Wildfires in Canada: What it Means for Oil Sands Investors

Description

Wildfires in western Canada knocked out about 10% of the region's oil production for the past two weeks. While oil production has since resumed, the fires will have a meaningful impact on oil sands producers **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) and **Canadian Natural Resources Ltd.** (NYSE:CNQ)(NYSE:CNQ), which had halted production at key oil sands sites. That production halt aside, what the wildfires did reminded investors that company-specific risk cannot be overlooked when investing in the energy sector.

A big hit for Cenovus

One of the hardest-hit companies by the wildfires was Cenovus Energy. Towards the end of May Cenovus Energy was forced to close its Foster Creek operations, which is jointly owned with **ConocoPhillips**. As a result of that closure the two companies lost 135,000 barrels of production per day from the facility.

That loss will have an impact on Cenovus Energy's second-quarter results as the company currently produces 144,000 barrels of oil per day from the oil sands, roughly half of which comes from Foster Creek. Furthermore, 31% of the company's total oil production comes from this one field, so getting the field producing at full capacity is really imperative for the company as it is losing a big chunk of its cash flow every day it's not selling oil.

What's worth noting is that while Foster Creek is vitally important to Cenovus Energy's business, it's a much smaller portion of ConocoPhillips's daily output. In fact, the field is less than 2% of the company's total daily output. Furthermore, just as Foster Creek was shutting down, ConocoPhillips and another partner started bringing their Surmont 2 oil sands project online. While the field isn't expected to deliver first oil until the third quarter and won't reach its full capacity of 118,000 barrels per day until 2017, it shows just how much more diversified ConocoPhillips is, which enables it to better withstand the shutdown at Foster Creek.

Canadian Natural Resources will feel a pinch

When we compare Cenovus to another company that has been hard hit by the shutdown, Canadian Natural Resources, we see just how much greater the impact was on Cenovus. Canadian Natural Resources had to shut down its 80,000 barrels per day Primrose facility, and on top of that the company lost 18,000 in daily output from the Kirby South project after a third-party pipeline was shut down for a few days.

The Primrose production loss alone is a big hit for the company, as it represents roughly 9% of the company's total daily output. However, that's not nearly as deep a cut as the one experienced by Cenovus. Because of this, Canadian Natural Resources won't have quite as meaningful an impact on its second-quarter results.

Dodging a bullet

While both companies lost significant oil production, estimated at a combined output of more than one million barrels, neither facility was damaged by the fires. In fact, Canadian Natural Resources estimates that it will only need to make minor repairs to Primrose in order to get it back to full production capacity. This means that both companies should be able to get their production back up to full capacity in short order.

However, things could have been much worse if the wildfires moved in and damaged the production facilities. Cenovus Energy in particular was at the greatest risk due to the fact that nearly a third of its current production comes from Foster Creek.

As such, the incident is a reminder to investors of the importance of diversification as Cenovus Energy is a lot less diversified than Canadian Natural Resources or ConocoPhillips, which are both in a much better position to withstand a direct hit from wildfire than Cenvous can at this point. Because of this, investors that want to reduce their risk might want to think twice about owning Cenovus Energy as its asset base is much more concentrated than its peers, which is a risk that could come back to bite investors in the future.

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Date
2025/08/05
Date Created
2015/06/10
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