High Costs Sink This Oil Sands Project

Description

Total (NYSE: TOT) announced that it's putting the brakes on the Joslyn oil sands mine. The project, which includes partners **Suncor Energy** (TSX: SU)(NYSE: SU)**, Occidental Petroleum** (NYSE: OXY), and a Japanese company, was expected to cost more than $11 billion. That high cost was just too much for Total and its partners to justify in today's operating environment.

Drilling down into Joslyn

Total, which owns a 38.25% stake in the project, had expected it to produce about 100,000 barrels of bitumen per day starting in 2020. However, cost inflation in the oil sands, combined with issues with pipeline takeaway capacity, have put a real dent in the project's economics.

The partners had been working since 2011 to find ways to reduce the project's costs, including the thought of boosting the size of the project by 50% to achieve greater scale. In the end it became apparent that the costs were not going to come down to an acceptable level to make an economic return in today's operating environment. While the project isn't dead, it's not likely to be restarted anytime soon.

While it's a blow to all of the partners, it's a really big hit to Occidental Petroleum, which spent $500 million in 2008 for its 15% stake in the project. At that time the company expected it would spend $2 billion more to develop the project, which it thought would be producing 11,000 barrels of oil per day net to Occidental Petroleum by this year. Needless to say it will be years before that oil ever starts to flow.

Total is down, but not out

For both Suncor Energy and Total the temporary halt to Joslyn isn't as much of a concern. Both already have another project to work on, as the pair actually decided to go ahead with the Ford Hills oil sands mining project. That project, which is led by Suncor, is expected to cost $13.5 billion. However, one of the reasons why Fort Hills did get the green light was because Suncor was able to secure enough pipeline capacity to bring in diluent and send out diluted bitumen.

Meanwhile, Total and its partner **ConocoPhillips** (NYSE: COP) are seeing great success at Surmont, which is a steam-driven in-situ project. Surmont currently has production capacity of 27,000 barrels per day; however, the venture is investing heavily to boost capacity to 136,000 barrels per day by 2015.

The difference with in-situ projects like Surmont is that they can be much more cost-competitive. According to ConocoPhillips, Surmont is expected to have a full cycle finding and development cost of just $20 per barrel, which for perspective is below the range of $20-$25 per barrel at ConocoPhillips' shale assets in the Eagle Ford and Bakken. The driving force here is that improvements in the steam-to-oil ratio have pushed costs down and really improved project economics.

The problem with mining projects is that they are much more capital-intensive because of the large physical footprints they require. While that enables producers to extract nearly all of the oil that's in place, it comes at a high cost. At some point it's likely that these costs will be worth it as most of the cheap oil is gone, which will leave Joslyn as an option when the world still needs more oil.

CATEGORY

1. Investing

TICKERS GLOBAL

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2. NYSE:OXY (Occidental Petroleum Corporation)
3. NYSE:SU (Suncor Energy Inc.)
4. TSX:SU (Suncor Energy Inc.)

Category

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