Restructuring Strategies for Oilfield Service Companies

As supply keeps piling up, oil producers in Western Canada are running out of places to store excess inventory. While some consumers have been relishing the lower gas prices, producers are feeling the crunch as the financial realities settle in. Derek Church outlines some key restructuring strategies that oilfield service companies should consider.

Oil supply has now outpaced global demand by approximately 25 million barrels per day, and both dry ground and floating storage options are reaching capacity. The situation tanked May oil futures contracts and has driven oil commodity prices into negative valuations.

Oil producers, if they haven't already, are transitioning to balance sheet and liquidity preservation. Uneconomical production is being shut in. Energy service companies and energy manufacturing will need to shift exclusively to products and services which are focused on maintaining the existing economical production, or environmental remediation which the Federal Government is funding.

Larger companies will be able to diversify geographically to areas of the globe where oil production will continue due to different economics and a more conducive political climate.

The situation that has persisted for weeks has brought into sharp focus the need to act quickly to preserve balance sheets and liquidity. In this article we will touch on strategies that energy service companies should be focusing on.

Emergency Funding

The low hanging fruit is government emergency funding deployed through EDC and BDC. Keep in mind, that these funds are being deployed as debt and are likely to have security agreement and personal guarantee requirements attached to them. The government is not just giving you the money, they are going to want it repaid with a return on their capital while mitigating their risk. Your company also had to be viable prior to the COVID-19 crisis.

Preserve Cash Flow

Start conversations with your capital providers early on alternative repayment structures. We are in completely unprecedent times, for the expectation to be that credit facilities, dividend structures and other such arrangements remain as status quo is not realistic. Attempt to negotiate a cash sweep repayment structure or reduced amortization for a set time frame. Most banks will grant relief in three to six-month tranches, allowing themselves the option to re-examine the situation periodically.

To successfully negotiate with your lenders, you need to prove you have a plan to mitigate risk and preserve cash flow, and this will need to be mapped out in a cash flow forecast. Act quickly and decisively, because the longer you wait the less options you will have.

Examine your suite of service and product offerings, along with the contribution margin each one generates in the current environment. Keep in mind what priorities producers will be shifting to in this environment. Non-core or low margin offerings should be discontinued.

Scrutinize Your Assets

Review the company's resources required to provide the core services you decide to move forward with. Take a first principle approach, breaking the business down into its separate functions. Be objective in assessing what resources are required to deliver each function, any resources not required to deliver the core functions should be eliminated or reduced. Payroll and equipment financing are often the two biggest line items on the operating statement of energy service companies and difficult decisions will have to be made.

Determining which pieces of equipment are underutilized requires proper control reporting, such as utilization metrics, operating expenses per piece of equipment, and proper project costing. This control reporting is critical for identifying redundant or under-utilized assets and it will improve the competitiveness of your proposals. This added competitiveness is important to maintaining market share in a contracting market.

Examine the company's facilities. Does the corporate group own the real property it operates out of? If so, is ownership the most economical option? A lot of energy service companies choose to own their premises as opposed to lease. The argument for owning is often, why pay lease payments when the company can make mortgage payments and build equity? The problem is this decision centers on the assumption that the property will maintain its value, and often excludes other situations or key factors in the analysis. Owning real property consumes a lot of balance sheet capacity and may not be the best option from a cash flow perspective. We will unpack this in more detail in future articles.

Liquidate non-cash flow producing assets

If you have purchased real property and other assets using financing, and are now struggling to make the payments, consider options to liquidate the assets and reduce the debt. Even at a loss, there are strategies to address remaining debt if proceeds from the sale do not address the indebtedness completely. The main priority should be reducing unnecessary cash outflows.

Consider a Merger

Do not rule out a merger strategy over concerns around weak valuations. The right strategy and combination of business entities can still produce adequate value, even if the value is intrinsic as opposed to tangible. The resulting entity will have a stronger balance sheet and more robust portfolio of capabilities. It affords the opportunity to decrease overhead costs with a streamlined command and control structure managing a larger balance sheet. A transaction which creates a larger financially viable entity, may unlock financing alternatives that a smaller entity would not have access to. You may have to give up control to get a transaction done. However, being 25% owner in a more resilient organization, is better than being 100% owner in an entity that is insolvent.

Moving Forward

In summary, in this uncertain environment it does not make sense to preserve capacity which is not assisting the company in cash flowing. It is time to make difficult decisions and anything not economical in the current environment should be eliminated. Preserve cash and liquidity as much as possible and focus on your core business which has the best chance of maintaining market share and generating positive cash flow in the current environment.

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Our Contributors

Derek Church is a Managing Director with the Restructuring practice of GlassRatner. His practice focuses on corporate restructuring and financial advisory services. Derek can be reached at dchurch@glassratner.com or at 587.747.7592

Allan Nackan is a Senior Managing Director at GlassRatner and co-leads the firm's Restructuring practice. His practice focuses on corporate insolvency and restructuring, financial advisory services, cross-border restructuring, fraud investigations, and forensic accounting. Allan can be reached at anackan@glassratner.com or at 437.294.4602