Are These Oil Sands Projects Really Losers?

Description

A new study released by the environmental advocacy group Carbon Tracker Initiatives is trying to cast a dark shadow on the oil sands industry.

The study suggests that oil sands producers like **ConocoPhillips** (NYSE: COP), **Cenovus Energy Inc** (TSX: CVE)(NYSE: CVE), and **Total SA** (NYSE: TOT) are wasting a massive amount of shareholder capital, as their projects need oil prices north of $150 per barrel to make money.

The only problem with this notion is that it couldn't be any farther from the truth. These projects are among the lowest-cost energy sources on the planet and are about to become huge cash flow generators for these producers.

Finding fault at Fosters Creek

One of the projects specifically picked on by the study was the Foster Creek oil-sands development, which is part of a joint venture between ConocoPhillips and Cenovus Energy. The study suggested that the project needed oil prices to be $159 per barrel in order to break even. That, however, is patently false. Cenovus Energy's supply costs for its oil sands projects are in a range of $35 to $65 per barrel. That's actually below the average global supply cost of $70 per barrel.

The reason its supply cost is so low is because the partners are focused on keeping their steam-to-oil ratio as low as possible. In fact, Foster Creek has the fourth lowest steam-to-oil ratio in the oil sands region, and two of the three projects it trails are part of the same joint venture and the third is solely owned by Cenovus Energy. Further, it's worth pointing out that not only does having a low steam-to-oil ratio improve the project's economics, but it also improves the carbon footprint of the project.

Surmont reversal is at hand

One of the other oil sands projects picked on by the study was Surmont, which is a joint venture between ConocoPhillips and Total. Like Foster Creek, the study suggested that Surmont needed oil at $159 per barrel to be profitable. That couldn't be farther from the truth as ConocoPhillips' full-cycle finding and development costs are just $20 per barrel, while full-cycle project returns are around 15%.

While Surmont's capital funding requirements are currently high, that's about to change as Phase 2 comes online next year. In fact, by 2017 the project will be at full production capacity and should produce a steady amount of oil until the 2030s. Because of this, the net cash flow ConocoPhillips expects to pull out of the oil sands starting in 2017 will be well over a billion dollars per year for the next few decades even if the price of oil doesn't budge.

Investor takeaway

Despite what this new study suggests, the oil sands projects are wildly profitable. In fact, ConocoPhillips' profit margin on every barrel of oil it produces in the Canadian oil sands is currently between $30-$40 per barrel of oil equivalent at current prices. This profitability is why the company's current plans call for it to grow its oil sands production by 21% annually through 2017. Bottom line here is, don't believe the headlines of this new study as the oil sands don't need higher oil prices to make investors a lot of money.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:COP (ConocoPhillips)
2. NYSE:CVE (Cenovus Energy Inc.)
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