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Wood Group (John) PLC

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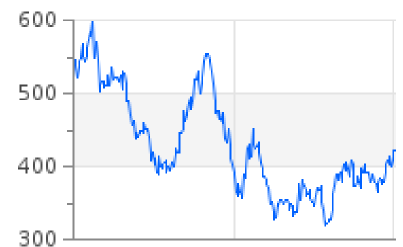
Wood Group: why a big split has emerged over its US shale move

Price: 404

Market Cap: £2.77 billion

1 Year Share Price Graph



Share Information

Code:		WG.
Listing:		LSE
52 week	**High**	**Low**
	598.6	**314**
Sector:		**Energy**
Website:		**www.woodgroup.com**

Company Synopsis:
Provision of selected engineering design, production support and industrial gas turbine services to the oil and gas, and power generation industries.

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Two years after the underwhelming merger with Amec Foster Wheeler, John Wood Group PLC (LON:WG.) has unveiled a new strategy to look at the future, but many hedge fund investors believe the company's shares are heading to a darker place.

The shares are now trading not far off a decade low, having dropped around 35% in the year to date, significantly worse than the sector's 8% dip.

While brokers seem to expect a turnaround - five out of nine City institutions have 'buy' recommends - the dark side of the stock exchange is betting on a further plunge.

Ten funds have shorted the stock over the course of a month, which means they expect the market to lose even more confidence in the Aberdeen-based group.

Short selling is a trading strategy that bets on a fall in the share price: investors borrow a stock from a fund in order to sell it, then repurchase the stock once the price has dropped to return it to the lender.

What do these short sellers think will happen, and why do brokers stay optimistic? Good Wood
In the 2018 results published in March, Wood Group attributed its shortcomings to external factors, namely slow recovery in the oil and gas sector, legacy contract commitments and the struggle to sell non-core assets at the price it wanted.

A new strategy presented on capital markets day this month set out a portfolio review and cost optimisation alongside a plan to grow revenue over the next three years, with an opportunity pipeline of US$13bn.

Some changes are already underway, such as the US$305mln sale of the nuclear business announced in August, which is expected to drive down debt.

With the market looking forward to portfolio diversification, Wood pleased the crowd with its plans to reduce reliance on the North Sea, an increasingly less attractive market which recently witnessed historical players like Chevron Corporation (NYSE:CVX) and ConocoPhillips (NYSE:COP) bidding farewell to their assets, while Exxon Mobil Corporation (NYSE:XOM) is planning a US$2bn divestment.

Shale I stay or shall I go?
However, the presentation on capital markets day highlighted an increased focus in the US onshore industry to "align with the entry of Big Oil customers".

Is it a wise move, considering the shale bonanza is past its golden days?

The US fracking industry thrives on lax environmental policies, meaning we may get a clearer picture only after next year's presidential elections, but current studies suggest only big companies are likely to survive thanks to their nine-figure budgets.

However, only a third of Wood Group's shale clients are big players, while the rest is independents, smaller operators and private equities.

According to Alex Brooks, analyst at Wood's house broker Canaccord Genuity, the company simply goes where there are contracts, whether it is the US or the Middle East.

"Is US shale a massive growth market? No, that ship has sailed. If the centre of your strategy is to grow within shale, then you should change your strategy," he told Proactive on the phone while referring to the industry in general.

"I do not think their strategy goes in that way, I think they go where the work is," he added when asked about Wood Group.

Two sides of a coin

Competitor Petrofac Limited (LON:PFC) seems to be following suit, as it announced on Wednesday the acquisition of US-based shale specialist W&W Energy Services marking its entry into the market, which does not seem to have lost its attractiveness.

Analysts at Berenberg defined the shale market as "attractive", although they pointed out a slowdown in oil and gas activity would negatively affect revenue and margins alongside lower oil expenditure and commodity prices.

Their forecast sees a drop in sales to 8% US$10bn in 2019, steadily regaining momentum to get back to US$11bn levels by 2021.

Similarly, Brooks said short-sellers may think the share price will be driven down by the unlikely jump in revenue over the next two years.

"Restructuring has obscured the underlying performance of the business, and delivering strong clean earnings and cash flow through 2019/20 will be key in boosting investor confidence in the story," Berenberg's analysts said in August, adding there are limited positive catalysts to drive the share price up in the short-term - namely debt reduction and portfolio review.

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