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Managing Through the Tough Times

As we near the end of the first quarter corporate reporting season, we note some of the major themes emerging from the earnings releases. From margin stabilization, to cost reductions, to survival amidst the worst industry conditions since the 1980s, companies have been finding ways to improve operations to stay profitable in a challenging environment.

The latter reference of survival speaks to the conditions in the oil and gas services industry. With drilling activity down over 50% in 2015 in North America, companies like Ensign Energy Services, which provides drilling rigs and field services, are just fighting to maintain their market position.

Ensign has been particularly hard hit by the oil and gas downturn. Production cut backs by oil and gas producers and pricing pressures have led to severe declines in revenue, and net income. Ensign has done a good job of managing costs through this downturn, allowing them to maintain gross profit margins and generate free cash flow.

In their first quarter release, management noted that the oil and gas industry downturn has begun to show stabilization, as supply decreases and the much needed rebalancing of the oil market begins. Price stabilization is needed to increase investments in drilling and other oil field services. Until then, management will focus on operational improvements and safeguarding their balance sheet. Ensign shares are owned across our Canadian equity mandates. We believe the company is well positioned to maximize returns for long term shareholders when the cycle reverses.

Shifting from a highly cyclical industry to a more defensive industry in the global equity strategies, Proctor and Gamble (P&G) also released earnings in May. As a global provider of consumer products, P&G owns some of the most widely used consumer brands including Tide, Pampers, and Gillette. Thus, we should expect earnings to be relatively stable. However, growth has been difficult to come by as the company announced its lowest dividend increase since 1977 following meagre organic sales growth of 1%. P&G faces the challenge of increasing competitive pressures in the emerging markets, particularly China. Foreign currency translation to rising US dollars also continues to be a headwind.

Over the past five years, the company has been actively trimming their brand portfolio to consolidate into segments where it has a high market share. This initiative improved P&G's profit margins despite weak revenue and earnings growth. Further cost-cutting measures are also being introduced, and the resultant higher cash flows will be used to invest in projects to drive growth in the medium to long term. The shares offer a dividend yield of 3.3%, and the prospect of more stable returns from margin improvements.

From consumer staples, we turn to transportation and the Canadian large cap strategy. Canadian National Railway (CNR) recently reported first quarter net income growth of 13%, aided by improving operational efficiencies. The company was able to trim operating expenses by 14%, as lower fuel and labour costs combined with favourable weather helped offset weakness from lower carloads. Further, free cash flow growth supported a 20% increase in their dividend rate.

Increased shipments of lumber, automobiles and domestic goods helped mitigate volume declines this quarter. Management, though, remains cautious and expects annual carload volumes to decline again in 2016 given the weakness in all commodities. The company will continue to focus on managing costs while maintaining market share in this tough economic environment. CNR's diverse customer base across North America provides important earnings support during this weak commodity cycle.

These three distinct companies share the same focus on cost containment, balance sheet strength, and free cash flow generation, helping them withstand various challenges in their respective industries. Their prudent fiscal management provides support to the portfolios at a time when market volatility has become commonplace. We expect their total return profiles to improve as industry conditions stabilise, while cost control persists.