



THE BIG SECRET ON WALL STREET

Energy Royalties

- The Big Secret Behind T. Boone's Fortune
- Now, You Can Supersize the Same Trade That Made T. Boone 9,000%
- The Best Resource Acreage in Texas at a Discount – Without Any Production Costs or Risks

The bottom half of the page features a dark, atmospheric photograph of an oil field. Two large pumpjacks are visible, their mechanical arms and structures silhouetted against a cloudy, twilight sky. The overall tone is somber and industrial.

FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

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The Big Secret Behind T. Boone's Fortune

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"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 the 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

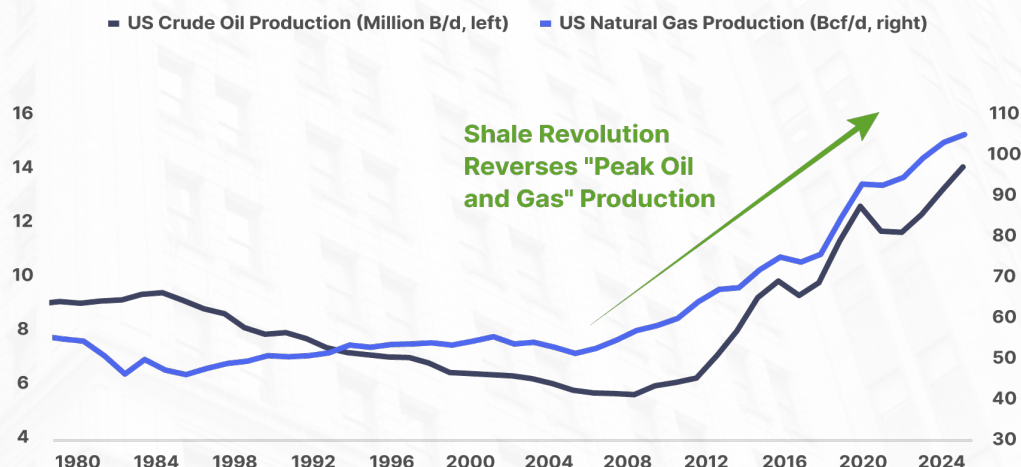
Just imagine what T. Boone would think of the opportunity being created from mineral rights in America today.

When Boone made his fortune betting on higher energy prices at the turn of the century, American energy production was stuck in a multi-decade trend of declining production. And the conventional wisdom at the time said this phenomenon, known as “peak oil,” would lead to ever-higher energy prices.

But then, the shale revolution happened, when U.S. energy companies discovered how to tap into massive reserves of oil and gas deposits that were previously trapped in tightly held shale rock formations. Specifically, the commercialization of horizontal drilling and hydraulic fracturing (“fracking”) techniques.

Starting in the mid-2000s, shale drillers using these technologies unleashed record volumes of new hydrocarbon production. This reversed the prior multi-decade trend of declining U.S. output, as oil production nearly tripled from 5 million b/d to nearly 14 million b/d today. Meanwhile, natural gas production more than doubled from 46 billion cubic feet per day (Bcf/d) to over 100 Bcf/d:

Shale Revolution Sends US Oil and Gas Production Soaring



In America, that will mean more oil and gas pipelines, more drilling, and more production. But the companies involved in building this infrastructure and pulling oil and gas from the ground have one problem: they require huge amounts of capital to grow. Drilling shale wells is like running on an endless treadmill; as soon as the well comes online, production begins rapidly depleting. This means a big chunk of the profits from existing wells must constantly go right back into the ground to drill more wells to keep production growing.

These investments create a lot of risk, as oil and gas prices are incredibly volatile. And the capital required significantly reduces the amount of profit that eventually reaches investors, especially 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 lifting of producing and distributing the energy. And what's the best way of buying a huge amount of energy in the ground, while avoiding the costs of bringing that energy to the surface? Owning the mineral rights, and getting paid royalties on the production from the companies that produce the energy.

Owning The Energy, Not The Production Costs

Viper Energy (Nasdaq: VNOM) is one of the world's best energy royalty companies.

The company's assets were developed by shale driller Diamondback Energy Inc. (NYSE: FANG) and are in the heart of Texas' leading oilfield, the Permian Basin. In 2014, Diamondback created Viper Energy as a separate company to own and manage these properties. Through this transaction, Viper became a separate publicly traded entity, although Diamondback retained a controlling interest, and today owns 56% of Viper's shares (more on this later).

Since Viper now owns these properties and the associated mineral rights, this means that if an oil company – Diamondback or anyone else – wants to produce oil from land that Viper owns, 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.

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.

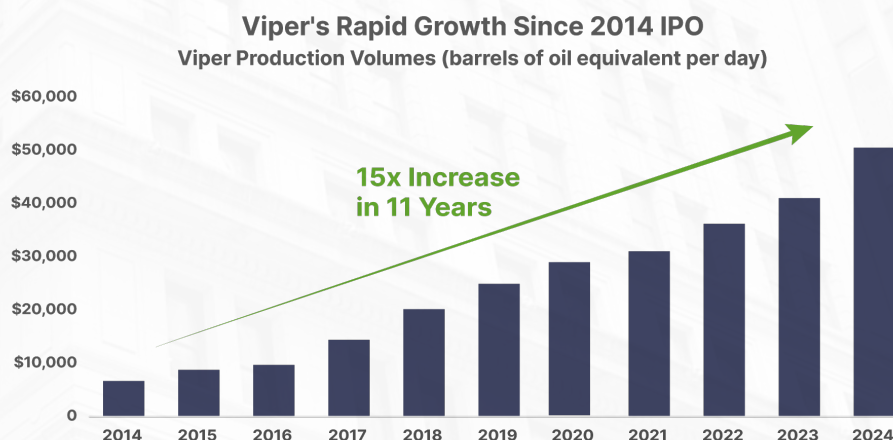
Consider: our standard rule of thumb when seeking out capital-efficient companies is finding businesses capable of converting at least 10% of sales into free cash flow, or a 10% free cash flow margin. Over the last five years, Viper has averaged an incredible 75% free cash flow margin.

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.

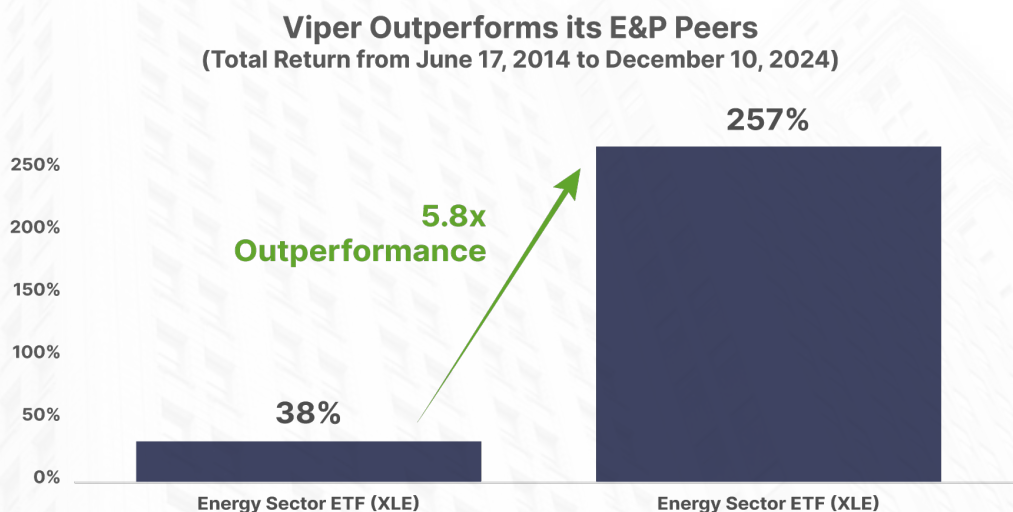
Zero capital expenditures and zero employees is how Viper offers one of the most capital-efficient businesses – not just in the shale patch – but in the entire stock market. But before explaining how this unique business model churns out gobs of cash with zero employees and zero capital expenditures,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

In the 11 years since it went public in 2014, Viper's royalty volumes have grown 15-fold, from average daily volumes of 3,000 barrels of oil equivalent ("BOE") to 49,000 in 2024:

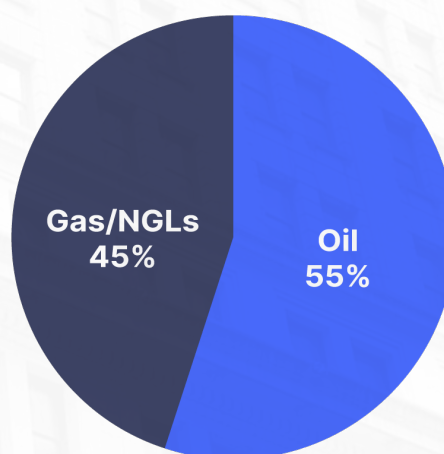


Investors have reaped the benefits, with Viper shares outperforming the broader energy sector (measured by the SPDR Energy Sector exchange traded fund) by a factor of 5.8 to 1 since its inception as a public company in June 2014:



Viper owns mineral interests spanning across 1.2 million gross acres and 15,000 producing wells, with net production of 49,000 barrels of oil equivalent per day ("BOE/d"). The company's total proven reserves stood at 179 million BOE as of year-end 2023, including 55% oil and 45% natural gas and natural gas liquids ("NGLs"):

Viper's Reserves by Component



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

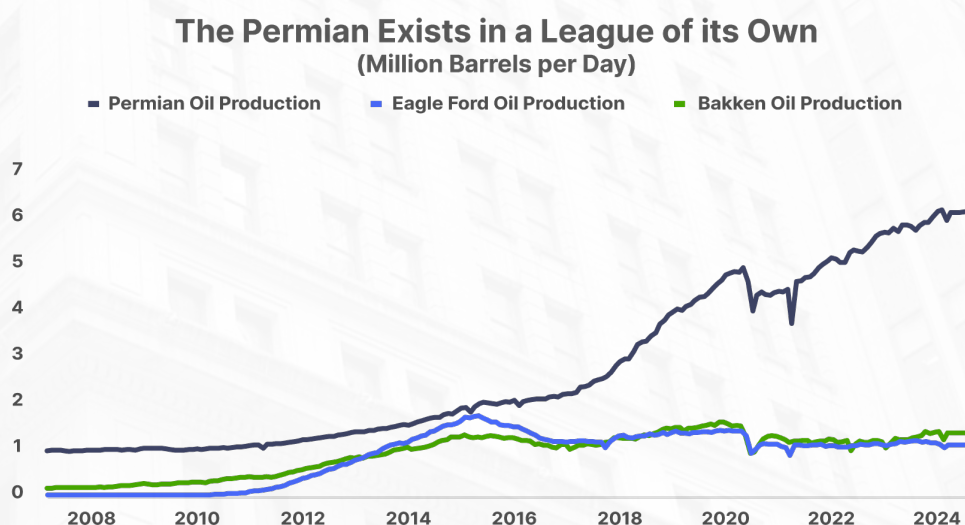
But more important than the what is the where. You see, the value of mineral rights goes beyond the cash flows that the existing oil or gas wells produce today. The real upside comes from buying the right acreage that has substantial upside from additional development in the future.

America's Most Prolific Oil Deposit

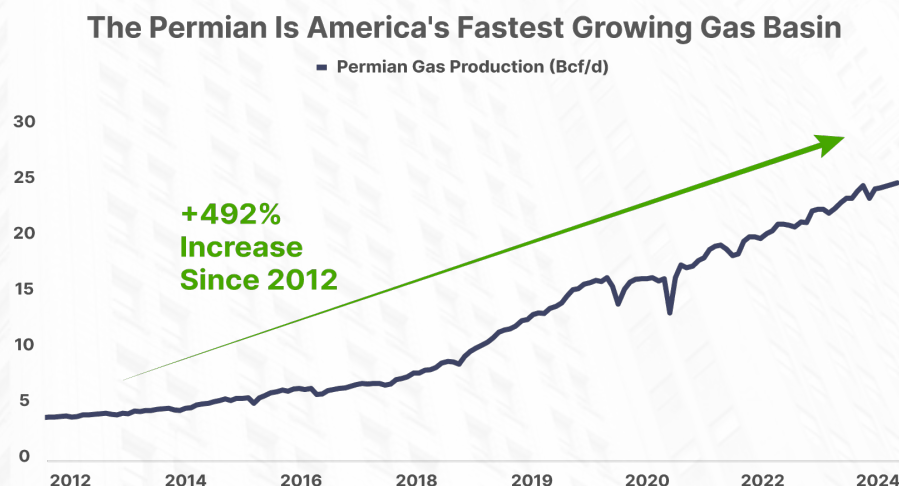
Viper's asset base is concentrated in the heart of the Permian – America's most prolific oil and gas deposit. The Permian spans across 75,000 square miles in West Texas and New Mexico, and it's one of the oldest producing formations in America.

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, the Permian has become America's fastest growing gas basin, with a remarkable 492% increase in production since 2012 (it's now the second-largest US gas basin by production, 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, one of the best operators in the Permian, operating more than half of Viper's acreage.

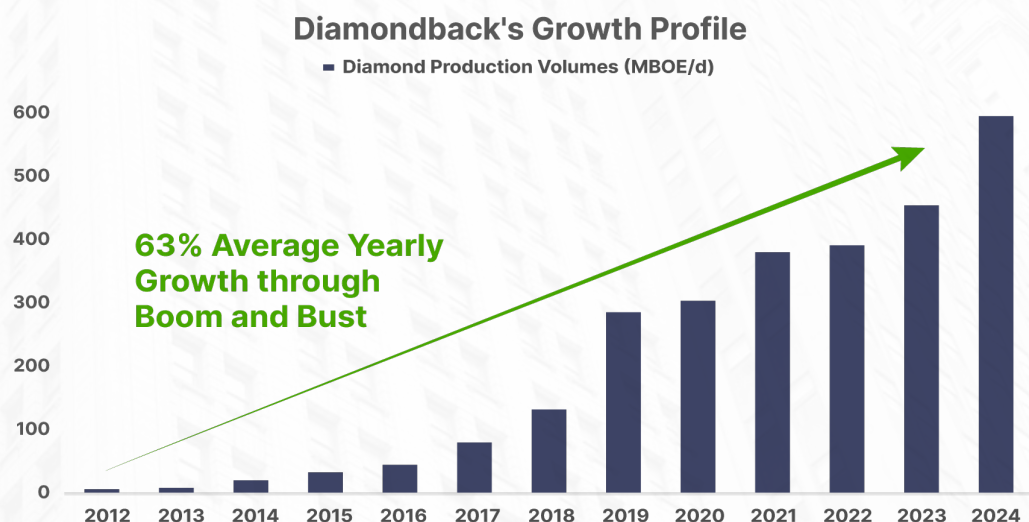
Diamondback was formed in 2007. Back then, T. Boone Pickens and just about everyone else believed that the Permian's best days were behind it... and for good reason. For the previous 35 years, production entered into secular decline, from a prior peak of 2.2 million barrels per day (b/d) in 1972 down 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 6 million b/d.

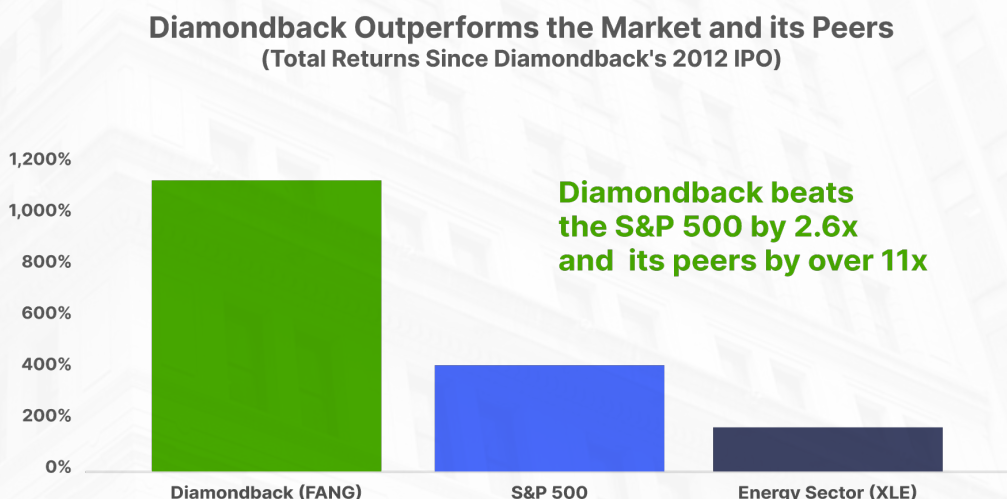
Diamondback was ahead of its time with a concentrated focus on the Permian from day one, starting with over 4,000 acres in 2007 and expanding from there.

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 averaging 63% per year since its 2012 IPO, through the ups and downs in energy prices along the way:



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 56% of all outstanding shares. 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 production inception, which has increased by 15-fold over the last 11 years.

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.

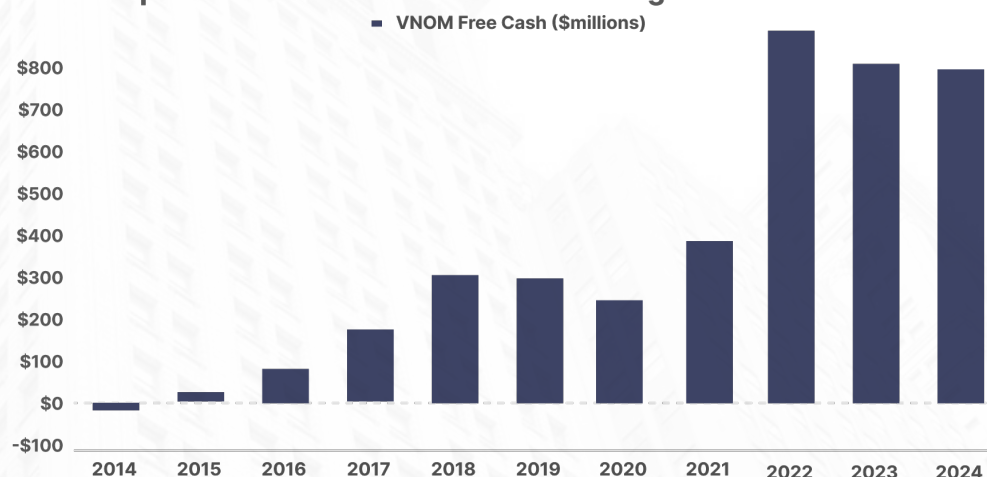
A Uniquely Safer Bet

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:

Viper's Resilient Free Cash Flow through Boom and Bust



Take another look at the chart above. You can see how Viper is enjoying substantial upside from the post-COVID recovery in energy prices... Free cash flow has more than tripled from less than \$200 million in 2020 to over \$600 million in each of the last three years, 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 \$10 billion, the company trades at just 16x free cash flow. That's a nearly 50% discount to the S&P 500's valuation at 31x free cash flow.

Said another way, Viper's free cash flow yield (or the percentage of its free cash flow divided by its current market capitalization) is over 6% versus 3% for the overall market. And because of Viper's highly capital efficient business model, it can return most of that free cash flow to investors through a current dividend of \$2.44 per year, or a yield of nearly 5%.

Of course, if energy prices fall, so, too, will the company's cash flow – and the dividend payments. Plus, because Viper is technically an “energy” company, the share price will fluctuate along with the volatility in energy prices.

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 employees, and high and stable cash flows that remain resilient even during energy bear markets. Best of all, this is a business built to consistently return its high (and growing) free cash flow to investors through steady dividend payments.

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

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