KPMG

Looking south

U.S. expansion beckons Canadian energy service companies but be wary of a steep learning

Faced with declining domestic investment and limited growth prospects, Western Canadian energy service companies that are considering expansion into the booming U.S. shale oil and gas basins need to fully appreciate the risks of entering a foreign country with vast regional differences.

"Don't be deceived. The U.S. looks so much like Canada but it's not," says January McKee, President, AMGAS Services Inc., an industry leader in hydrogen sulfide (H2S) treatment, with offices across Canada, the U.S. and the Middle East.

The U.S. market is different and it's competitive but, despite these challenges, KPMG Partner and Co-Energy Services Leader Rick Mussenden says it's not surprising that many KPMG clients are looking south to expand their geographic footprint.

"While we are seeing some potential bright points on the horizon in Canada, with proposed projects like LNG Canada, Teck's Frontier Oil Sands Project and the SinoCan Global refinery, the industry continues to face headwinds in the form of access to markets, regulatory roadblocks and low capital investment," Mussenden says. "Contrast this Canadian landscape with the frenetic pace of economic activity in the U.S."

According to the U.S. Energy Information Administration, the United States likely surpassed Saudi Arabia and Russia earlier this year to become the world's top crude oil producer. This combined with the fact that the U.S. shares a common language and is literally at Alberta's doorstep makes it a very attractive market for many Canadian-based oil and gas service companies.

The risks

Trican Well Services' top executive, Dale Dusterhoft, says it's easy to be lured by sheer size of the U.S. opportunity.

"Don't underestimate the competitive landscape and everything else that goes with it," Dusterhoft says.

Trican entered the United States in 2007 through an acquisition of a stimulations company in the Barnett Shale. Trican rode the wave of horizontal fracturing into the Marcellus, Eagle Ford, Haynesville and Permian basins until the crash of oil commodity prices in late 2014. Then it divested its U.S. and other international assets to pay down debt and focused on Western Canada.

The speed with which capital is deployed in the U.S. astonished Dusterhoft. This can turn an attractive prospective market into a saturated battlefield before a company is fully established.

"In busier years, the amount of equipment that was built [in the U.S.] exceeded what we thought could be built," Dusterhoft says. "Probably 7 to 10 million horsepower was added to a base of 7 to 10 million in a year and half to two years. The market became very competitive very quickly."

In Canada, Trican squares off with five to eight competitors. In the U.S., it had 50 competitors. "When things got tough, you could have 35 companies in the Permian bidding on a job," Dusterhoft says.

The U.S. is also a very regional market. Operating in the Barnett Shale is different from the Marcellus, which is different than the Permian.

"Sales approaches are different in each region. Customer relations are different. Customers are generally more predatory in the U.S. than in Canada, with fewer long-term relationships," Dusterhoft says, citing entire pumping crews

quitting after being offered a dollar an hour more in day rates by a competitor. "A buck an hour and suddenly you've lost 40 or 50 people. That has happened in the Permian with various companies. In Canada, you don't see that."

The upside

If done right, expansion into the U.S. can provide new growth, revenue stability through geographic diversification, access to a market that is more accepting of new technologies and a new company footprint that is more interesting to investors.

To manage the risks of entering the U.S. market, STEP Energy Services, President and CEO, Regan Davis urges companies to learn from the mistakes of others who have ventured south.

"Establishing yourself in the U.S. is not easy, so learn from others and really heed their advice," Davis says.

STEP carved out a profitable niche in Texas as a coil tubing service provider. That momentum allowed it to acquire a small regionally focused Oklahoma fracturing company this spring, which positions STEP for grow in stimulations both in the U.S. and Canada.

"Our success to date has been as a smaller regional operation. Avoid getting caught in that middle market no-man's land," Davis says.

When Trican exited the U.S. in 2015, it found itself in that middle market. No longer a niche player with tightly controlled costs, it was a multi-basin player competing with the likes of global heavyweights.

"The middle is the spot not to be," Dusterhoft says. "The middle is tough mainly because your cost structure can't compete on either side."

Success in the U.S. requires copious upfront preparation and then going "all-in." In Texas, operators "can smell you a mile away" if you have only a local phone number, says AMGAS' McKee. Canadian companies need to ensure they have an on-the-ground local presence and a support team in place.

"Like any business," Dusterhoft adds. "You need the right people. Find someone to fit your culture, but also who absolutely understands how to make money in that market because making money in that market is a whole different ballgame."

Jason Boland, KPMG Partner and Co-Energy services leader, agrees. "This high risk – high reward opportunity should not be taken on blind, seek expertise and experience for your best chance of success in the U.S."

"The U.S. market presents Canadian companies with an exciting opportunity, however, as Service companies leaders have pointed out, making the move is not for the faint of heart. If done well, expanding to the U.S. can have significant benefits for a Canadian company, but the downside risks are real and companies need to be prepared. KPMG can help companies navigate the risks and increase their chances of succeeding the competitive U.S. market."

For more information please contact:

Jason Boland
Partner, Tax
Co-Energy Service Leader
KPMG in Calgary
jboland@kpmg.ca

Rick Mussenden
Partner, Audit
Co-Energy Service Leader
KPMG in Calgary
rmussenden@kpmg.ca