A Case For Casting Your Net Beyond the Canadian Market

Description

Energy service firms are sprinkled among today's worst performers on the S&P/TSX Composite Index. **Calfrac (TSX:CFW)** released disappointing earnings this morning, causing the stock to fall by about 6%. This has impacted the entire group.

Revenues at Calfrac in Q4'12 were down 25% from Q4'11 – a remarkable decline. Perhaps more astounding was that the company's full year 2012 EPS was just $2.17, down from $4.22 in 2011. Reduced activity in both Canada and the U.S. impacted results as energy producers continue to navigate the low natural gas price environment.

Canadian energy service firms are quality companies but they suffer from a lack of geographic diversification. Calfrac derives 88% of revenues from North America. **Trican Well Services (TSX:TCW)**, which is nearly double the market cap of Calfrac, also derives 88% of revenue from North America. No wonder Trican's stock is down by about 4% after Calfrac revealed low activity levels in North America. These two stocks have a correlation of 0.87 over the past five years.

What's the alternative?

Energy service firms are cyclical which can make this a tricky space for investors to play. That two of the larger Canadian firms in this sector derive so much of their business from North American accentuates the volatility, making it even tougher for long-term investors.

If you like the space, but can't stomach the volatility, think about looking beyond the Canadian market for your exposure to energy services. The two most obvious choices to consider are **Halliburton (NYSE:HAL)** and **Schlumberger (NYSE:SLB)**. These U.S. based behemoths derived just 56% (HAL) and 32% (SLB) of revenues from North America over the most recently completed 12 month period.

This geographic diversification leads to a smoother ride for each company's financial results and helped to provide a higher average ROE over the 2007 to 2011 period. The table below provides this comparison.

	Calfrac	Trican	Halliburton	Schlumberger
5 Yr Avg ROE	11.3%	11.3%	25.9%	24.8%

Source: Capital IQ

The Foolish Bottom Line

There are many areas of the Canadian stock market that are narrow and poorly diversified. The energy service space is one of them. If you are going to hold just one energy service stock in your portfolio, a well-diversified, global giant is likely to serve you better over the long-term than a company tied to just one energy market. If you are bullish on the space, it might make sense to then add a Canadian name or two on top of this core holding. Calfrac and Trican are solid companies, but core portfolio positions they are not.

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Fool contributor Iain Butler owns April 2013 put options on Halliburton. The Motley Fool has no positions in the stocks mentioned above.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CFW (Calfrac Well Services Ltd.)

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