



Oil Services: The Opportunity in Volatility

Description

Trican ([TSX: TCW](#)) and **Calfrac** ([TSX: CFW](#)) reported second quarter 2013 results yesterday and the take away for investors was that both companies have a more optimistic outlook, similar to that of **Precision Drilling** (TSX: PD, NYSE:PDS), which [reported earlier this week](#).

Oil service stocks have increased significantly of late on the back of these positive outlooks, but let's take a minute to review what it means to be an investor in such companies.

A quick review of Precision Drilling, Trican and Calfrac's second quarter results demonstrates how volatile this industry is. Given that declines in revenue and earnings can be quite shocking in this industry, one can't have a weak heart if they wish to invest in this portion of the market.

Precision Drilling reported a 97% decrease in net earnings during the second quarter, Trican reported a net loss of \$56.4 million and Calfrac reported a net loss of \$15 million. While the results of the entire first half of 2013 are not as bad (Precision Drilling's earnings declined 39%, Trican reported a net loss of \$31.1 million and Calfrac reported net income of \$12.1 million), it's clear that these stocks need a very watchful eye.

The volatility in earnings should lead investors straight to the balance sheet to evaluate the financial strength of these companies and therefore the company's ability to withstand further losses. Precision Drilling has \$127 million in cash, Trican has \$52 million in cash, and Calfrac has \$31 million in cash and they all have a debt to capitalization ratio in the mid 30% range, which is below the industry average, and is quite reasonable for companies in this sector.

If you're convinced the company is financially secure and can withstand the volatility in earnings, there are significant gains to be made in this space. Because of the volatility, the returns that can be made on the way up are extremely high. When these stocks are on the upswing, they can provide a lot of torque to a well-diversified portfolio.

Let's review the last up cycle in oil services to get a sense of what the upside potential looks like. The following table demonstrates the returns of a handful of companies during the previous trough-to-top portion of the cycle. This progression lasted about 3 years and the returns on these stocks were quite

spectacular.

Stock Price performance in the 2003-2006 cycle

		Jan-03	Jan-06	Return
Calfrac (TSX: CFW)	\$	24.99	\$ 43.60	74.5%
Ensign (TSX:ESI)	\$	8.55	\$ 22.77	166.3%
Precision Drilling (TSX:PD)	\$	13.05	\$ 40.28	208.6%
Trican (TSX: TCW)	\$	3.42	\$ 29.93	775.1%
Trinidad Drilling (TSX:TDG)	\$	2.10	\$ 16.55	688.1%

Bottom Line

With the outlook in the oil service industry improving, due in large part to a ramp up in drilling related to future Canadian LNG projects, we may be at the onset of another up-cycle for these names. And the market is beginning to take notice. While this sector is very fast moving and volatile, there is opportunity if we find our way through the volatility.

For a smoother ride to riches, many investors rely on investing in great businesses that aren't exposed to such wild cyclical swings. The Motley Fool's special **FREE** report "[3 U.S. Stocks That Every Canadian Should Own](#)" profiles three such businesses. [Click here now](#) to download your copy at no charge.

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Fool contributor Karen Thomas owns shares in Precision Drilling. The Motley Fool doesn't own shares of any of the companies mentioned at this time.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:PDS (Precision Drilling Corporation)
2. TSX:CFW (Calfrac Well Services Ltd.)
3. TSX:PD (Precision Drilling Corporation)
4. TSX:TCW (Trican Well Service Ltd.)

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