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# The Impact of the Current Oil Price on Canada’s Energy Patch

## Description

Since hitting a one year high in August 2013 on the back of growing geopolitical tensions in the Middle-East, the price of crude has fallen back and now sits below $100 per barrel. The sudden summer spike renewed interest and investor activity in Canada’s oil patch. But this pull back in the price of crude, coupled with high development costs and transportation bottlenecks that are impacting profits, have put Canada’s oil sands companies under threat.



**What is the outlook for crude?**

Even more concerning is that markets expect the price of crude to continue softening, placing greater pressure upon the profitability of Canadian oil companies. The price of West Texas Intermediate (WTI) or light sweet crude – which is typically the benchmark price for Canadian crude producers – has fallen to just under $95 per barrel. And if that wasn’t enough, WTI futures contracts deliverable in December 2013, are now under $94 per barrel – indicating that oil prices will soften further over the short-term.

**Higher costs and softer crude prices threaten profitability**

High development costs have always been an issue for Canadian oil sands producers. It’s estimated that the development cost per barrel produced is between $30 and $99. But now the lack of pipeline transportation infrastructure is forcing producers to rely heavily upon rail transportation to access crucial markets.

Typically this adds an additional transportation cost of $10 to $15 per barrel over using oil pipelines, which increases the total cost per barrel produced to somewhere between $40 and $114. One of the positive developments however from using rail is that bitumen and its most common blend – West Canadian Select heavy crude – can be transported without the need for additional diluents.

This reduces production costs keeping development costs per barrel at the lower end of the range. But as discussed in my earlier article on the future of the oil sands industry, West Canadian Select tradesat a considerable discount to West Texas Intermediate. This discount is typically between $20 to $26per barrel. It means that at the current price of crude, producers of West Canadian Select are receiving between $69 and $75 per barrel.

This is significantly lower than the average price per barrel realized by a number of Canada's major oil producers for oil produced from oil sands during the third quarter 2013. For that period **Husky Energy** (TSX:HSE) realized $85 per barrel for heavy crude, **Imperial Oil** (TSX:IMO)(NYSE:IMO) $81per barrel for bitumen and **Suncor** (TSX:SU)(NYSE:SU) averaged $99 per barrel for all of its oil sands production.

If the bitumen is passed through an upgrader creating synthetic crude, the discount falls substantially to as little as 90 cents per barrel. Making synthetic crude $94 per barrel at the current oil price. But this increases the development cost to around $99 per barrel.

**What does this mean for Canada's oil sand producers?**

When examining the third quarter 2013 results of the key operators in Canada's oil sands industry it becomes clear that softer crude prices in conjunction with higher transportation costs will have an impact on profitability.



For the third quarter 2013 the benchmark price for West Texas Intermediate averaged $105.83 per barrel, which is a premium of 10% over the current price of West Texas Intermediate. It would be fair to assume that if crude prices remain at current levels or continue to fall, then fourth quarter 2013 revenues for Canada's oil companies will also fall proportionately.

But it doesn't mean that now is the time to panic and throw in the towel on investing in the Canadian oil patch. The impact of the softening oil price on the profitability of Canadian oil companies depends on a range of factors. These include the diversification of their production, whether they have access to an upgrader and their strategies for controlling costs and deploying capital.

The hardest hit companies in this operating environment, will be heavily leveraged smaller explorers and producers like **Athabasca Oil Corporation** (TSX:ATH). Whereas the larger diversified operators should continue to perform strongly. Two that standout are **Suncor** and **Imperial Oil**.

Both have diversified operations producing bitumen, heavy crude, synthetic crude and conventional light oil. They are also implementing cost reduction strategies and focusing on deploying capital to maximize the return received. All of which should continue to boost returns for shareholders.

**Foolish final thoughts**

Softer crude prices will certainly impact Canada's oil patch. But companies with diversified production, strong cost controls and quality assets will continue to thrive. As such they should continue delivering solid returns attracting further investment.

**CATEGORY**

1. Investing

**TICKERS GLOBAL**

1. TSX:IMO (Imperial Oil Limited)
2. TSX:SU (Suncor Energy Inc.)

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