



3 Canadian Oil Story Lines to Watch in 2016

Description

There's no doubt about it—2015 was a rough year for the Canadian oil sector. Oil prices kept falling, which put even more pressure on producers' profits. Making matters worse, a change in government could make it harder for the industry to operate should it impose tougher tax laws and environmental regulations. Having said all that, the industry entered 2016 on a hopeful note as a number of key story lines hinted at better days to come.

1. Will a merger wave hit the industry?

One of the big story lines from 2015 was **Suncor Energy Inc.'s** ([TSX:SU](#))([NYSE:SU](#)) pursuit of rival **Canadian Oil Sands Ltd.** (TSX:COS). While Canadian Oil Sands has been fighting that overture, its fight might be nearing an end, especially after leading shareholder Seymour Schulich changed his tune and is now willing to support a deal if Suncor sweetens it up a bit.

Should this deal go through it could set off a wave of consolidation within the sector, especially given that the pressure on smaller producers is mounting due to their weaker balance sheets and lack of scale.

Many of these smaller producers have been using asset sales to repair their balance sheets, but with crude continuing to plunge, it is taking asset values with it. That could leave these companies with no other option but to merge with a stronger rival in order to reduce costs.

2. Will cost deflation continue?

After 15 straight years of cost inflation, the cost to produce crude from the oil sands dropped last year. That helped companies like Suncor offset some of the oil-price weakness. Having said that, the cost to produce oil in Canada remains higher than most other areas, while the cost to develop new oil sands projects remains noncompetitive with other regions. Because of this, cost deflation will need to keep happening before another project gets the green light.

A key sign that oil sands costs are growing more competitive would be if a producer gave the green light to a new oil sands development in 2016. There are a number of projects awaiting a final

investment decision, including **Cenovus Energy Inc.'s** ([TSX:CVE](#))([NYSE:CVE](#)) first phase of Narrows Lake, the second phase of **Husky Energy Inc.'s** (TSX:HSE) Sunrise Energy project or **Statoil's** (NYSE:STO) Corner project.

3. Will a new oil sands pipeline get the green light?

That said, before any of those projects can be built the country will need additional pipeline capacity. Unfortunately, last year marked the end of **TransCanada Corporation's** ([TSX:TRP](#))([NYSE:TRP](#)) attempts to build the Keystone XL pipeline after it was rejected by President Obama. While that dimmed the hopes that a new oil sands pipeline would be built, there are still a couple of projects that await decisions in 2016.

Westward projects by **Kinder Morgan Inc.** ([NYSE:KMI](#)) and **Enbridge Inc.** ([TSX:ENB](#))([NYSE:ENB](#)) face regulatory deadlines this year. Kinder Morgan's Trans Mountain pipeline expansion is expected to finish its regulatory review by May with construction potentially beginning this November. Meanwhile, Enbridge also expects a decision on its Northern Gateway pipeline to come in late 2016.

In addition, TransCanada's Energy East pipeline continues to move forward; the company recently increased the project's proposed cost from \$12 billion to \$15.7 billion. That cost inflation aside (which is partially due to the nearly 700 route changes) TransCanada expects to move forward with the project with an in-service date of 2020.

While all three projects remain on the table, what Canada really needs is for one of them to move from concept to construction. Should that happen by the end of 2016, it would remove a huge roadblock to the country's future growth.

Investor takeaway

Despite the current downturn, 2016 will be an important year for the future of Canadian energy. The industry really needs two things to happen next year for it to become more competitive with the global market: it needs to add more pipeline capacity and reduce its costs, either after a merger wave removes a layer of competition or once deflation really takes hold. If these story lines play out as hoped, it could set the sector up for a much stronger run in 2017 and beyond.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:CVE (Cenovus Energy Inc.)
2. NYSE:ENB (Enbridge Inc.)
3. NYSE:KMI (Kinder Morgan Inc.)
4. NYSE:SU (Suncor Energy Inc.)
5. NYSE:TRP (Tc Energy)

6. TSX:CVE (Cenovus Energy Inc.)
7. TSX:ENB (Enbridge Inc.)
8. TSX:SU (Suncor Energy Inc.)
9. TSX:TRP (TC Energy Corporation)

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