COMMENTARY

April 28, 2017

Dear clients and colleagues,

US private sector employment has grown for 86 consecutive months, completing its seventh consecutive year of growth. As a comparison, the average post-World War II recovery is just 61 months.

For the past seven years, the US economy has expanded on a wave of new technologies. Bandwidth, the cloud, apps, smartphones and tablets are all examples. The old economy has also thrived on new technology. For example, the oil and gas industry has benefitted from extraction technology improvements which have rejuvenated the US onshore oil and gas industry and assisted in its quest to be globally competitive.

Fracking technology has advanced at a pace that has doubled oil well production every two years, which has helped drive costs and prices down over the long term. That pace of productivity improvement is almost identical to the computer industry's Moore's Law, which expects the speed of processing chips to double every two years. Technology also brought speed and agility to the oil and gas industry as lower costs helped it rapidly adjust to the 2014 oil price downturn.

However, it seems that energy costs are now reversing. For the first time since 2012, shale producers will see a rise in break-even production costs in 2017, according to data from Rystad Energy, a company that surveys oil producers. The per-barrel costs are predicted to rise an average of $1.60 across the shale patch.

Using this new found agility, oil and gas rigs are being added at a ferocious pace in 2017 (as noted in our February 17 commentary). Firms that supply rigs, crews and technological expertise are clamoring to take back discounts they extended during the recent slump, in some cases asking for between 10 percent and 15 percent more as the number of rigs and crews deployed in the fields rises. Oil and gas prices have already started to be affected by this quick ramp-up.

Most recently, large oil service companies reported on the state of the industry with interesting comments. In the first quarter of 2017, Halliburton added 2,000 jobs and its revenue in the US and Canada increased 24% over the previous quarter while sales in the rest of the world dropped 8%. "In North America, the momentum is building and we only see it getting better," Halliburton's President Jeff Miller told analysts and investors on a conference call.

We are entering a phase of the oil and gas recovery where the environment may be more advantageous to service companies than it was in 2015 and 2016, a period which favoured oil and gas producers.

Global Alpha is positioned in the oil and gas services industry through Schoeller-Bleckmann Oilfield Equipment and Unit Corporation.

Schoeller-Bleckmann offers next generation multi-stage stimulation systems. Its drilling equipment is lightweight, compact and highly functional, allowing for reduced expenses for costly drilling stages such as transport and joint attachments.

Unit Corporation offers its clients the BOSS rig, an advanced drilling rig that can be built or torn down in three days, lessening the cost of exploration. The company is also an oil and gas producer.

Schoeller-Bleckmann (SBO VIE – €66.68)
http://www.sbo.at

Schoeller-Bleckmann is the global market leader for high-precision components, providing non-magnetic drillstring components to oil field service companies engaged in directional drilling. It also manufactures drilling motors and drilling tools used for extracting oil and offers repair and maintenance services. The major manufacturing and customer base is in the US (80% of revenues) and Europe. Major clients include Schlumberger, Halliburton and Baker Hughes. Its sales mix is split between high-precision components (53%) and oilfield supplies and services (47%).

Strengths

The company is a market leader in its niche with +50% market share. High barriers to entry with technical expertise, certifications, patents and value added products. Small local competition, especially in Houston area (Trident, MIC, Hunting PLC).

Management

Gerald Grohmann is CEO/Chairman and has been at company since 2001. Executive average tenure is 9 years.

Non-Executive directors represent 100% of the board of directors.

Unit Corporation (UNT US – $22.12)
http://www.unitcorp.com

Business overview

Unit Corporation is a diversified energy company engaged through its subsidiaries in the exploration and production of oil and natural gas, the acquisition of oil and natural gas properties, the contract drilling of onshore oil and natural gas wells, and the gathering and processing of natural gas. Production breaks down as follows: NGLs 25%; oil 22%; gas 53%.

Strengths

Knowledge of upstream and downstream market requirements, working relationships with small and large producers, lower leverage than peers and large acreage allows for production flexibility

Management

Larry Pinkston has been President and CEO since 2005. Executives have been at the company 19 years on average.

Non-Executive directors represent 89% of the board of directors.

Have a good weekend.

The Global Alpha Team