T. Boone Pickens: How he uses futures markets

By Ginger Szala, associate editor

When crude oil prices hovered in the upper $20 per barrel range last fall, T. Boone Pickens Jr. determined they were about to break.

He decided to use futures to hedge the entire 1986 crude oil production — 4 million barrels — of Mesa Petroleum Co., an independent oil company he founded and heads as chairman. He locked in a price of $26.50 per barrel.

The rest is history. Oil prices skidded more than 50% over the next seven months. The hedge, which Mesa pulled at $16, well above the bottom of the market, saved the company from losing $30 million as oil prices crashed.

Pickens' name didn't become a household word because of his futures market savvy, of course, but because of his part in restructuring the oil industry. Almost single-handedly, Pickens has throttled this huge industry, forcing Cities Service to sell out to Occidental Petroleum, Gulf Oil to be purchased by Chevron and Phillips Petroleum Co. and Unocal to put up a lot of money to offset takeover bids.

By shaking up corporate America, Pickens has raked in more than $400 million in profits for Mesa (now Mesa Limited Partnership or MLP). Shareholders of his takeover targets haven't fared badly, either. Values of holdings have grown more than $12 billion due to his actions.

It's hard to believe the Oklahoma native turned Texan could raise such a ruckus. The grandfather of seven, who calls an interview "visitin'," is pleasant, wry-humored, straightforward.

He laughs at descriptions that peg him as a "go-in-shooting" or "fast-draw" type, a "gambler," a "corporate raider." The way he sees it, he's just a good businessman who knows how to assess risk.

"When I think I have the odds strongly in my favor, I don't hesitate to put the money in," he says. "For instance, I won't go to Las Vegas to gamble because I don't like the odds. I can do better than that as far as getting odds in my favor."

Pickens started Mesa, based in Amarillo, Texas, back in 1956 with $2,500. Today, the company has almost $2 billion in assets and is the largest independent oil company (88% of reserves are natural gas) in the United States.

Pickens himself came from a modest background. Today his personal net worth is an estimated $140 million, just shy of the Forbes 400 hit list, which he notes he's never made. He says 90% of his net worth is in MLP, of which he owns 7%.

Which leaves you to believe his crude oil futures hedge wasn't a lark. Actually, Pickens has used futures since the 1970s when Mesa "got into the cattle business in a big way." In fact, in 1973 or 1974, Mesa was the second largest owner of cattle in the United States with about 165,000 head, according to Pickens.

"You don't always want to be speculating in a commodity at that magnitude," he says.

So he taught himself how to use the futures market, concentrating on live and feeder cattle contracts.

"They were a great aid to us," he says. "What I like about it is if you got uneasy about the market, you just went ahead and sold inventory of cattle for future delivery and put the hedge on it. Another thing I particularly liked was, when you didn't know which direction the market was going, you could at least stop the bleeding if you had a loss."

Futures aren't difficult to understand, he contends. But Pickens, who believes "there are more banks in the United States than there are bankers," has had to explain them often to that audience.

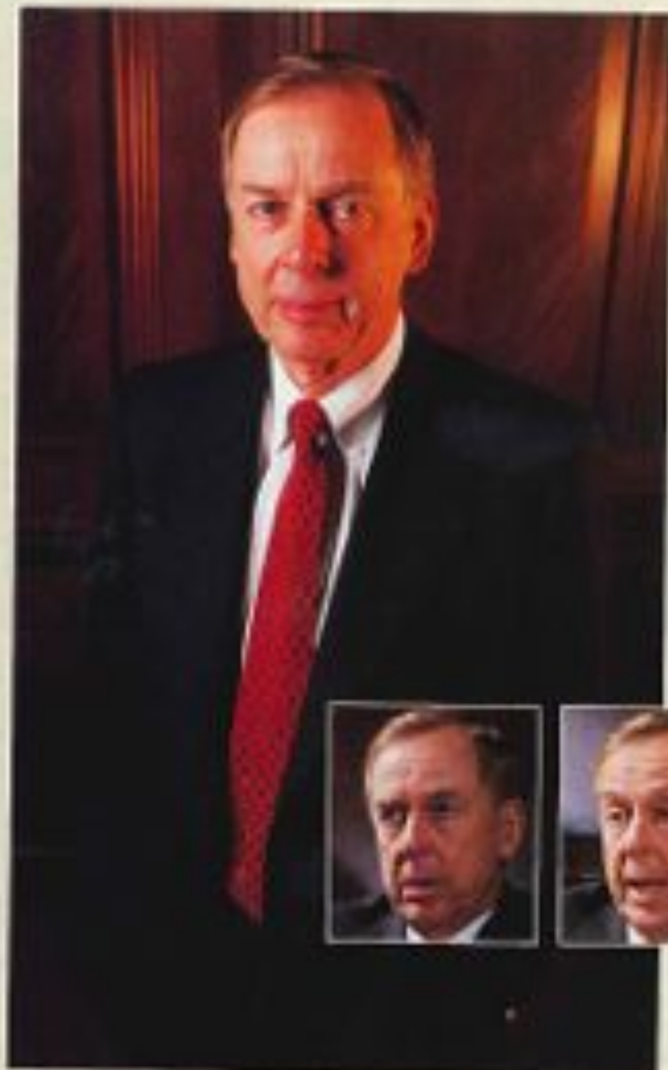
Margin calls 'meaningless'

"As far as I'm concerned, margin calls on a hedged position are meaningless," he says. "Bankers should be willing to make margin calls for you because you're going to get it back when you sell (the product). It's so clear cut. But I've had bankers say when we were in a hedged position, 'That's fine. We don't mind advancing money on a margin call. But could you explain one more time how we're going to get our money back?'"

He recalls a time in 1973 when Mesa had margin calls of $9 million on a hedged position. Because the company was so strong financially, the banks kept putting up the margin without questioning it.

"And then the market turned. Before we ever closed out the position, we actually recovered the $9 million and picked up another $10 million," Pickens recalls. "So we had a swing of $19 million. Then (the bankers) were telling us how good we were doing, and we said, 'No, we're not any better off than when we had $9 million worth of margin calls because the cattle are sold.'"

He does acknowledge, however, that Mesa was able to use the $10 million as working capital over a 60- to 90-day



period, which he agrees is "not insignificant."

Pickens says that, before crude oil prices dropped, Mesa had about a $10 million margin call in the November hedge. Some financial people asked if he wondered about the hedge as the margin calls grew. He says he replied that it didn't matter, the deal had been made.

"You cannot pull a hedged position in an up market in my book," he says. "The reason is you can take a double dip then. Assume your analysis was correct initially but your timing was off, and you take the up market margin calls. Then you take the position off, and the market responds like you thought it was going to. Then you've taken the margin calls going up, and you've taken the loss on the inventory going down. You've just wiped yourself out."

Yet, he thinks he could have improved on the oil hedge.

"We own 14 million shares of Unocal," he says. "They took a hit on the price of oil going down. We could have hedged our position right there."

Although he consults with Mesa's President David Batchelder and Executive Vice President Paul Cain, Pickens is the futures guru of the group. He keeps tabs on support and resistance areas on charts, but he makes his trading decisions on the basis of fundamentals.

"I get quite a bit of input from Europe and different places, so I'm not isolated with the analysis," he says.

He decided to short oil last fall largely because he suspected Saudi Arabia was going to raise its production level by 1 million barrels per day and flood the market.

"With that analysis in place, then the price of oil was going to drop," he says. "Now where was it going to go to? I did not believe it would go down to $12 a barrel. In fact, (that's why) we pulled the hedge at $16."

Mesa reversed course and went long crude oil at $12. In early 1986 he thought there was a one-in-three chance oil prices would make it back to $18 to $20 by July. But by June, he put the odds of making that level at three out of four chances by October, and he was "counting on it by the first of the year."

The reason for higher prices is pure logic, he says, explaining, "If OPEC (Organization of Petroleum Exporting Countries) produces an average of 18 million barrels a day, you've got $10 to $12 oil. If they produce an average 16 million barrels a day, you've got $18 to $20 oil. From a logical analysis, you would have to assume producers would accommodate the Saudis and let them produce about 4 million barrels a day and everybody else cut back a little. I think that's exactly what's going on now (mid-June). It may take another 60 to 90 days to get that all in place, but it will have to be by the first of the year."

Plateau in $20 area

Once oil hits $20 again, he believes "the Saudis will be very slow to raise it after that. I don't think you'll get back up to $28 a barrel for a couple years."

He contends Saudi Arabia doesn't want U.S. producers to start drilling again. And, he reasons, U.S. exploration won't resume until oil is substantially above $28 a barrel because it isn't economically feasible to do it until then.

Pickens, who spends about 30 minutes a day on personal investments, says he has "consistently made more annually off my investments than I have off my salary."

He's attached to commodities and stocks because he likes investing in something "I can get in and out of quickly."

"I don't want the responsibility of managing something else because I'm not paid to do that," he says. "I'm paid to work for Mesa."

In his own speculative account in mid June, he was long crude oil and live cattle futures (actually, long June live cattle and short August but overbalanced in June). He "in-

continued on page 78

If you're confused about futures support services, here's some help.

The **BRC Futures Service & Support System** helps keep you in control of your business. Research and insight in front of your clients. Money in your pocket. And prompt professional trading services within everyone's reach.

Whatever futures related service or services you need, the **BRC Futures Service & Support System** is flexible enough to let you choose the services and support levels you and your clients need.

The **BRC Futures Service & Support System** provides you with...

1. Competitive rates on a variety of products and services **2.** Guarantees available to IBs **3.** Lead assistance programs **4.** A Choice of managed account programs **5.** Daily market commentary & summaries **6.** Bi-weekly market letter **7.** Efficient and accurate back office **8.** Operations and options manuals **9.** Multiple WATS lines direct to our order center **10.** Many orders executed and confirmed while you wait **11.** Compliance assistance **12.** Much More.

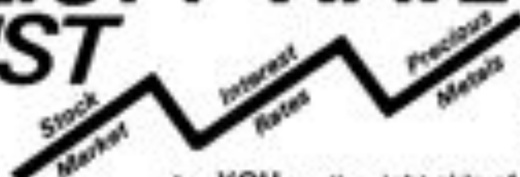
BRC For details and our free brochure, write or call 1-800-231-2240

The BRC Futures Service & Support System

Clearing, Research, Compliance Assistance, Processing, and Marketing.

For more information circle No. 29

THE ELLIOTT WAVE THEORIST



Editor Robert Prechter, Jr.

Are YOU on the right side of

THE STOCK MARKET?

If not, then you need *THE ELLIOTT WAVE THEORIST.* We're not a "stopped clock" and we're not afraid to trade the market from both sides. Don't take our word for it! Read for yourself what *independent* rating services say about ROBERT PRECHTER'S track record:

- *"Robert Prechter had every market nailed, and those who followed his Elliott Wave Theorist last year must have been among the most satisfied newsletter subscribers around."* – Wealth Magazine
- *"EWT called for explosive upmoves right on target."* – Rating the Stock Selectors
- *EWT is ranked #1 for long term stock market timing (a two-year tracking period) for the second year in a row.* – Timer Digest, Jan. 1986
- *EWT's Telephone Update for short term traders is #1 in profit per trade among 26 Hotlines for the three-year period 1983-1984-1985.* – Commodity Traders Consumer Report, Jan. 1986

GET YOUR MONEY'S WORTH every single month! Get a thorough, *detailed analysis,* from long term to short term. If you're a professional or semiprofessional who needs *more* than a run-of-the-mill opinion, if you want the whole picture, you need EWT. Our latest issue is hot-off-the press! Won't you join us? (If you want to learn more first, just call the TOLL-FREE number below and ask for our FREE information package.)

VISA/MC? For immediate service call TOLL FREE ▶ 24 hr. 7 days a week (including Sunday!) **1-800-336-1618**

Full year subscription: **$233** ($250 overseas). Two month trial: **$55** ($60 overseas). Make checks payable to **New Classics Library, Inc.,** P.O. Box **1618-C**, Gainesville, GA 30503. US$ only, drawn on a US bank. GA residents add sales tax. VISA, MC, or info, call (404) 536-0309. Pro-rate refunds guaranteed!

For more information circle No. 32

continued from page 49

frequently" plays the financials but thinks there could be a "real play" on the downside of stock indexes, perhaps triggered by rising oil prices.

He says he's usually in the market himself.

"I've got action somewhere all the time," he says.

His best trade was in live cattle, when he ran $36,000 into $6.6 million.

"I did not get away with all of it," he admits. "I got away with about half of it."

Pickens believes the future for the oil industry will be toward smaller companies.

"You're going to see the majors downsize themselves," he predicts. "They'll have to get competitive. They haven't been competitive. And the independents will hang on by their fingernails until activity begins again sometime after 1990."

Mesa prospects

What about Mesa?

Pickens thinks his company has learned to adapt to the changing industry and is constantly finding new ways to make money for stockholders.

He notes that, although Mesa was one of the most aggressive exploratory oil companies in the United States, it was one of the first to say it wasn't going to look for oil when it was costing $15 a barrel. Instead, Mesa consolidated its offices and started acquiring companies to replace reserves. He mentions this, he says, to prove he was working hard before he was pegged a corporate raider.

"Our whole activity hasn't been investing in other companies," he says. "When we saw we could make better use of our capital by investing in undervalued assets, we did that."

Currently, Pickens is developing a lobby to represent some 48 million U.S. shareholders. He says that's about as much politics as he wants.

"I enjoy what I'm doing. I may be doing more for this country by helping restructure corporate America than I would in some political office." □