Is This the Final Nail in the Coffin for the Oil Sands?

Description

One of Canada's greatest advantages in the global energy marketplace is the country's political stability. That stability is a big draw to energy companies because they know that they can confidently invest to develop Canada's energy reserves without the risk that those reserves will be nationalized. However, Canada's political stability was dealt a major blow when the pro-energy government of energy-rich Alberta was ousted last week. That shift in power has investors gravely concerned, which is why many bailed on energy stocks last week.

oil sands Image not found or type unknown

That chart shows the dramatic sell-off in Canadian oil sand stocks as behemoths **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE), **Husky Energy Inc.** (TSX:HSE), and **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) were all hammered after election results came in on May 6. This sell-off, of course, begs the question of whether or not we've seen the end of the oil sands boom.

Why this change could be bad

The reason energy stocks have sold off so dramatically is because of what the new government intends to do. The leader of the New Democratic Party Rachel Notley has said she would raise the corporate tax rate in the province to 12%, which would eat into the profits of oil sands producers at a time when weak oil prices have already taken a deep cut.

To make matters worse she has said that she would not lobby for **TransCanada's** Keystone XL pipeline on behalf of oil sands producers; she has also spoken out against **Enbridge's** Northern Gateway pipeline. Without these pipelines it will make it tough for oil sands producers like Cenovus, Husky, and Suncor to grow; they would have fewer options to get oil out of the province as current pipelines are already running at capacity. This would likely push additional oil volumes to more expensive rail options, which are much less appealing at lower oil prices.

Finally, she has said that she would review oil royalties, which could lead to an increase in royalty rates. Higher royalty rates, like higher taxes, would eat into the profitability of oil companies.

It could be worse

Obviously, none of these proposed changes would be a positive development for oil sands producers. However, it is important to note that none would lead to a ban on new projects, nor a shutdown of current production. Instead, these proposed changes would just make it harder for producers to grow production, which, honestly, is nothing new as oil companies have always faced an uphill battle when it comes to growing production.

Oil companies are known for their resiliency and seem to always find a way to make it through tough times. For example, as pipeline capacity tightened due to the delays in the Keystone XL pipeline, producers turned to rail to get their oil out. This suggests that oil producers will find a way to grow production in Alberta as long as the economic incentive exists.

While that incentive has been severely diminished in the past year due to weak oil prices, there is a very good chance that oil prices will be meaningfully higher in the future due to all of the oil projects that have been delayed or canceled. That economic incentive would provide an opportunity for the industry to rise from the grave and restart growth, even if the new government moves ahead with all of its proposed changes.

Investor takeaway

There’s no doubt about it: the recent elections in Alberta will result in a big blow to oil sands producers. The new government will likely push for higher taxes and will no longer advocate on the industry’s behalf. However, none of the proposed changes will result in the industry closing down. Meanwhile, meaningfully higher oil prices in the future will be all it takes to drive future growth from Canada’s oil sands.

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