The State of the Canadian Energy Industry Today: There Are Many Losers but Some Winners, Too

Description

What's bad for one company is often good for another company or group of companies. This week, oil services company **Calfrac Well Services** (TSX:CFW) reported third-quarter 2019 results that were pretty disastrous — a reflection of the oil and gas market today. Calfrac's services include hydraulic fracturing, cementing, and other well-stimulation services. Needless to say, with reduced activity levels here in Canada and the U.S., energy services companies are taking a big hit.

Typically, when activity levels (drilling) decline, we can look forward to the consequent reduction in supply raising oil and gas prices. Today, we have a more complex situation going on, and so other factors, such as insufficient takeaway capacity and increased environmental regulations, muddy this relationship.

Activity and pricing falling dramatically

With rig counts falling dramatically both in Canada and the U.S., the last year has been another brutal year. For Calfrac, Canada represents 25% of total revenue, the U.S. represents 56% of total revenue, and the remaining revenue comes from Russia (7%) and Argentina (10%).

A 13% decrease in the company's job count coupled with a 28% decline in consolidated revenue per job wreaked havoc on Calfrac's results. Revenue fell 37%, and the company swung to a net loss per share of $0.20 compared to a net profit per share of $0.10 in Q3 2018.

Clearly, reduced activity levels out of the oil and gas fields is bad for Calfrac, as is reduced pricing. On the flip side, reduced activity levels eventually means lower supply (good for oil and gas prices), and the lower pricing on oil and gas services that we are seeing means greater profitability for those exposed to this pricing — that is, oil and gas exploration and production companies.

Energy producers to benefit from this silver lining

Assuming that the oil and gas industry is not dying, we can feel fairly confident that the supply/demand relationship will sort itself out. As I stated at the beginning of this article, we have some variables that are interfering with this relationship these days, but in the longer term, it seems like the oil and gas market must return to functioning off of this fundamental relationship.

For now, large, well-capitalized oil and gas producers are the most likely of the energy companies to benefit from the current chaotic oil and gas industry. In Canada, **Cenovus Energy** (TSX:CVE)(NYSE:CVE) sticks out as one such company. With free cash flow generation of $622 million last quarter, we can see that even in the roughest of times, Cenovus is kind of thriving, which says a lot about the company. Imagine what it can do in better times!

Debt is falling dramatically, the dividend is rising dramatically, and Cenovus is implementing its strategy to work around market access problems and Canadian oil and gas price weakness. Declining oilfield services pricing will add to Cenovus's bottom line, and a reduction in Canadian activity levels will take away some of the oil and gas supply, thereby eventually lifting prices.

Foolish bottom line

Oilfield services are a reflection of the health or lack of health of the oil and gas industry. Falling activity levels and pricing for this group of energy companies comes as no surprise, as we all know the severe problems that exist in this sector. Through all this, we can see that the supply/demand mechanism is hard at work, trying to re-balance the market. Cenovus Energy stock is one potential beneficiary of the dynamics that are playing out in the oil and gas services industry, and the positive effects on oil and gas producers may be evident sooner than we think.

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