



Oil Sands Stocks: Are They a Good Investment?

Description

Oil's latest sustained rally, which sees West Texas Intermediate (WTI) trading at over US\$65 per barrel, has brought the spotlight firmly back on oil stocks. Since the end of 2014, when Saudi Arabia embarked on its strategy aimed at curtailing the explosive growth of the U.S. shale oil industry, energy stocks have languished.

Among some of the hardest hit were Canadian oil sands companies because of the high operating costs associated with extracting crude from bitumen and the pronounced discount applied to Canadian heavy crude. While oil sands giant **Suncor Energy Inc.'s** ([TSX:SU](#))([NYSE:SU](#)) stock has soared by almost 4% for the year to date, other majors, including **Canadian Natural Resources Ltd.** ([TSX:CNQ](#))([NYSE:CNQ](#)), have remained flat, and **Imperial Oil Ltd.** ([TSX:IMO](#))(NYSE:IMO) is down by almost 5%.

However, regardless of the [improving outlook](#) for oil, oil sands companies may not be the highly attractive investment that many investors believe.

Now what?

A key factor weighing on Canadian oil sands producers are the steep costs associated with developing and operating oil sands projects. It has been estimated by some industry analysts that breakeven costs per barrel on average across the industry can be as high as US\$70 per barrel compared to less than US\$30 for shale assets.

The impact this is having on company earnings is magnified by the considerable discount applied to heavy oil blend Western Canadian Select (WCS). This has been as high as US\$30 a barrel in recent months, although the price differential has narrowed considerably recently to be at ~US\$18 per barrel. The high discount applied to WCS can be blamed on transportation bottlenecks caused by a lack of pipeline capacity.

Nevertheless, the price differential is expected to narrow further, as the volume of crude by rail increases over the remainder of 2018.

This underscores just how difficult it can be for oil sands companies to remain consistently profitable in

an operating environment dominated by weaker and volatile oil prices.

Environmental legislation is shaping up as another significant hurdle for the oil sands. The industry is ranked as the largest emitter of greenhouse gases in Canada, and carbon-pricing policies to be implemented nationally as well as at the provincial level in Alberta will cause production costs to rise. There is the very real risk, because of the energy-intensive nature of oil sands production compared to other sources of unconventional and conventional oil, that much of Canada's vast oil reserves could become [stranded assets](#). That poses the very real risk of them becoming liabilities for oil sands companies, which will be obliged to engage in costly reclamation operations while losing their principal source of earnings.

So what?

Despite being bullish on beaten-down oil stocks for some time and believing that firmer oil prices are on the way, there are signs that Canada's oil sands are becoming an increasingly unattractive investment. Growing costs, transportation constraints, and the risks of them becoming stranded assets in an increasingly emission-sensitive world focused on battling climate change should weigh heavily on investors' minds. While the price differential for WCS, when compared to WTI, is expected to narrow during 2018, it will weigh on the profitability of oil sands companies.

Nonetheless, Suncor constitutes a solid opportunity to gain exposure to Canada's energy patch. The oil major is estimated by analysts to have a company-wide breakeven cost to WTI price of just under US\$40 per barrel, which means it can remain profitable in an environment dominated by lower oil prices. Management has also recognized the threat posed by growing environmental legislation and are maximizing returns by focusing on their highest-quality oil sands projects and reserves.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CNQ (Canadian Natural Resources)
2. NYSE:SU (Suncor Energy Inc.)
3. NYSEMKT:IMO (Imperial Oil Limited)
4. TSX:CNQ (Canadian Natural Resources Limited)
5. TSX:IMO (Imperial Oil Limited)
6. TSX:SU (Suncor Energy Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date

2025/06/30

Date Created

2018/04/19

Author

mattsmith

default watermark

default watermark