
# Canadian Oil Sands Stocks Remain a Risky Investment

## Description

Canada's oil sands have been receiving copious criticism over the last decade, primarily because of the extensive environmental impact associated with the extraction of bitumen and the energy-intensive nature of the production process. That and a range of other headwinds, including a distinct lack of pipeline exit capacity, which is preventing the bitumen produced from reaching crucial U.S. refining markets, have been weighing on their performance.



Currently, **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ) and **Suncor Energy** (TSX:SU)( NYSE:SU) are being targeted by short-sellers; they are ranked as the ninth and 10th most-shorted stocks on the TSX. Canada's third-largest oil sands operator **Cenovus Energy** (TSX:CVE)(NYSE:CVE ) also attracted considerable criticism after doubling down on the future of oil sands by acquiring **ConocoPhillips's** Canadian assets for a massive $17.7 billion in 2017.

## Long-term headwinds magnify risk

While some pundits remain enthusiastic proponents of oil sands companies, the range of headwinds facing the industry is sparking considerable doubt as to whether those companies are worthwhile investments. A key issue is the fear that Canada's oil sands will become a stranded asset. Renowned asset manager Jeremy Grantham, as far back as 2013, was calling oil sands a stranded asset that would eventually cost their owners more to clean up than their economic value.

Those concerns are being fanned by claims that peak oil demand is just around corner. This theory essentially posits that demand growth for crude will deteriorate sharply due to a marked reduction in the consumption of fossil fuels because of the rising popularity of renewable sources of energy and electric vehicles. While many oil majors accept that this is inevitable, there is still considerable disagreement about when it will occur.

Industry consultancy Wood Mackenzie estimates that peak demand for crude will be reached in 2036. After that point, it will decline sharply as the uptake of electric vehicles gains considerable momentum. Think tank Carbon Tracker Initiative anticipates that it will occur sooner, possibly arriving by the late 2020s with electric vehicles displacing up to two million barrels of oil demand daily.

The threat this poses to the oil sands becomes apparent when it is considered that to produce one barrel of bitumen, it takes five to eight times more energy than conventional or shale oil production. That makes the oil sands uneconomic compared to other sources of oil.

In 2016, Suncor recognized that a large portion of its 6.4 billion barrels of oil reserves, which are 95% weighted to bitumen, would be uneconomic to recover. That problem is even greater for Canadian Natural; 11 billion barrels of its total proved and probable oil reserves of 13.4 billion barrels are oil sands assets. The threat to Cenovus is clear: it has bitumen reserves of 6.4 billion barrels, which represents 92% of its total hydrocarbon reserves.

## Short-term threats abound

These pressing long-term headwinds aren't the only major hazards facing oil sands operators; a lack of pipeline exit capacity continues to weigh on the industry and Canadian heavy oil prices. While Alberta's mandatory production cuts significantly boosted heavy oil prices, causing the Western Canadian Select (WCS) benchmark to roughly triple from record 2018 lows, they have done little to alleviate the underlying issues.



Key is a critical lack of pipeline exit capacity, which is preventing Canadian heavy crude from reaching crucial U.S. refining markets. Industry consultant Genscape released data showing domestic oil inventories were at record highs and still growing despite the production cuts. Even record volumes of crude by rail in December 2018 failed to have any meaningful impact, and the number of carloads has fallen sharply since January 2019.

Those factors — along with delays impacting the introduction of **Enbridge's** Line 3 Replacement and **TC Energy's** Keystone XL pipeline — mean that WCS prices will likely collapse once the cuts come to an end. That will have a marked impact on Cenovus and Canadian Natural because, unlike Suncor, they lack substantial refining capacity. Cenovus only refines 39% of its first quarter 2019 bitumen production. That makes it heavily reliant on profitably accessing U.S. refining markets to generate earnings.

## Pulling it together for investors

The oil sands are facing hefty headwinds that make most companies, except Suncor, unattractive long-term investments. The extreme short- and long-term risks mean investors seeking exposure to oil and its improving outlook should look elsewhere.

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**Date**
2025/08/25
**Date Created**
2019/05/22
**Author**
mattdsmith