



Schlumberger Limited Has Really Bad News for Precision Drilling Corporation Investors

Description

The past year has been a rough one for **Precision Drilling Corporation** ([TSX:PD](#))([NYSE:PDS](#)) because of the impact that weak oil prices have had on demand for drilling rigs. While the company's revenue is more secure than most due to its strong contracts with top oil companies, that hasn't been enough to keep the stock from falling about 40% over the past year.

Unfortunately, industry conditions don't appear to be showing any signs of improving. In fact, if we listen to what oilfield-service kingpin **Schlumberger Limited** ([NYSE:SLB](#)) recently had to say, 2016 will be another rough year for Precision Drilling and the rest of the oilfield-service industry.

Learning from the industry leader

Last week Schlumberger reported its third-quarter results, while also providing its outlook for the near term. That outlook was a real downer to say the least. Here's what Schlumberger CEO Paal Kibsgaard had to say about his company's outlook on the oilfield-service industry:

In spite of the expected improvements in oil prices, the market outlook for oilfield services looks challenging for the coming quarters, as we expect additional reductions in activity and further pressure on service pricing. This is driven by the financial pressure on many of our customers where a year of very low oil prices is now exhausting available cash flow and corresponding capital spending and also leading them to take a very conservative view on 2016 E&P budgets...Based on this industry outlook, we expect E&P investments to fall for a second successive year in 2016...we instead see an increasing likelihood of a timing gap between the expected improvement in oil prices and the subsequent increase in E&P investments and oilfield services activity...we have to factor in that the likely recovery in our activity levels now seems to be a 2017 event.

In other words, despite the view that oil prices will improve next year, Schlumberger isn't banking on oilfield-activity levels improving next year. Instead, Kibsgaard believes that oil companies will use any

improvement in the oil price to repair their balance sheet instead of accelerating drilling. As such, Schlumberger does not expect to see oilfield activity rebound until 2017. That means next year will be another tough year for companies like Precision Drilling.

Where things could get tough

In light of this outlook, one of the areas Precision Drilling investors need to monitor is the company's average-term contracts. For 2015, the company boasts about having revenue security as it has 104 contracts for 2015. However, in its last investor update the company only had 63 contracts for 2016 in hand. That's a significant drop in contracts heading into what might be a very weak year.

What Schlumberger's outlook suggests is that with no rebound in industry-activity levels next year it will make it tough for Precision Drilling to secure new contracts at anywhere close to the scale or day rates as prior periods. That suggests that revenue and earnings could weaken materially over the next year.

Having said all that, the good news is the fact that Precision Drilling is financially strong thanks to its robust liquidity, including \$434 million of cash on its balance sheet as of the end of June. So, it can withstand a rough year better than many of its peers. Further, it has the Tier 1 rigs that oil and gas producers want because these are the most efficient rigs in the industry, which lead to lower overall drilling costs.

When these factors are combined with the company's downturn initiatives to reduce its own costs, it suggests that the company is well positioned for a prolonged downturn and won't have any issues waiting things out until 2017.

Investor takeaway

Schlumberger thinks 2016 will be a rough year for the oilfield-service industry, which doesn't exactly bode well for Precision Drilling. However, this doesn't mean the company is doomed, but that its revenue and earnings will likely take another hit next year. It's not an ideal situation, but it is one that the company is equipped to handle.

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