2 Oil Services Stocks to Watch Now

Description

Natural gas prices have been on a tear in the last year, and have performed far better than many analysts expected. Prices have risen almost 15% since last year and could be headed higher based on the most recent inventory reports, which are showing big decreases in supply. Last week, the U.S. Energy Information Administration reported that natural gas inventories were 822 billion cubic feet (bcf), a full 51% below last year's inventory level and almost 55% below the 5-year average.

With this strength in natural gas prices comes increased drilling. With increased drilling comes increased pricing power for the drillers (a.k.a. the oil service companies). And with increased pricing power we will see the earnings swing dramatically to the upside.

Volatility

This sector is notorious for its volatility. Potential revenue and earnings decreases are quite shocking and investing in this industry is not for the weak of heart. Let me illustrate by reviewing some of the oil services companies' results for the first half of 2013.

Precision Drilling (TSX: PD)(NYSE: PDS) reported a 97% decrease in net earnings, **Trican** (TSX: TCW) reported a net loss of $56.4 million and **Calfrac** (TSX: CFW) reported a net loss of $15 million. While the results of the 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 is clear that these stocks need a very watchful eye.

But there are always two sides to a coin, and the flip side to this is that the leverage to pricing increases is also very high, and this translates into very strong earnings power, and of course stock returns.

Let's look at two of the bellwether oil service names here in Canada and see how they are doing.

Trican

Following last year's lackluster financial performance, the market has been hopeful that Trican would see improvements in its business this year. But on March 31, Trican issued an earnings warning that highlighted some of the issues that the company continued to struggle with, most notably the difficulties in Canada, where higher revenue and activity levels were offset by continued pricing pressure and increased costs.

The company is planning on increasing pricing in the third quarter in order to get back to its return on capital targets. Interestingly, the stock did not react negatively to the warning, and this highlights investors' expectation that Trican's problems will be short-lived and that the industry will benefit from improved natural gas prices, increased drilling and increases in pricing.

Trican is one of the largest pressure pumping companies in North America. The problem is that the pressure pumping market is in oversupply, so pricing has suffered. The company has stated that in Q1, pricing is down 25-30% compared to peak pricing in Q1 2012, and that it will look to increase pricing in the second half of 2014. Trican's shares are up 8.9% year-to-date.

The company will release its first quarter results on May 7, and it will be very interesting to hear the update with regard to the pricing environment at that time.

Precision Drilling

Precision Drilling had a good end to 2013. While overall fourth quarter drilling activity in both Canada and the U.S. were similar to levels seen in 2013, Precision saw higher international and U.S. drilling activity and higher pricing in Canadian contract drilling. Furthermore, the company achieved a big swing to profitability, with EBITDA margins increasing over 5% in the fourth quarter, to 35%.

Precision recently increased its planned 2014 capital expenditures to $634 million (a $119 million increase from its plan just a month earlier), due to new rig builds and deployments and to increasing customer demand for contracted rig upgrades. All signs of a booming business. Precision Drilling's shares are up 31% year-to-date.

Precision will be reporting Q1 2014 results on April 28.

Foolish bottom line

There is continued optimism with regard to the pace of development of unconventional resources and its impact on activity levels and ultimately, pricing. For example, Duvernay activity is expected to increase in 2014, and this will help drive activity levels, and ultimately pricing, upwards.

While the oil service names are a volatile way to invest in the energy space, these stocks have seen spectacular returns in good times. It is not for the conservative investor, but for those who are ready to follow these companies closely, and are willing to stomach the potential volatility, now would be a good time to invest in this sector due to stronger natural gas prices, expected increases in drilling, and improving pricing power.

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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