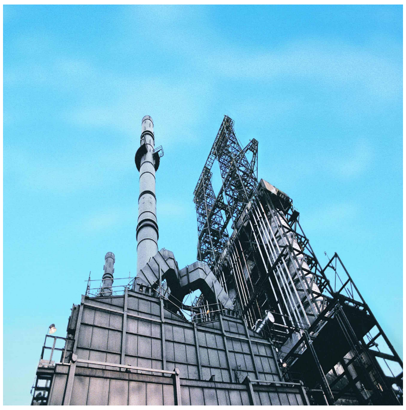

The Recent Pullback in Oil Is Good News for Computer Modelling Group Ltd.

Description

The dust appears to be settling following a volatile two years in oil prices. Management throughout the industry seem to be breathing a bit easier (although cautiously) based on sentiment in recent management discussion and analysis reports. Selling, general, and administrative costs have shown an uptick among several energy firms—an indication of industry confidence (with perhaps a hint of greed). Yet with the energy sector in the tail end of recovery mode, can savvy investors still find an opportunity?

The most vulnerable during the oil crisis were the oil and gas equipment providers. On the periphery, these services were typically cut as clients struggled to survive. The result, for those fortunate enough to stay in business, was typically a staff reduction and desperate financing measures (high-interest debt or additional public offerings). Myopic as it was, these firms simply could not afford to plan for future growth.

Computer Modelling Group Ltd. (TSX:CMG), a software company focused on oil-reservoir simulation, followed a different path. Although exposed to the same risks, Computer Modelling did not require drastic changes to the balance sheet. Furthermore, while other providers were cutting dividends, Computer Modelling consistently raised its distributions. One can argue that a software company should not be compared to, say, **Canyon Services Group Inc.** (TSX:FRC), a provider of stimulation and fluid management services. However, when two companies are competing over the same waning budget, I'd suggest the contrary.

The long-term prospects of Computer Modelling appear to be sound. The greatest risk to the business would be customers bringing a similar technology in house. This seems unlikely given the company's commitment to cutting-edge software, as evidenced by its 20% R&D budget. In fact, while other companies were slashing R&D (including customers), Computer Modelling has grown its department year over year.

With the oil prices always an unknown, Computer Modelling is not impervious to risk. That said, should energy companies begin to open their wallet once again, Computer Modelling could stand to be a top beneficiary. An increase in global revenue from rising oil and gas spending would directly impact the bottom line, unlike other providers who face large interest payments. Should the price of oil lose its lustre, Computer Modelling has longer-term contracts to support much of its capital expenditures.

Valuation must always be the final checkmark. Trading at 33 times trailing 12-month earnings, Computer Modelling is no bargain relative to other software companies. That said, in comparison to other oil and gas equipment stocks, it looks to be a good value. The 4% current dividend yield signals a mature market; this company should not be selected for a growth portfolio. However, for speculators in the energy space, this unique angle could provide a strong upside should oil decide to rally.

For the savvy investor with a longer-term horizon and income in mind, the recent pullback in crude may support a good entry point for this oil and gas tech stock.

CATEGORY

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Date
2025/06/30
Date Created
2017/03/24
Author
jshulman