Expect the Second Quarter Results of Major Drilling to Reflect a Mining Industry in Turmoil

Description

Major Drilling Group International Inc. (TSX: MDI) will be reporting earnings after the market closes later today. As a leading drilling services company primarily contracted by the mining industry, the outlook is bleak at best. According the company's own website, it deems itself a good proxy for the mining industry. Unfortunately for the company, the mining industry is in a deep hole that appears to be getting deeper, and now is not a good time to be a proxy.

Where do the analysts come down?
Analysts are currently expecting a major hit to revenues for the fiscal second quarter ended October 31, estimating a decline of approximately 46% to $107.1 million. Despite the huge hit to revenue, the consensus earnings estimate still shows a profit of $0.05 per share. Sentiment has become much more negative as the estimate has been cut from $0.07 just 30 days ago and $0.14 only 90 days ago.

Surprisingly, only one analyst has the stock rated a sell, and that is offset by another rating the stock a buy. The remaining analysts fall into the outperform or neutral camp with a slight edge going to outperform giving the rating a modest positive bias. At recent prices, the stock is currently trading near analysts target price of $7.75 per share, leaving little upside for the next 12 months in the minds of the professionals.

Taking a look at last quarter
Last quarter certainly represented the abysmal shape the mining industry finds itself as the company reported revenues plunged 54% to $108.2 million. This was well below the consensus estimate of $132 million. Earnings, while positive, still missed estimates by $0.03 per share as the company saw its net income plunge 90% to $0.04 per share after adjusting for a $2.0 million restructuring charge.

The news was not all bad, as management did a reasonable job controlling costs in the face of such negative head winds. Gross margin only slipped by 170 basis points thanks to a highly variable cost structure. In addition, the company trimmed general and administrative costs by 25% compared to the same period in the prior year and by 15% when compared to the preceding quarter.

Coping with the downturn

The company cannot control the activity in the mining industry, but it can control how it responds to the current downturn. During the first quarter, management took a series of steps in order to help keep costs in line with the reduction in revenue. The company reduced staffing levels by 45%, trimmed senior management salaries, and cut directors fees. In addition, the company reduced its capital budget and downsized its environmental business. By taking these measures the company still expects to produce positive cash flow in fiscal 2014.

The company is not just relying on cost cutting alone and is also taking steps to diversify its revenue base. To this end, the company made its first entrance into the Alberta oil sands and is seeing incremental growth in the U.S. shale market.

Financial health
The balance sheet of Major Drilling is its strong point. During the fiscal first quarter the company paid long-term debt down by $13.07 million leaving it with total debt in the amount of $30.6 million. The company's strong cash position of $61.1 million puts the company in a positive net cash position of $30.5 million. The sound financial position even prompted management to declare a semi-annual dividend which was paid last month.

Final thoughts

Major Drilling is a good proxy on the state of the mining industry and therefore makes it one to watch whether you have a direct interest or not. I would expect the second quarter will look much like the first as the capital markets remain very challenging for the junior minors and the larger miners remain conservative on exploration activities. However, it will be interesting to see what impact the actions of management on the expense side of the ledger in the first quarter have on the bottom line.

The cost cutting measures and the financial strength of the company will help it weather the storm and when it passes, shares of Major Drilling will rise again. Unfortunately, the current disruptive forces in the mining industry look to be with us for some time. At this point in the cycle, it would seem premature to fight the downside momentum prior to seeing a turnaround in capital spending on mining projects.

CATEGORY

1. Investing

Category

1. Investing

Date
2025/08/25
Date Created
2013/12/03
Author
agray