This Threat to Canada's Oil Sands Is Bigger Than the Rout in Crude

Description

The recent recovery in the price of oil has given hope to Canada's energy patch, but it appears that this relief may only be short term. The collapse in crude has brought the focus firmly back on the viability of continuing to extract crude from Canada's considerable oil reserves, which are the third-largest in the world after Venezuela and Saudi Arabia.

However, there are a multitude of headwinds that bring into question the sustainability of these oil assets and their continued extraction. Key among them is the threat posed by global warming and the increasingly concerted efforts to prevent global temperatures from rising.

Now what?

The historic Paris Climate Change Accord was the latest in a raft of globally focused environmental policies. It aims to reduce greenhouse emissions and prevent global warming. The agreement, which comes into effect in 2020, was the first global legally binding agreement to reduce the impact of climate change by limiting global warming to less than 2 degrees Celsius. In order to achieve this, fossil fuels will eventually need to be eliminated from the global energy mix.

According to research from the Grantham Research Institute, this would make approximately 80% of the total coal, oil, and gas reserves of publicly listed companies "unburnable."

This is a distinct threat to the viability of Canada's oil sands and companies such as **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), which is focused on extracting crude from these vast oil sands reserves.

You see, oil sands are the single largest emitter of greenhouse gas emissions in Canada. They produce more than four times the greenhouse gas emissions of conventional oil.

This, along with the push to transition the global energy supply, was a reason for Alberta's government to introduce a range of regulatory requirements to limit greenhouse gases from oil sands production. One of the key planks of this legislation is the introduction of an economy-wide carbon tax.

As a result, the new regulatory environment will increase the costs associated with operating in

Canada's energy patch. This couldn't have come at a worst time with crude caught in a protracted slump.

These factors create considerable risks for Canada's oil sands companies. They increase the cost of production and will eventually prevent them from generating a return on their core asset: their oil reserves.

However, this risk is limited by the fact that the majority of those assets, where considerable capital investments have been made, are proven oil reserves and can be monetized over the next 10-15 years. This is well before fossil fuels will be eliminated from the global energy mix.

So what?

This represents a distinct risk to Canada's oil sands industry and has the potential to turn oil sands assets from valuable assets into costly liabilities, particularly when reclamation liabilities are taken into account. It also brings into question whether or not investing in the energy patch is a good long-term proposition with the secular trend to renewable energy sources gaining considerable momentum.

However, it is unlikely that demand for crude will fall sharply for some time. This means that integrated energy companies such as Suncor, which have established developed reserves, solid balance sheets, and the ability to offset weak crude prices through their downstream or refining operations, remain superior investments.

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