



What Will Happen to Oil Sands Stocks?

Description

Depending on what you read, oil sands stocks are either dead or on the rise. It can be difficult to parse out the truth. Opinions seem to be more divisive than ever. But when the market is confused, *opportunity* is created.

Oil sands stocks like **Imperial Oil**, **Suncor Energy**, **Husky Energy**, and **Canadian Natural Resources** are all trading near historical lows. That's invited many famous investors to jump in. Notably, Warren Buffett's **Berkshire Hathaway** [purchased](#) 10.8 million shares of Suncor earlier this year.

Despite Buffett's bullishness, several headwinds could completely derail any oil sands investment, including a new global environmental policy that could devastate the industry in as little as six months. We'll talk about that possibility and more as we uncover what will happen to these controversial stocks over the next few years and beyond.

Costs are aligning

One of the biggest knocks against oil sands projects is their high cost of production. Oil sands output is often lower quality than the light, sweet crude found farther south in places like Texas. That means it needs heavier and lengthier processing before reaching the market. This extra processing costs more, forcing oil sands suppliers to sell at a discount. When global oil benchmarks hover around US\$60 per barrel, oil sands output may fetch just US\$50 per barrel, sometimes far less.

While this structural cost disadvantage will never go away, the industry has come a long way in reducing costs to remain competitive. Suncor believes it can break even at prices below US\$50 per barrel. Canadian Natural can remain cash flow neutral at US\$40 per barrel. That still doesn't provide much room for comfort, especially considering regional pricing has dipped below US\$40 per barrel several times in recent years. But it's important to note that costs are moving in the right direction.

But wait

There's always a catch with oil sands stocks. For decades, bulls have promised surging profits, yet these wishes have largely been left unfilled. The share prices of Imperial, Canadian Natural, Suncor, and Husky are all lower than they were in 2006! This industry has a strong reputation for destroying shareholder value, and despite falling production costs, new headwinds have the potential to upend future promises yet again.

Ever since these projects began development, regulatory pressures loomed. Environmental concerns were always at the top of the list. Those headwinds have finally arrived. In 2018, the *Financial Post* reported that new fuel standards for shipping vessels could disrupt the entire industry by 2020. "The coming marine shipping rules could double or even triple the discount on heavy oil, pushing it much wider than the US\$30 a barrel discount from earlier this year."

On January 1, 2020, International Maritime Organization will mandate that the sulphur content limit of maritime fuel drop from 3.5% to just 0.5%. Other industries have already faced similar shifts, with jet fuel sulphur content regulated as low as 0.1%. Significantly more refining capacity will need to come online to process oil to meet the new standards. Because oil sands output requires more processing, it's at a steep disadvantage. Up to [20%](#) of oil sands production could instantly be rendered uneconomical.

Steer clear

We could dive deeper into the economic and political climate for oil sands production, but there's likely no use — the cards are stacked against the industry. We've known for decades that the environmental concerns were steep. In an age of ramping regulation to fight climate change, it's not clear that oil sands have a place in the future. If you would have accepted this thesis in 2006, you would have avoided 13 years of zero returns.

There are still opportunities in the energy sector, but oil sands stocks should be avoided.

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