If You Believe in Oil, Buy the Services Companies

Description

While giving a presentation on the energy sector, Bernstein analyst Bob Brackett described energy services companies as "the hair on the tail of the dog." In other words, the services companies are even more sensitive to oil prices than the producers are.

This should make some sense. As oil prices fall, producers are able to cut costs primarily by reducing drilling activity. And for the few wells that producers drill in this kind of environment, they are able to negotiate lower prices with drilling contractors. Meanwhile, the services companies have to contend with lower demand, idle equipment, and very weak pricing. For the ones with poor balance sheets, this can be a lethal combination.

So it's no surprise that as oil has shown signs of life, the share prices of services companies have taken off. We look at a couple of examples below.

Secure Energy Services

To put it bluntly, 2015 was an awful year for **Secure Energy Services Inc.** (TSX:SES). The company saw its revenue decrease by more than 40% during the year and posted a net loss of $184 million, which included nearly $140 million in impairment charges. To help deal with the problem, Secure raised about $200 million worth of equity, which severely diluted existing shareholders. Unsurprisingly, the stock fell by over 50% during the year.

But there are some things to like about Secure. Like most companies in the energy space, costs and capital budgets have been slashed. And thanks to the equity raise, Secure's net debt fell by more than half during the year and now stands at a very manageable level.

And the stock is clearly a levered bet on oil prices. Just look at what's happened over the past month: while oil prices have gone up by 23%, Secure's stock price has surged by more than 30%.

Precision Drilling

Precision Drilling Corporation (TSX:PD)(NYSE:PDS) has been facing the same challenges that

Secure has. Falling oil prices have led to a falling rig count, which has wreaked havoc on the company's financials.

Just to illustrate, Precision's revenue decreased 38% in 2015, and the company reported a net loss of $363 million. The company's cash flow was not enough to cover capital expenditures, and to help cover the shortfall, Precision increased its debt load to $2.2 billion, which is well above the company's market value. The dividend was suspended last month, a move that probably should have been made much sooner.

But as you can imagine, Precision's stock has responded well to rising oil prices. In fact, the stock is up by more than a third just in the month of March.

So if you're looking for a strong bet on oil prices, services companies such as Secure and Precision are two very compelling options. But they are quite risky; thus you should make sure your bet isn't too large.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:PDS (Precision Drilling Corporation)
2. TSX:PD (Precision Drilling Corporation)
3. TSX:SES (Secure Energy Services)

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