The unfortunate reality for Canadian energy: The oil sands have lost their lustre

By Tim Kiladze, business columnist, *The Globe and Mail*, Mar 7, 2019

With his retirement from Devon Energy Corp. set for June, John Richels will spend his last few months doing what once seemed unthinkable: getting the U.S. company out of Canada.

A Canadian and former corporate lawyer who served on the organizing committee for Calgary's 1988 Olympic Winter Games, Mr. Richels joined Devon two decades ago when the American producer acquired Alberta's Northstar Energy Corp. He went on to lead Devon's Canadian division, then the entire company. In 2016, he became chairman. Now based in Oklahoma, he is someone who understands the Canadian oil business intimately.

Yet under his watch, Devon is fleeing from Alberta. In 2014, when he was still CEO, the company sold its conventional oil and gas assets to Canadian Natural Resources Ltd. for $3.1-billion. A few weeks ago, Devon announced plans to sell its remaining oil sands assets – namely the Jackfish project in northeast Alberta. If a buyer emerges, the company is expected to fetch about $4-billion.

The proposed sale follows a slew of divestitures from the likes of Royal Dutch Shell PLC and ConocoPhillips Co. When those companies left, Canadian companies often stepped in as buyers, grabbing the assets on the cheap. With Devon's planned departure, the exodus from Canada's oil sands can no longer be glossed over. The industry's economics have changed and foreign energy companies are losing faith in the business case for oil sands projects. Are our domestic producers – and are Canadians, for that matter – in denial about the industry's true potential?

In the face of deep discounts on the price of Canadian crude, many Canadians have become obsessed with pipeline policy and regulation. With the Trans Mountain expansion project trapped in purgatory, the federal government has been made out to be Enemy No. 1 in Alberta. Some energy executives have blasted Ottawa's approach to regulation, including Hal Kvisle, the former CEO of Talisman Energy and TransCanada Corp. He recently told The Globe and Mail that the regulation is "horrific, inept, incompetent and incomprehensible."

But even if we expand our pipeline network – and we absolutely should – the global energy market is going through a revolution. We're on the losing end of a supply race with our closest economic partner.

Fifteen years ago, the oil sands were one of the hottest resource plays on the planet. But technological advances in drilling techniques have turned the United States into the world's most promising oil-producing country and the cost of extracting its crude is far cheaper than in most of the oil sands.

The sheer amount of oil directly south of us is stunning. In the Permian Basin, which spans western Texas and eastern New Mexico, crude production has doubled in the past three years, to

3.4 million barrels a day. By 2023, production from this basin alone is projected to hit 5.4 million b/d, more than Canada's projected total of 5.2 million b/d.

"The attractive economics of Permian oil development has resulted in oil majors shifting capital to the basin," rating agency DBRS Ltd. noted in a recent report. The agency added that getting crude to market there is also cheaper because of its proximity to refineries and export hubs on the Gulf Coast, which lowers pipeline tolls.

Global environmental standards are also changing. For one, by 2020 the International Maritime Organization will require that sulphur limits in marine fuel fall to 0.5 per cent from the current accepted level of 3.5 per cent. Oil sands crude has more sulphur in it. And carbon taxes have complicated things for oil sands producers, which are heavy emitters.

What's playing out in oil markets has parallels to our natural gas crisis – something Mr. Kvisle knows a lot about. Because Canadian gas producers are reeling, with no recovery in sight, the Alberta government appointed a panel of industry veterans to develop a road map to recovery last year. Mr. Kvisle was one of them.

Like oil, Canadian natural gas is suffering from pipeline woes, but the panel appreciated that more infrastructure can't change geography. The United States is also experiencing a shale gas revolution. "Our dominant export market is now our primary competitor, and Western Canadian gas will struggle to retain, let alone grow, its market share within North America," they wrote.

At the moment, Canadian gas producers in British Columbia and Alberta export to the western United States, but new gas production in the U.S. Rockies is stealing some of that market share. Our domestic producers also send gas east, across Canada, but the Marcellus and Utica basins in the U.S. Northeast "are now, or will soon be, moving significant volumes of U.S. gas into Eastern Canadian markets, reducing demand for Western Canadian gas on the TransCanada Mainline," the DBRS analysts noted.

A powerhouse U.S. doesn't mean Canadian energy is toast. "Energy stocks are being crucified," value investor Kiki Delaney of Delaney Capital Management told me recently, "but I have a very hard time believing that somewhere in there you aren't going to make a tremendous amount of money buying a handful of well-capitalized Canadian oil stocks – as long as you have an appropriate time frame."

John Richels, though, isn't interested in waiting out the rebound. Like so many of its global peers, Devon Energy is cutting and running. Its new strategy, to build what management calls the "New Devon," is centred on developing – what else? – the Permian Basin.