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ProPetro Holding Corp (PUMP): Q3 Disclosures Cast Further Doubt on Internal Review

In our view, ProPetro's preliminary Q3 results confirm our [original report](#): the internal review was a sham, while the Company continues to circle the wagons, failing to lay out the full extent of related party transactions. We published our original report on October 31. Yesterday, the Company disclosed—well, would you look at that—it has identified \$3.6 million in additional related party transactions not previously disclosed.

We called out these transactions in our original report, as Ian Denholm sold 2 properties to the Company in late 2018, and Denholm's employment agreement stipulated that he would assist in the ongoing investigation of these transactions. As we earlier stated, we found it highly puzzling that the Company declared "substantial completion" of its internal probe while this investigation remained ongoing.

Today, we find it even more puzzling that after we called the Company out on its inconsistencies, it revealed these previously undisclosed millions of dollars in transactions after the review was supposedly substantially complete. How could the Company claim to have not previously identified these during the original internal review, given that it was already investigating these transactions in connection with Denholm's resignation? Given the nonsensical explanation of this supposed pattern of events, we believe that ProPetro continues to knowingly mislead investors.

Further, the Company again amended its language regarding who conducted the probe by citing not "the audit committee and management" as previous, but the "audit committee ... with assistance of independent outside counsel and accounting advisors" as if this exonerates Audit Committee member Alan Douglas from the conflicts of interest we called out both as (1) Redman's personal accountant, and (2) signatory on undisclosed entities.

Finally, regarding these supposedly newfound, previously undisclosed related party transactions, **we find it highly convenient for ProPetro that of the numerous undisclosed entities we identified in our original report, the Company wheeled out only the entity and transactions involving the former Chief Accounting Officer: the only person no longer getting paid a salary by ProPetro.**

Regarding the SEC investigation, it appears that much like the former Chief Accounting Officer's transactions, ProPetro was unwilling to disclose these items until outside coverage forced its hand. In our view, these are the actions of a management team that continues to be allergic to engaging transparently with shareholders.

We note that the Company's disclosures regarding the SEC investigation state that the SEC is "requesting that the Company provide certain documents, **including documents related to the Company's internal investigation** (referenced in the Company's August 8, 2019 Current Report on Form 8-K) and related events." Investors ought to recognize that the SEC is not only concerned with the subject matter of the Company's internal probe (i.e. related party transactions) **but is investigating the internal probe itself**, confirming our original view that the probe was a sham. Given that the SEC has the ability to subpoena records from the Company itself, a power we lack, we believe the agency will be capable of raising far more questions than what we've already identified publicly, questions which remain largely unanswered. To reiterate from our November 4 report:

1. Given Alan Douglas is a signatory on multiple undisclosed entities that name ProPetro executives and employees, how does the Board justify Douglas's role as both (a) an "independent director" per NYSE listing standards and (b) a member of the Audit Committee responsible for the recent "internal review"?

2. How much has CEO Dale Redman paid to Alan Douglas in each of the past 3 years, given their numerous undisclosed professional and personal entanglements?
3. By what conditions did the Company declare “substantial completion of fact finding for [its] internal review” given the myriad of conflicts of interest and related-party entities that remain undisclosed?
4. How much did ex-Chief Accounting Officer Ian Denholm receive from property sales to ProPetro? Given Denholm’s separation agreement stated, “that he will assist the Company with respect to its investigation of the Clarabby Transactions,” by what conditions did ProPetro also declare “substantial completion of fact finding for previously disclosed internal review”?
5. How many of ProPetro’s vendors were owned, in part or in full, by ProPetro executives, board members, or employees as of year-end 2018?
6. How many ProPetro employees are immediate family members of other ProPetro executives, board members, or employees?
7. What is the extent of ProPetro’s contractual relationship with Diamondback Energy?

In August 2019, the Company stated that the delay in Q2 financials could result in an internal weakness, though it said nothing of 2018. Now, due to “at least two material weaknesses” wherein “at least one of these material weaknesses existed as of December 31, 2018,” the Company admits that investors ought to no longer rely on the 2018 annual report. As for re-filing its 2018 financials, as well as Q2 and Q3 2019 reports, the Company “does not currently expect to be in a position to file amended, delinquent or future SEC filings prior to the end of 2019.”

That said, time appears to be running out on what we see as the Company’s attempts to avoid substantive discussion as fundamentals continue to worsen. Despite purchasing \$400 million in assets in January 2019, ProPetro burned \$54 million in free cash flow in the quarter, worse than our \$50 million estimate, and significantly worse than Q3 2018, in which the Company produced \$67 million in free cash flow. Finally, this \$54 million in cash burn was on average utilization of 25.1 fleets vs. the 18 to 20 that the Company guided for Q4 2019. Nevertheless, CEO Redman remained his usual promotional self:

Although the current market for our services is challenging and the market is **increasingly oversupplied** from an equipment perspective, **we remain confident** that our differentiated service model, ability to pull through new technologies to the wellsite, and our operational efficiency position us to compete effectively and continue to support our customers’ operations.

We continue to believe that the Company will look to raise capital in 2020, which ought to be a precarious task given worsening cash burn, financial statements which will remain past due into 2020, and a now confirmed SEC investigation. As such, we believe the Company’s time for engaging promotionally while remaining disinterested from substantive discussion of governance and disclosures is nearing its end. We remain short ProPetro.