



Precision Drilling Corp. Is Feeling Some Pain

Description

Precision Drilling Corp. ([TSX:PD](#))([NYSE:PDS](#)) reported first-quarter earnings on Monday, and it wasn't pretty. The company posted a \$19.9 million loss compared with a profit of \$24.0 million the year before. Revenues were crushed, falling to \$301.7 million from \$512.1 million during the first quarter of 2015.

The company says revenues from its contract drilling services and completion and production services segments both fell by 39% and 57%, respectively, with the business experiencing nine contract cancellations since the start of the downturn.

With such terrible results, it's no wonder that shares are down roughly 70% from their highs in 2014. Can patient investors capitalize on Precision's current pain and depressed valuation?

A downturn to remember

As an oilfield-services company, Precision provides contract drilling, well servicing, and support services to oil and gas producers. The latest oil collapse has caused turmoil in the industry, sending drilling activity plummeting as producers try to rebalance supply to a world with lower selling prices.

Even today, global oil production is still about two million barrels per day above consumption. This has caused the rig count to fall precipitously, severely impacting Precision's revenues. Drilling activity in Canada and the U.S. fell over 80% last year. Long term, only higher oil prices can remedy this situation.

Image Source: Precision Drilling Investor Presentation
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The focus today is survival

While companies in cyclical industries prefer to invest throughout the business cycle, too many over stretch during bull markets and are left saddled with elevated costs and debt levels when prices plummet. While Precision wasn't too imprudent during the last upswing, the downturn has become so severe that even the best-capitalized drilling companies have been forced to maintain liquidity rather

than prepare for the future.

Can Precision survive?

Currently, the company's net-debt-to-capitalization ratio is 38% and climbing. To service short-term needs, it has \$476 million in cash and \$734 million in revolving credit lines. That revolver expires in 2019, however, and banks have proven increasingly strict with the industry, limiting withdrawal maximums and boosting interest rates.

If oil prices don't improve by 2019, Precision could be in trouble. A large chunk of its cash hoard will likely have been used up, and the company faces \$850 million in debt maturities between 2019 and 2020.

While Precision is rolling back its spending dramatically (capital expenditures are down 70% since 2014), it won't be enough to stem the tide should oil prices remain around US\$40 a barrel.

A tricky investment

If you're a long-term oil bull, a reasonable strategy would be to buy a basket of beaten-down energy stocks, playing an eventual rise in commodity prices. Precision Drilling is a trick case, however, as you need to get both the timing and direction correct. With its limited financial flexibility, you could lose money on the stock if oil rebounds later than you expect.

If you're not confident in oil prices staging a sustainable rebound in the next 12-18 months, avoid betting on Precision.

CATEGORY

1. Energy Stocks
2. Investing

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Date

2025/08/17

Date Created

2016/04/28

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