Ouch! Major Drilling Disappoints Big Time

Description

It was not a big surprise to see another difficult quarter for **Major Drilling Group International Inc.** (TSX: MDI) as was evidenced by the 14% decline in shares in the days leading up to the release. However, earnings came in much worse than analysts expected – 300% to be exact. Revenues also missed coming in roughly 14% below expectations.

The numbers

Revenue for the quarter was down 53% to $92.3 during the second quarter compared to $199.6 in the same period a year ago. Gross profit as a percentage of sales slipped 90 basis points to 32.5% and EBITDA as a percentage of revenue fell 700 basis points to 17%. All of this combined for an ugly quarter with earnings swinging to a loss of $19.1 or $(0.24) per share compared to positive earnings of $22.3 million or $0.28 per share during the same quarter in the prior year.

While earnings for the second quarter were not good, there were some significant nonrecurring and noncash charges. Due to current market conditions, the company took a $12.1 million goodwill impairment charge related to operations in Chile. The company also wrote down and unrecognized by $5.5 million certain Australian and Columbian deferred tax assets due to the poor near-term outlook for taxable income. Lastly, the company took a $700 thousand charge related to ongoing restructuring in order to reduce costs.

Mining industry continues to struggle

Gold prices continue to slump adding to the depression among the miners. Many projects have been delayed or cancelled altogether. The poor demand for drilling services will continue to increase competiveness for projects and put pressure on margins.

Major saw substantial declines in revenue across all geographical locations. Revenue in South and Central America plummeted 66% while the Asian, Australian and African operations saw revenue fall by 43%. The company's Canadian and U.S. operations were also weak with revenue sliding 54%.

As mentioned earlier the company recorded impairments and write downs associated with goodwill and deferred tax assets. Both of these entries are further evidence the company does not expect a recovery in the industry any time soon, especially as it relates to its Chilean, Australian and Columbian operations.

In addition to low commodities prices, the company is also being negatively impacted by geopolitical factors. Such factors have slowed exploration in Argentina, Columbia and Mongolia. In Australia, projects have been completely cancelled due to high costs and new mining taxes.

Is there a silver lining?

It is hard to find a light at the end of the tunnel in the mining industry, but when things look the darkest is when you may just find that gold nugget. Currently, most of the pros are predicting more of the same poor performance for most commodities and miners. It certainly looks like bad news for as far as the eye can see. However, it may just be all of this bad news which may serve as the catalyst for a turnaround in the metals markets.

Many projects have been delayed or cancelled, yet the world has not stopped using inventories of minerals. Sure, you can argue that current supplies will keep a lid on prices for some time to come, but at some point the supply numbers will turn in the favor of the miners. There are signs of an improving economy in the U.S. and other countries around the world which will expedite the industry's transition to a more positive outlook.

Final thoughts

The management of Major has done a respectable job protecting the balance sheet. The company's net cash position continues to improve and was up $18.1 million to $48.5 million during the quarter. The company's operating cash flow remains in positive territory producing $22.07 million during the quarter and $24.78 million for the first six months of the fiscal year.

Management's focus on the balance sheet and cost cutting should keep the company on stable ground while the industry works through the current supply glut. Once the industry begins to turn, Major should be in good position to compete for projects and the recent steps taken to improve the cost structure should serve to make Major a solid performer when the time comes.

For now though, Major is heading into what is traditionally the weakest quarter of its fiscal year. Many miners have extended shutdown periods over the holidays and many budgets are not yet in place. The lack of budgets will put added pressure on the month of January when shutdown periods typically end as many projects, even if approved, will take time to get started. This has all of the signs of a disappointing third quarter and should give investors pause if considering an investment in Major.

CATEGORY

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