Oil Services Stocks: Only for the Brave

Description

We all know that it doesn't look good right now for oil service stocks. Reduced drilling, pricing pressure, and uncertainty are really what characterizes the industry right now. The question is, however, is all this bad news already priced into oil service stocks? And is now a good time to start adding these stocks in order to be prepared for when the industry bounces back?

Activity plummeting

Schlumberger Limited (NYSE: SLB), one of the world's largest oilfield services companies, has painted a bleak picture of the industry, at least in the short term. Spending cuts ranging from 25-60% have resulted in an approximately 45% drop in the rig count since the end of 2014. The forecast is for a very sharp drop in activity in 2015.

What is obviously required here is a rebalancing of the market. As investors we have to ask ourselves when we would rather buy these stocks: Do we buy when they are trading at highs or after they have experienced a sharp correction? The answer, of course, is the latter.

Cyclical lows are the right time to buy

So, we have determined that the oil service industry is in for some treacherous times in the coming months. We are clearly closer to a cyclical low than to a cyclical high, so that makes me interested in the sector.

It's hard to say exactly when all the bad news is priced into stocks, but after reviewing a few of the Canadian oilfield services stocks, it appears that some have. **Trican Well Service Ltd.'s** (TSE:TCW) one-year return is -73%, **Precision Drilling Corporation's** (TSX: PD)(NYSE: PDS) one-year return is -32%, **Ensign Energy Services Inc.'s** (TSX: ESI) one-year return is -34.8, and **Calfrac Well Services Ltd.**'s (TSX: CFW) one-year return is -43%.

Now let’s look at the flip side. Because this is a very volatile sector, the returns that can be made onthe way up are extremely high. And when these stocks are on the upswing, they can make a great partof a diversified portfolio and can provide some much-needed torque.

Precision Drilling has a total debt-to-capitalization ratio of 43%, but has $500 million on the balance sheet as of the end of 2014. Ensign has a debt-to-capitalization ratio of 28%, with $54 million in cash on the balance sheet. The point is if you choose a company that can withstand the bad times, you will be greatly rewarded.

The bad news will be plentiful this year, and we will see shocking declines in revenue and cash flow throughout the sector. If you have patience, and you choose a company with a strong balance sheet and room for additional leverage, you will likely not regret putting some money into this group.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

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

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