The Awful Oil Market Causes Another Oil Sands Project to Get Shelved

Description

Bloomberg is reporting that **Royal Dutch Shell Plc** (NYSE:RSD-A)(NYSE:RDS-B) is shelving its Pierre River oil sands mining project. In doing so, it joined a growing list of peers that are either shelving or delaying oil sands projects in the industry.

So far this year **Suncor Energy Inc** (TSX:SU)(NYSE:SU) has announced that it is deferring investments in its MacKay River 2 project, while **Cenovus Energy Inc** (TSX:CVE)(NYSE:CVE) and partner **ConocoPhillips** (NYSE: COP) have stopped work on Christina Lake Phase G and Foster Creek Phase H. A combination of weak oil prices, high costs, and the lack of pipeline takeaway capacity is making it uneconomical to continue to grow production in the region, which is very disappointing news for investors.

What Shell is shelving

Shell has decided to withdraw its application to develop an oil sands mine in order to focus all of its attention on making its existing projects more profitable. In withdrawing the application, the company has decided that now is not the right time to start working on another oil sands project in Canada. However, the company isn't completely abandoning the idea, but instead it will wait until the economics of the oil sands improve.

Shell has been in the planning stages of this project since 2007 and its initial application was for a 200,000 barrel-per-day project that was to begin production in 2010. However, the company had delayed the project, as it has never gained any traction because the economics didn't look great when the price of oil was higher, and those same economics have only gotten worse as the price of oil has plunged.

The list keeps growing

Pierre River isn't the only oil sands mine that couldn't make it when the price of oil was higher. Last year French energy giant **Total** (NYSE: TOT), along with Suncor and other partners, put the brake on the $11 billion Joslyn oil sands mine, as that project's economics were unappealing at $100 oil. The partners haven't given up on the project, as they're looking at supersizing it in order to achieve greater scale, but the project doesn’t have a hope of seeing the light of day as long as oil is around $50 a barrel.

Meanwhile, $50 oil is causing more projects to be delayed. Suncor Energy shelved its MacKay River 2 project for the time being, as it has decided to focus all of its attention on bringing its already sanctioned Fort Hill project online. In doing so, it joined a growing list of companies that are finishing up current projects, but shelving those that are earlier in their development.

Cenovus Energy and ConocoPhillips, for example, halted future phases of Christina Lake and Foster Creek, while Cenovus has also halted work at its emerging oil sands assets at Narrows Lake, Telephone Lake, and Grand Rapids. Instead, both companies are focused on completing phases of Christina Lake and Foster Creek that were more than two thirds complete, while ConocoPhillips is working with Total to finish up work on their Surmont 2 project. Once those projects are complete, it could be a while before growth is restarted, as producers will want to ensure that they’ll earn an adequate return on their investments, which means higher oil prices, lower costs and the approval of a new pipeline or two.

Investor takeaway

In a sense, oil companies are digging in right now. They are finishing projects that they’ve already started, but are simply refusing to begin new work until the price of oil and the overall economics of oil sands projects improves. That’s something these companies can afford to do, as the oil isn’t going anywhere, so it makes sense to wait until the economics are better before they invest billions to pull it out of the ground.

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