Introduction
Energy services companies have struggled through the collapse of crude oil prices as producers slash capital expenditures and seek cost reductions from their service providers. Some energy services companies have managed to position themselves for a recovery by taking advantage of private equity sources to acquire distressed assets, or by diversifying to other sectors. Unfortunately others have had difficulty accessing what many say is a substantial pool of private equity.

In that context, KPMG’s Energy Services Roundtable event, held May 17 in Calgary, AB, brought together a panel of CEOs from companies that have funded recent acquisitions. The panel was comprised of Horizon North Logistics and STEP Energy Services as well as leading private equity fund, Wynnchurch Capital. KPMG’s Othello Tuason, Vice President, Corporate Finance, moderated the event and guided the discussion on opportunities for energy service providers to survive and thrive, and how to access the well-funded private equity pool.

A tough two years
The past 24 months of falling oil and gas prices has created a challenging environment for Canadian oil and gas producers. Rhys Renouf, KPMG’s Managing Director of Corporate Finance, told the audience that capital expenditures by conventional producers are expected to decline nearly 60 percent from 2014 levels this year, while capex in the oil sands sector is projected to decline by 25 percent for the same period. As a result, fewer wells are being drilled in 2016. The Petroleum Services Association of Canada predicted only 3,300 wells this year compared to more than 11,000 in 2014.

The impact on energy services companies, particularly those closest to the drill bit, has been dramatic. Market capitalization of the top 20 publicly traded energy services companies has been slashed to less than $15 billion this year from more than $35 billion in 2014, while the same group has seen total enterprise value fall to less than $22 billion from nearly $41 billion. At the same time net debt in the sector is increasing from $5.9 billion in 1Q 2014 to $7.6 billion in 3Q 2015. In 1Q 2016, net debt remained at nearly $6.5 billion for the top 20 companies.

“What’s even more concerning,” Renouf said, “are the debt to EBITDA ratios of the service sector. From less than two times EBITDA in 1Q 2014 the ratio has soared nearly four times in 1Q 2016. As these ratios climb debt becomes increasingly more difficult and expensive to access and to service.”

Survival challenges, never mind growth opportunities, are top of mind for many executives. Some energy service firms have managed to survive and thrive in the current climate. KPMG brought their CEOs to the roundtable discussion to explain how they engineered that growth.

Growth by acquisition
Leading coiled tubing services provider STEP Energy Services has seized acquisition opportunities afforded by the current market and in the past year has bought significant assets from distressed service companies. In March 2015, STEP expanded into the hydraulic fracture services market with the acquisition of GasFRAC, followed by the purchase of Canadian pressure pumping assets from Sanjel a year later. With these acquisitions STEP is now the third largest pressure pumping company in Canada.

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1 CIBC April 26, 2016, Weekly Oilfield Services Update
2 http://www.psac.ca/no-improvement-to-sector-activity-or-market-access
3 Capital IQ
4 Earnings Before Interest, Taxes, Depreciation and Amortization
What factors drove STEP’s expansion to include frac services? Regan Davis, STEP’s President and CEO, offered his explanation:

1. Changing completion systems that utilize coiled tubing suggested that 2015 was the right time to move to more of an integrated services package for clients. “Frac clients are the same as our coiled tubing clients so we had those relationships and a reputation to build on. We saw that we were heading into a downturn and we could reposition the company to be something much more substantial coming out and GasFRAC was that opportunity.”

2. Late in 2015, STEP entered the U.S. coiled tubing market in Eagle Ford, TX. In early 2016, Sanjel assets became available under a CCAA process. If the company could purchase specific Sanjel Canadian assets at a fair price, STEP would be in a stronger position during a recovery. “We can build more scale in the organization and position ourselves to be a more substantial business at a very favorable cost.”

**Growth by diversification**

Seizing opportunities in a sector you are familiar with is one way of enhancing value. Diversification, both operationally and geographically, is another way. Horizon North Logistics, a leading industrial camp and catering services provider active in Alberta’s oil sands, took this opportunity when recently purchasing Okanagan Falls-based modular home-builder Karoleena.

Horizon North did not want to be bound to the lower-for-longer mentality that was spreading through the Canadian oil and gas sector. What it needed was a transformational change that would allow it to move into sectors of the economy less dependent on the commodity price of oil or gas.

President and CEO Rod Graham offered these insights on initiating transformational change:

1. Horizon North diversified their talent pool by seeking professionals who were experienced in the same kinds of challenges that energy services companies are facing in the downturn. World-class professionals in human resources, legal, manufacturing, sales, marketing and business information systems were recruited from outside the oil and gas industry. Targeted sectors included airlines, auto-parts, automotive, aircraft manufacturing, telecom and industrial products.

2. Who are we as a company now that we’ve diversified? On one hand, Horizon North is still a camp and catering services provider and that business continues. On the other hand, with the world-class design competencies that the Karoleena acquisition has brought in the modular residential, retail and commercial sectors, Graham sees immense opportunities. “There’s a whole business that’s sitting out there that is outside the lower-for-longer mentality that is impacting our legacy industrial business. We now have the quality, cost structure, IT interface, design software and creative capability to offer our customers an exceptional experience.”

**Private equity is big on Canada**

What are the alternatives to fund opportunities that present themselves? This is where private equity steps in. Morty White, Managing Director of Wynnchurch Capital, joined the roundtable to provide investor perspective. Wynnchurch is a Chicago headquartered private equity group with offices in Toronto and Montreal with four funds and over $2 billion of money under management.

Both STEP and Horizon North leveraged private equity for their growth. What is it about Canada that attracts private equity funds? Morty White had these observations on why Wynnchurch supports investment in Canada:

1. Wynnchurch likes industrial niche companies that rank top-tier in what they do. “We invest a minority piece or a controlling interest in industrial manufacturing and services companies and help the management team take the business to the next level. Sometimes this involves helping them through geographic expansion, helping them go out and make acquisitions, or working with them through operational or strategic improvements.”

2. Wynnchurch is agnostic about whether they invest in Canada or the United States; the exchange issues usually resolve themselves when it comes time to exit. White says that a weaker Canadian dollar and distress opportunities available in the resources sector is a very attractive climate for US funds to look to Canada. “We want to do more in Canada; this is our type of market. We’re not into fancy shoes or retail; we like good manufacturing and service businesses and this should be our environment. We are always bullish about Canada and having the dollar where it is now makes it even more attractive.”

Wynnchurch and one of its major portfolio companies, Group Moreau, a Quebec-based provider of electrical and mechanical services to the oil sands sector in Alberta and the mining industry in northern Quebec, are currently examining ways to grow in the lower-for-longer commodity climate, White said. Amongst other services and end-markets, hydroelectric is on their radar, as are larger scale fabrication and piping services.

“We actually look at this downturn as an opportunity to consolidate the market. For our platform companies, we want to help buy other companies, make strategic acquisitions, grow product and service offerings, and expand geographies.”
“We actually look at this downturn as an opportunity to consolidate the market.”

Morty White  
Wynnchurch Capital

**Keeping your banker happy**
In a distressed environment with the potential for missed covenants looming, energy services companies need to ensure they are on good terms with their banks. Securing time to explore options is critical and KPMG Restructuring & Turnaround Partner, Ryan Adlington, offered advice for preserving the relationship with lenders.

“The lenders need a line of sight to what the end game looks like. Why they should stick around and put in more cash, why they should be flexible,” he said. “It starts from communication and from under-promising and over-delivering. If you’re dealing with a syndicate you need to be sensitive to the workings of your syndicate. Certain banks are exiting or minimizing investments in oil and gas and that may be driving the situation. The other banks in the syndicate may not have the ability to take over that debt.”

**The power of people**
Regardless of any chosen strategy to survive and thrive, the panelists were unanimous in their observation that neither is possible without good people and retaining those people is even more of a challenge in the current environment.

STEP’s Davis stated, “We decided from the first day to intentionally create a culture that people love to be a part of. If your employees personally care about the success of the company, you have a competitive advantage and that is something we have invested a great deal of time and energy into creating.”

“You have to inspire people into greatness. This is a foundation of our culture that the leadership team supports and invests in. I like to say culture is really something that I have to own but that the rest of the organization has to live with and support. Our hiring practices are very deliberate around screening people that will fit and support our culture. Ultimately if you do it well, it becomes contagious. There is an identity to our culture that helps people understand the organization. It is really definable and I can say with some clarity that STEP has created that.”

Horizon North on the other hand, underwent a painful right-sizing process and worked to improve efficiency and productivity. Their strategy focused on gaining the most out of the business without increasing the number of employees.

Each company is unique in their challenges, but common to all is the need to plan for the future.

**Conclusion**
In a world of $50 a barrel oil where barriers to survive in the competitive energy services sector are aplenty, the ability to thrive can be a challenge. Breaking through these barriers could be possible through careful attention to your balance sheet, disciplined use of your own cash resources, outside capital, and a little thinking outside-the-box. Making strategic acquisitions, diversifying service offerings, and expanding geographic horizons are a few tips to consider to get ahead even when the market turns.