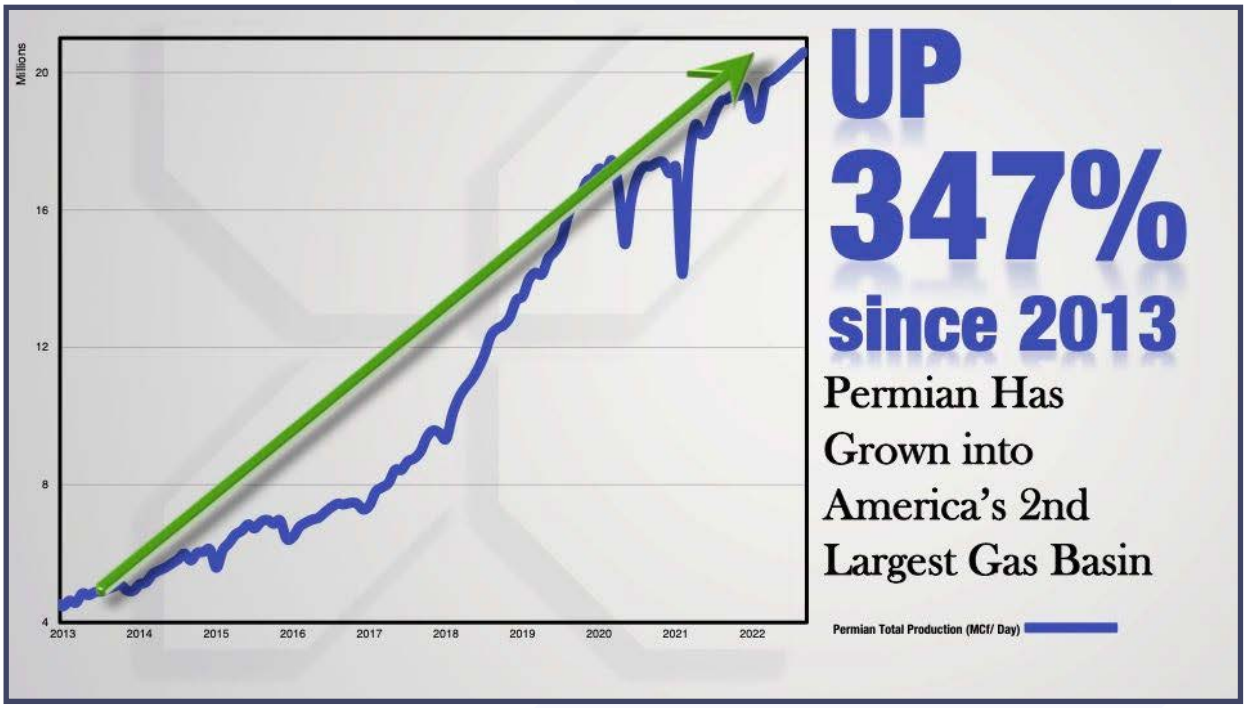
Viper's asset base is concentrated in the heart of the Permian – America's most prolific oil and gas deposit. The Permian spans across 75,000 square miles in West Texas and New Mexico, and it's one of the oldest producing formations in America.

Unlike its next two closest peers – the Eagle Ford and the Bakken, which only sprang to life during the last decade's shale revolution – the Permian has produced oil and gas since the 1920s. The depth and quality of reserves are simply unmatched, as we can see in the data.

During each of the previous oil bear markets, including 2016 and 2020, the Permian suffered a shallower decline and faster recovery compared with the Eagle Ford and Bakken. And only the Permian has reclaimed new highs in output during each subsequent recovery, compared with the Bakken and Eagle Ford, which both remain below their production peaks reached back in 2014:



Going beyond oil, the Permian also hosts one of America's largest deposits of low-cost natural gas. Over the last decade, explosive growth in gas production has pushed the Permian into America's second-largest gas basin, trailing only the Marcellus formation in the Appalachian shale:



Finally, even more important than the what and where is the who.

POWERFUL PARTNERSHIP

You see, owning mineral rights on great acreage is only half the battle. After all, mineral owners only get paid when oil and gas gets produced. That's why it's critical to partner with the right operators to maximize the value of that acreage.

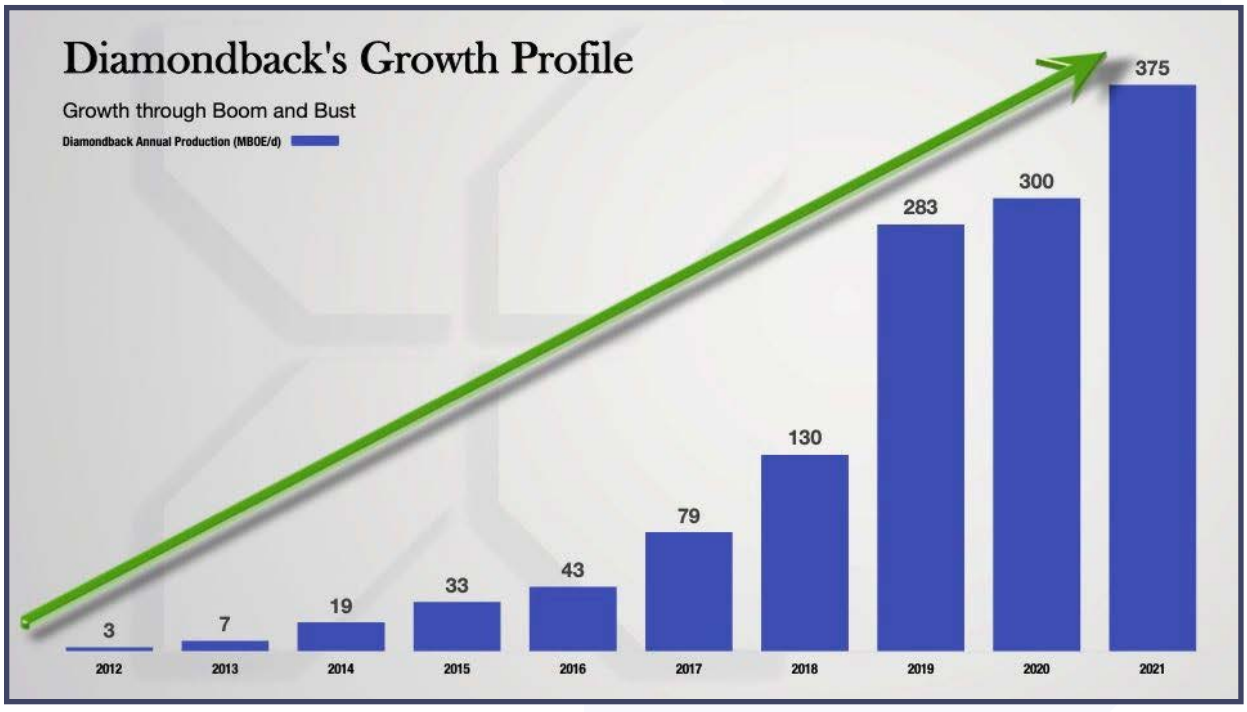
And that's where Viper's biggest edge comes from, through its strategic partnership with Diamondback Energy (NYSE: FANG), one of the best operators in the Permian, operating more than half of Viper's acreage.

Diamondback was formed in 2007. Back then, T. Boone Pickens and just about everyone else believed that the Permian's best days were behind it... and for good reason. For the previous 35 years, production entered into secular decline, from a prior peak of 2.2 million barrels per day (b/d) in 1972 down to a low of around 750,000 b/d in 2008.

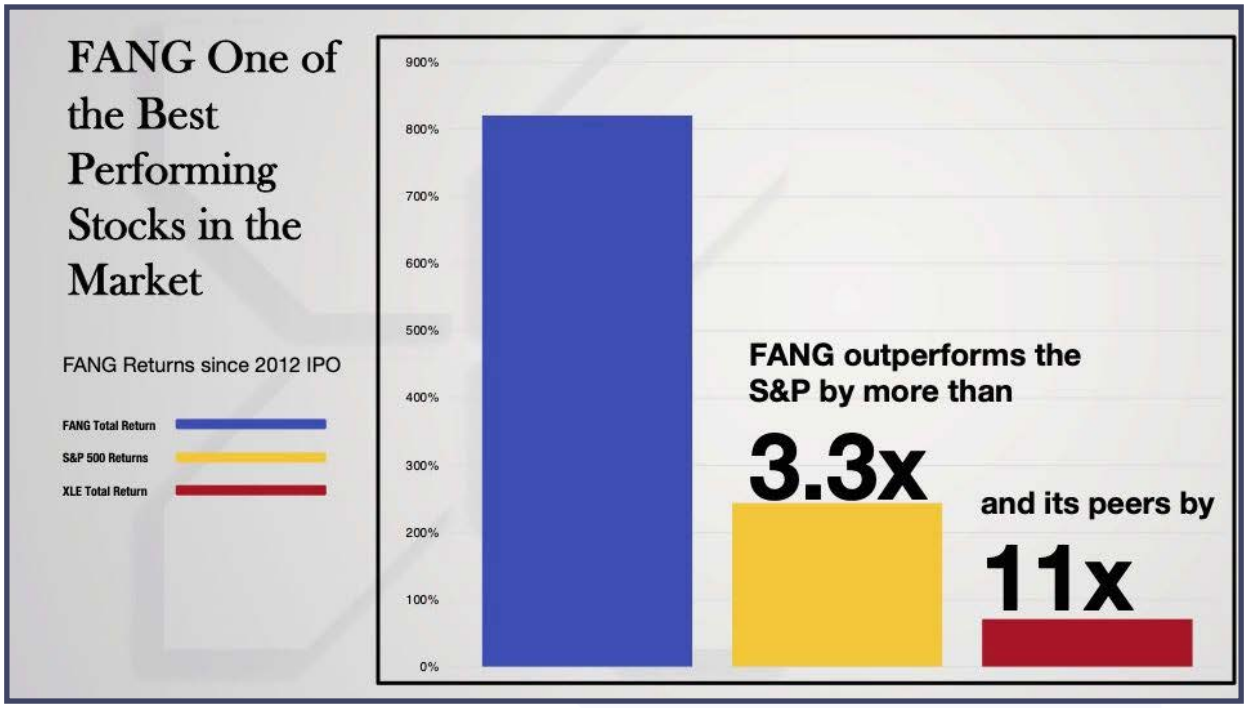
But operators like Diamondback, along with the new production and completion techniques of the shale revolution, brought the basin back to life. Today, the Permian is America's largest low-cost oil basin, producing over 5 million b/d.

Diamondback was ahead of its time with a concentrated focus on the Permian from day one, starting with over 4,000 acres in 2007 and expanding from there. Because Diamondback began leasing up the Permian years before the shale boom, the company secured a leading acreage position that paved the way for incredible growth in oil and gas production over the last decade.

Meanwhile, management is among the best in the business, maintaining a disciplined approach to capital allocation and a conservative balance sheet. That's how Diamondback posted consistently impressive growth through the ups and downs in energy prices over the last decade:



In an industry that largely destroyed shareholder capital during the last decade, Diamondback became one of the best-performing stocks – not just in energy, but in the entire stock market. Shares compounded at an incredible rate of 24% since going public in 2012, handily outperforming the energy sector and the overall stock market:



With record profits and production and more than a decade of tier-one inventory in the heart of America's top oil and gas basin, Diamondback's prospects look brighter than ever. This, in turn, is great for Viper.

That's because Viper enjoys a unique relationship with Diamondback, which unlocks tremendous capital efficiency in a way that we haven't found anywhere else in the shale patch.

Diamondback is the majority owner of Viper, holding 54% of all outstanding units. This aligns Diamondback and Viper's incentives, ensuring that both parties profit from Viper's success. And it's this relationship that makes Viper's unit economics so compelling. Diamondback allows Viper to draw upon its internal staff and resources to the point where Viper requires zero of its own employees.

Viper leans on Diamondback to identify the best Permian oil and gas acreage – something Diamondback has already done for the last 15 years and will continue to do going forward. Viper uses this information to strike deals that involve an upfront payment to acquire mineral rights on highly productive acreage.

We can see clear evidence of the success of this model through Viper's track record of growing oil and gas reserves since inception, which has grown by an incredible 7-fold from 18 million BOE in 2014 to 128 million at the end of 2021:

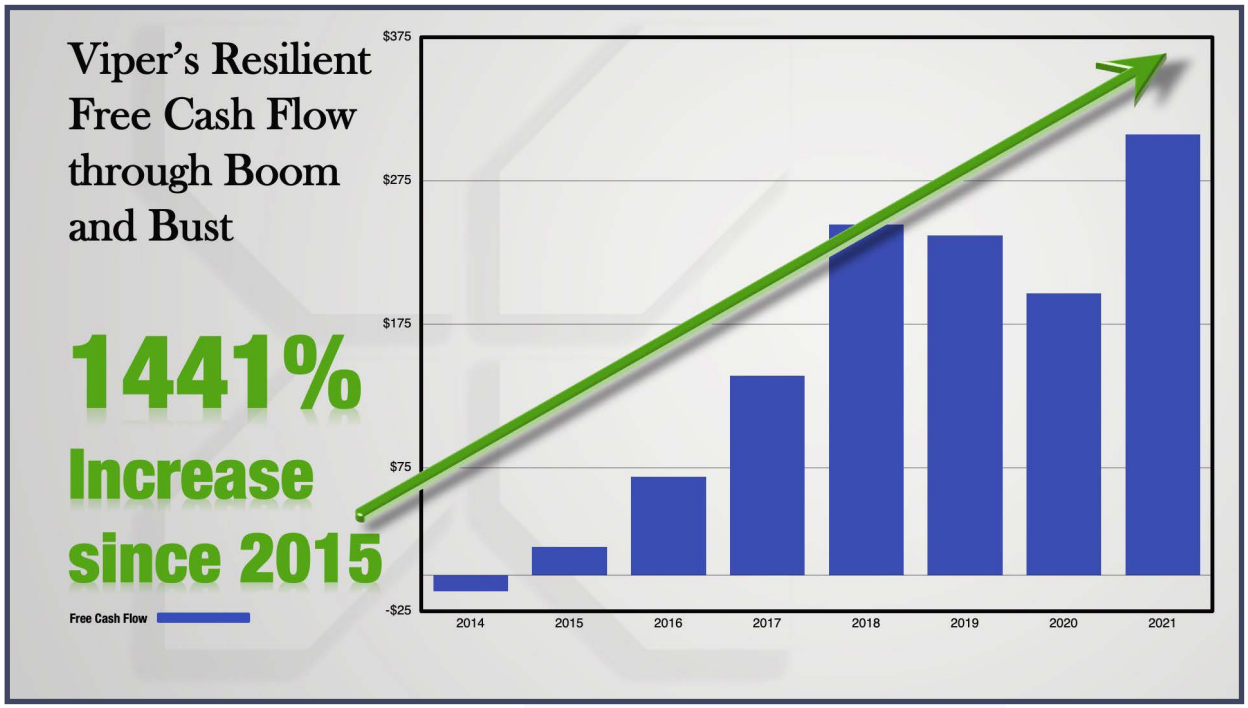
Viper is simply the publicly listed portion of Diamondback's huge royalty book. It allows investors to buy hydrocarbons directly, without the risks and capital requirements of production. In that way, Viper is more like a financing company than an energy company.

A UNIQUELY SAFER BET

Viper's unique business model offers remarkable resilience against the inherent volatility of oil and gas prices.

This is another feature of the company's capital efficiency. The cash flow statements for most commodity producers plunge deep into negative territory during commodities bear markets because the prices of the things they sell goes down, while operating costs and capital expenditures remain stubbornly high.

Viper's business model is designed to be immune from this defect. The following chart shows how Viper sailed through 2020 energy price collapse with barely more than a blip in its cash flow trajectory:



Take another look at the chart above. You can see how Viper is enjoying substantial upside from today's high-price environment... Free cash flow is surging, thanks to the combination of higher prices on its royalty volumes along with its longer-term trend of volume growth.

In other words, Viper provides all the upside from higher energy prices, with only a fraction of the downside compared with traditional oil explorers and producers.

For such a compelling business model, you would expect Viper to command an exorbitant valuation premium. And yet, with a market capitalization of roughly $5 billion, the company trades at less than 10x free cash flow today.

The best part? Without needing to recycle earnings back into expensive equipment and other operating costs, that cash flows right back to investors. That's how the company pays out a current distribution of $1.96 annualized, or a yield of nearly 7% on the current unit price of around $30 per share.

Of course, if energy prices fall, so, too, will the company's cash flow – and the distribution. Plus, because Viper is technically an "energy" company, the unit prices can fluctuate wildly, along with the overall volatility in the energy sector.

That's why anyone owning these units should be able to separate short-term market volatility from the true risks in the underlying business. For all the reasons we've discussed today, we view Viper as one of the lowest-risk businesses in the energy sector. No capital requirements, no operating costs, high and stable cash flows (even during energy bear markets), and a clean balance sheet.

In terms of business risk, you can't do much better... in energy or elsewhere in the market.

WHY WE THINK IT'S SAFER

One final note on the "safety" of the business at current prices.

The valuation for a mineral company like Viper can be broken down into two basic factors:

1. **Value of existing assets**
2. **Upside from asset growth**

To consider an extreme downside scenario for Viper, let's assume the business stops all future growth tomorrow and enters into "liquidation" mode. Let's also assume crude oil prices crash to $66 per barrel (from around $90 now) and stay there indefinitely as the company cashes in its royalty streams.

What would the business be worth?

Well, we have an answer in the company's official SEC filings, via the audited, third-party report of the company's reserves. reserve report.

Reserve values provide the closest thing to book value you can find in the energy world. Reserve reports provide standardized measures of "proven reserves". A proven reserve is a volume of economically viable oil (or natural gas, or NGL) deposit that sits within a certain distance from already-producing wells. This allows engineers to extrapolate the reservoir characteristics of the existing producing wells to the yet-to-be-produced "reserves" located underground.

When companies file reserve reports in their annual reports, the SEC requires the volume of these reserves as well as an estimate of the future cash flows the company will earn as these reserves get produced.

Historically, energy companies tend to trade at premium valuations to their proved reserve values. The reason for this is that the SEC definitions are considered conservative regarding future reserve development, and because most energy companies will grow their reserve values over time.

The chart below shows how this was the case for Viper, whose enterprise value traded at a historical premium to its proven reserve value – reaching as high as 4x in late 2018. Today, the company trades at a roughly 12% discount to its proven reserve base:

Here's the kicker – the company's current reserve value was calculated for year-end 2021, using $66 oil as the price assumption.

In other words, oil prices could plunge to $66 per barrel – and stay there indefinitely – and investors buying Viper units today would still be getting the company below fair value.

So as you can see, even in the hard-to-imagine scenario of perpetually depressed energy prices and a rundown of Viper's existing asset base, investors buying at current prices are getting a fair deal.

Meanwhile, if you believe that Viper and Diamondback will continue thriving in America's best oil and gas basin – as they have for the last decade – then it's all upside from here.

Plus, if you buy into the view that energy prices will remain inflated at much higher values going forward (even despite some volatility and a potential recession along the way), well, Viper is the ultimate vehicle for capturing that upside without taking big risks along the way. In the meantime, you can collect a nearly 11% yield while you wait to see how it all unfolds. That's about as safe a bet as you can get anywhere in today's financial markets.

Action to Take: For the latest updates on our open positions, please visit our live portfolio **here.**