Canadianization of the Oil Sands Fosters Moderate, Sustainable Growth

OCT 24, 2017 – VIEW ISSUE – MAURICE SMITH – JWN ENERGY – DAILY OIL BULLETIN

As recently as 2013, when the WTI price of oil was hovering in the $90-$100-plus range, the majority of high-cost oilsands production in Canada was owned by foreign entities. A wave of consolidation over the past year has transformed the sector as Canadian-based companies have amassed the assets of several foreign-based super majors that have exited the sector amid the most prolonged downturn in a generation.

Calgary-based **Sproule** estimates Canadian companies now operate approximately 70 per cent of oilsands production. Major transactions have included **Suncor Energy**'s taking a controlling stake in Syncrude Canada, **Canadian Natural Resources Limited**'s (CNRL) $12 billion purchase of **Royal Dutch Shell**'s Albian mining assets and **Cenovus Energy**'s $17.7 billion megadeal for **ConocoPhillips**' oilsands assets. Norway's **StatoilASA** and U.S.-based **Murphy Oil Corporation** also unloaded oilsands assets and France's **Total** is reported to be marketing its properties.

In essence, the sector has gone from one in which dozens of decision makers were ensconced at head offices around the globe to one in which most of the major power brokers can now be found in a several-block radius of downtown Calgary and Fort McMurray.

That means greater opportunity for collaboration, exchange of ideas and sharing of technologies, and alignment of interests — such as in the pursuit of lower carbon intensity and costs — is now possible. And the remaining companies, for which the oilsands represent their core strategic resource, can concentrate on what they do best — extract and market bitumen.

"On the whole having a group of players that can provide some leadership by virtue of the oilsands being a core part of their strategy and focus should be a positive driver for the industry in coming years," said **Christoffer Mylde**, Sproule vice-president, Corporate Development.

"The focus on optimizing existing projects and looking at more modular projects going forward, introducing technologies such as automation and more remote management, will also create efficiencies that will help make the oilsands more

competitive. You need some champions to drive those changes, and we have got some very strong players in the ranks of Canadian companies that have stepped up and are prepared to provide that leadership."

Portfolio Play

The oilsands emerged as the key portfolio play that most global exploration and production companies sought to access 10-15 years ago — when it represented one of the few big plays not under sovereign control of national oil companies. "If you go back a decade the oilsands really represented the only opportunity for those players from a portfolio perspective to get a taste of arguably the largest resource that was available. If you had a global portfolio of assets it was important to have some exposure to the oilsands as a stable supply with low decline and long-term economics," said Mylde.

That all changed with the opening up of unconventional resource plays in the U.S. made possible by the development of horizontal drilling and multistage fracturing technology, and the international supply glut and ensuing price slump triggered in part by the resulting flood of light tight oil into the market.

Today the focus of the supermajors has shifted to what is deemed lower hanging fruit elsewhere. U.S. seniors have retreated back to the burgeoning U.S. unconventional market and sold their stake in the oilsands as part of a wave of divestitures of their global portfolios more broadly, Mylde said.

National oil companies (NOCs) that were big investors in the oilsands in the last major investment wave have also exited or scaled back their exposure, partly due to economics and timing of transactions that did not generate expected returns. Future investment has been discouraged by changes in the Investment Canada Act, designating oilsands as a strategic resource with a higher approval hurdle for state-owned companies. Market access and high costs have also been cited as key concerns.

"This has on paper been a perfect storm for the oilsands. We have had collapsing commodity prices, little progress on market access through new pipelines, increased focus on climate change and an exodus of capital," said Mylde.

"However, there are some good stories that are emerging from this disruption, which may help create a more sustainable industry in the long term. The oilsands were a 'made in Canada' story 50 years ago and it is now again led by Canadian companies with Canadian expertise, technology and capital. Canadian companies like Suncor, CNRL and Cenovus are well positioned to help shepherd the next era of growth, as they have the requisite capital, expertise, scale and focus on the oilsands as a core part of their portfolio."

For many of the international portfolio players the oilsands were just one piece of their assortment of assets and more exposed to a potential shift in strategy, added Mylde. “I don’t think we are going to see that with the Canadian companies because the oilsands are a strategic part of their portfolio. That is going to give the industry more stability to build around, both in terms of technology improvement and in the interaction between the Canadian companies and governments, both federally and provincially, to see how we as a country can leverage the significant resource we have in the oilsands.”

“At the same time, it’s also an opportunity for the oilsands industry to grow at a healthier pace, without the cost pressures you might have seen otherwise which could have impacted the economics of projects, and to manage cost containment and focus on optimizing existing and new projects to make sure they remain competitive in whatever commodity price environment they are faced with.”

The sharper focus brought about by the pure-play oilsands producers is bound to help drive innovation and new technology solutions that will help mitigate the carbon footprint and improve economics over time for an industry that has been continuously looking at ways to improve even prior to the Alberta Climate Leadership Plan launched last year, noted Mylde.

Moderate and Sustainable Development

Despite a more moderate rate of growth expected compared to forecasts prior to the 2014 oil price plunge, the oilsands are likely to continue to play an important role to maintain the industry’s base supply of crude, he added. “With our current demand growth, globally and the limited investment in megaprojects over the last few years during the downturn, there will be an important role for the oilsands to play in the coming decade.”

Unlike light tight oil production in the U.S., which can be turned on and off relatively quickly, oilsands projects are designed to deliver returns through long-term economics, which makes them more immune to the whims of the market price of crude. Given the long-term nature of projects, they require a long-term view and vision for development.

“Light tight oil production in the U.S. has a very different return profile — you have got payout in sometimes 12 to 18 months. But then you have to continue to reinvest into new wells to sustain that production. Whereas with the oilsands you have very low decline and you can continue to generate those cash flows over a long period of time. So they have very different return characteristics.”

Though the oilsands are unlikely to return as a global portfolio play of choice for international oil companies, the strength and focus of the consolidators will ensure continued investment under most conceivable commodity price scenarios, he said.

Sproule

While greenfield mining megaprojects are unlikely to be sanctioned unless and until players have confidence in a price longer term that is north of at least $60-$70, in situ projects “will be a more realistic growth prospect for the oilsands industry,” Mylde said.

Smaller and nimbler in nature, cyclic steam stimulation and SAGD projects can leverage cost effective modular designs and other new technologies to significantly alter the cost profile, he said. Such projects also allow for a shorter timeline to first revenue and more gradual expansion.

Sproule’s view is that commodity prices will return to around $60 to $80 over the next three years, which would be supportive of a healthy oilsands industry. The sunk cost and infrastructure of existing projects will also ensure continued competitiveness for current production, said Mylde.

Sproule is a global energy consulting firm with a 65-year legacy of driving value for clients by helping professionals in the oil and gas sector make better business decisions—decisions that build sustainable prosperity from resource assets around the world. Sproule is anchored by deep geoscience and engineering expertise combined with a strong commercial understanding of energy markets. Headquartered in Calgary, Canada, Sproule has offices in Brazil, Colombia, Mexico, and the Netherlands. Learn more at Sproule.com.