Investor Alert: Canadian Drilling Companies Face a Major Threat

Description

A recent interview with the head of Canada's drilling association highlighted a major threat facing Canadian drilling companies moving into 2017 and beyond–a Donald Trump presidency. I'll be looking at how the fundamentals of Canadian oil and gas drilling may change as a result of the recent election, and how the long-term outlook for this industry in Canada may have shifted in the past weeks.

Mr. Scholz, head of the Canadian Association of Oilwell Drilling Contractions (CAODC), spoke to the potential for increased U.S. production and increased production levels south of the border–something that would continue to provide downward pressure on a commodity which has seen its fair share of headwinds over the past two years and reduce demand for Canadian oil.

Canadian oil trades at a discount to world oil prices, and with newly imposed carbon taxes in Alberta, Canada's competitive position as a major global oil producer may be hampered further.

This renewed potential for a boost in production levels comes from Mr. Trump's rhetoric on the campaign trail of removing regulatory barriers in the energy sector, bringing back jobs in the coal industry and other inexpensive forms of energy production, and driving energy independence within the U.S.

What does this mean for drilling companies?

Increased U.S. production pushing global oil prices down will only hamper Canadian oil and gas drilling efforts. On the bright side, several Canadian drilling companies have begun to rehire employees that were let go due to the recent downturn in the price of oil, as oil has nearly doubled from its low of about $27 earlier this year.

Major producers such as **Precision Drilling Corporation** (TSX:PD)(NYSE:PDS) have rehired employees (in Precision's case, the company has brought back approximately 1,000 North American workers), but drillers have compromised by reducing capital expenditures further to manage growth in the current low-price commodity environment.

For example, Precision Drilling Corp. announced this week a capital expenditure plan for 2017 consisting of a reduction in capital spending from $213 million this year to $109 million next year–a cut of approximately 50%. Large cuts in capex should've been expected; many Canadian oil producers and drillers have used cash flows from operations to fund capex and pay back debt over the past two years.

The past two years have been a tumultuous period for the oil and gas industry; the price oil producers could obtain at the world market often dipped below the cost of producing oil.

Moving forward, I see significant headwinds for the Canadian oil and gas drilling industry from a competitive standpoint. A combination of reduced revenues (due to the nature of Canadian crude being a lower-grade commodity product) along with increased U.S. production, and carbon taxes coming into play, put the Canadian drilling industry at a competitive disadvantage.

It looks like a cautious, Foolish investing strategy is in order.

Stay Foolish, my friends.

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