Has the Oil and Gas Industry Bottomed?

Description

In the last week, the market has seen a glimmer of hope from some in the oil and gas services industry. It may seem like nothing when we consider the dismal first-quarter 2016 results, but the stock returns of the highly volatile oil services companies (and most companies, for that matter) do not follow what is happening today, but what the market expects to happen in the next year or so.

So if CEOs are slowly becoming more hopeful about the future and starting to actually put their money where their mouths are, so to speak, then investors should take notice.

Mullen Group Ltd. (TSX:MTL)

We have seen Mullen's first-quarter results and how badly the oilfield services segment was hit as things continued to get worse. First-quarter revenue declined 19.4% and, as expected, the oilfield services segment was the dark spot; its revenue declined 37% as demand dried up and rig counts were low.

As an illustration of just how low the rig count is, consider this:

Earlier this month, the North American natural gas rig count was a mere 122, which is a small fraction of rig counts in prior years. For example, in April of last year, the rig count was over 300. In fact, in my data set from **Baker Hughes**, which goes as far back as the 1990s, this is the low. And in some years, like 2006, the number was over 1,500. So clearly, we are seeing a real and dramatic supply-side response. And this can only lead us to become more optimistic on the state of the industry.

So Mullen is viewing 2016 as a year of positioning as short-term fundamentals remain very weak. The company expects at least two more quarters of pain, but demand for energy continues to grow and supply is now contracting, so things are moving in the right direction.

Earlier this week, Mullen announced a share offering, which was surprisingly well received by the market–so much so that the company increased the offering. Insiders will also make a $10 million investment in the company on a private-placement basis. This could mean that the company is thinking that now is the right time to strike, and they may make an acquisition sooner rather than later and capitalize on these hard times by buying on the cheap, thereby creating real long-term shareholder value.

Precision Drilling Corporation (TSX:PD)(NYSE:PDS)

Management over at Precision Drilling has turned decidedly more hopeful on the state of the industry. As CEO Mr. Neveu put it in the first-quarter 2016 press release, “While the timing for an eventual rebound remains uncertain, we are turning our minds from cost reduction and downsizing to stabilization and preparation for a rebound, ensuring we are a first choice in the minds of customers.”

While the first-quarter results were bad, with a 41% decline in revenue and cash from operations down 48%, Precision has a cash balance of $476 million and has been able to get a relaxation of its debt covenants.

In closing, with a supply response as drastic as we have seen and certain CEOs seeming to be more hopeful, we are probably close to a bottom, and investors who get in at this stage stand to benefit handsomely.

CATEGORY

1. Energy Stocks
2. Investing

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2. TSX:MTL (Mullen Group Ltd.)
3. TSX:PD (Precision Drilling Corporation)

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