Oil Companies Are Finally Dusting Off Long-Dormant Oil Sands Projects

Description

With the oil market in turmoil, **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) and **Canadian Natural Resources Limited** (TSX:CNQ)(NYSE:CNQ) made the difficult decision in late 2014 to slash investment spending. Those spending cuts led the companies to slow the pace of development at their oil sands assets, including pressing pause on new phases of development that were not already under construction.

However, by sacrificing growth to strengthen their balance sheets, Cenovus and Canadian Natural Resources have emerged on the other side of the downturn much stronger, which puts them in the position to restart dormant growth projects with an eye towards future growth.

Restarting the growth engine

Cenovus currently has one of the strongest balance sheets in the industry with $3.9 billion of cash and $4 billion of unused available credit. Because of that, the company has ample financial firepower to invest in new projects to grow production into an improving oil market. It is taking the first step by bolstering its capex budget for 2017 by 24% to a range of $1.2-1.4 billion. That said, investment spending is still half of what it was before oil prices crashed, though that is partially because industry costs have fallen so dramatically that the company can get more for its money theses days.

That increased capital investment will enable the company to boost oil production by 14% next year, driven by a 20% output increase at its oil sands operations thanks to the recent completion of two previously sanctioned expansion phases that will ramp up over the next year. This growth will offset a 4% decrease in the company's conventional production where the company still isn't spending enough capital to drill the wells necessary to make up for the natural decline rate of its legacy wells.

While the company is ramping up spending to drill conventional wells, it will spend the bulk of its capital on its oil sands assets.

This budget includes money earmarked to restart the dormant phase G expansion at Christina Lake, which it stopped developing two years ago. The company did spend some capital on the project last year to rework the construction plan and rebid the work, which enabled it to capture $500 million in cost savings or about 20% of the initial estimate. Further, thanks to its prior work on the phase, the company is already roughly 20% complete with the project, which should deliver first oil in 2019.

Starting work on the next phase of growth

Canadian Natural Resources took a similar approach during the downturn; it chose to complete projects already in development, while pausing those that were further out. As such, it continued working on phases 2B and 3 of its Horizon Oil Sands expansion, while stopping work on its Kirby North project.

However, with phase 2B now complete, and phase 3 expected to deliver first oil by the end of next year, Canadian Natural Resources’s financial flexibility will increase in future years due to the ramp down in capex spending on these projects, which are in the process of ramping up their cash flow. Because of that, the company’s board authorized it to restart development on Kirby North.

That project is a bit further behind, which is why Canadian Natural Resources expects to spend the next year focused on engineering and procurement, so it can push the project’s costs down. That said, the company plans to move forward on construction with an eye towards delivering first oil in early 2020.

Investor takeaway

Confidence is clearly returning to the oil patch, which is leading producers to dust off projects that they put on the shelf years ago. More project approvals could be on the horizon in Canada after the country recently approved two new pipeline expansion projects. Those pipelines should ease some of the transportation constraints, which, when combined with higher oil prices, could make new oil sands projects very lucrative when they do finally come online in a couple of years.

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