

Forget Shale: Canada's Oil Sands Are Having Their Moment

The American oil patch's poor northern neighbor offers investors stellar returns

Wall Street Journal, By [Jinjoo Lee](#) June 25, 2024



Canadian oil sands remain among the most carbon-intensive sources of oil.

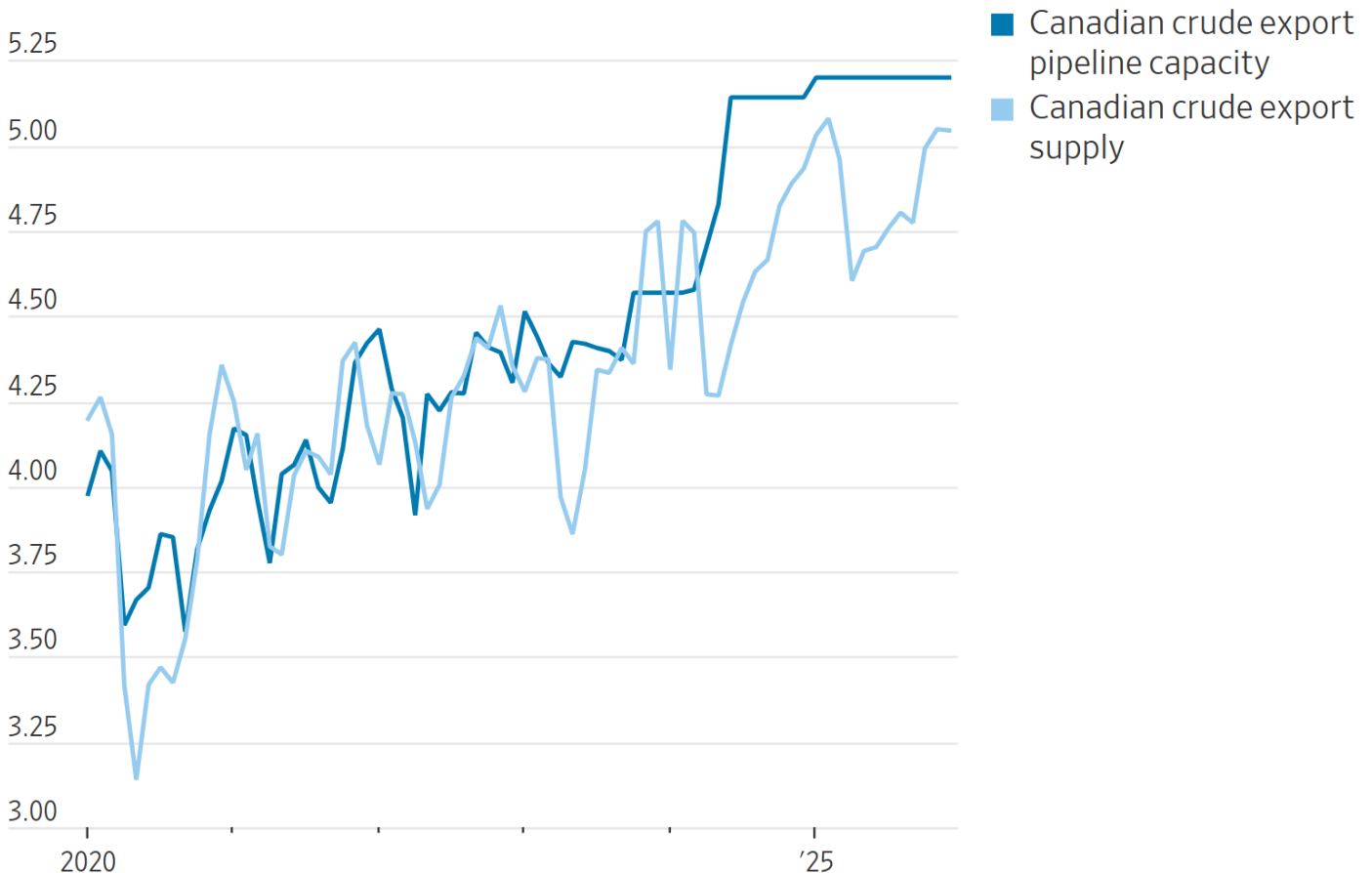
Canada's oil sands were once the high-cost, dirty and unloved sibling to America's fast-growing shale. Not anymore.

Oil-sands producers have been among the top-performing companies in the energy sector over the past year. Shares of the four largest Canadian oil-sands producers by market capitalization have gained an average of 37% over the past 12 months, outpacing an index of the largest U.S. energy companies by 19 percentage points. Two of those companies—[Canadian Natural Resources CNQ](#) -0.74%decrease; red down pointing triangle and [Imperial Oil IMO](#) -0.38%decrease; red down pointing triangle—now fetch higher valuation multiples on some measures than U.S. supermajor [Chevron CVX](#) -0.53%decrease; red down pointing triangle.

Things weren't always so rosy. Oil-sands facilities required enormous upfront spending, were expensive to operate and had a controversial environmental footprint. Not only that, but also Canadian oil typically commanded steep discounts because of a chronic lack of pipeline capacity. Global energy giants such as [ConocoPhillips COP - 0.16% decrease; red down pointing triangle](#) and [Shell SHEL 0.47% increase; green up pointing triangle](#) raised billions of dollars by selling a substantial chunk of their [oil-sands stakes years ago](#).

Canadian crude export pipeline capacity vs. export supply

5.50 million barrels a day



Note: Figures from July 2024 are S&P estimates.

Source: S&P Global Commodity Insights

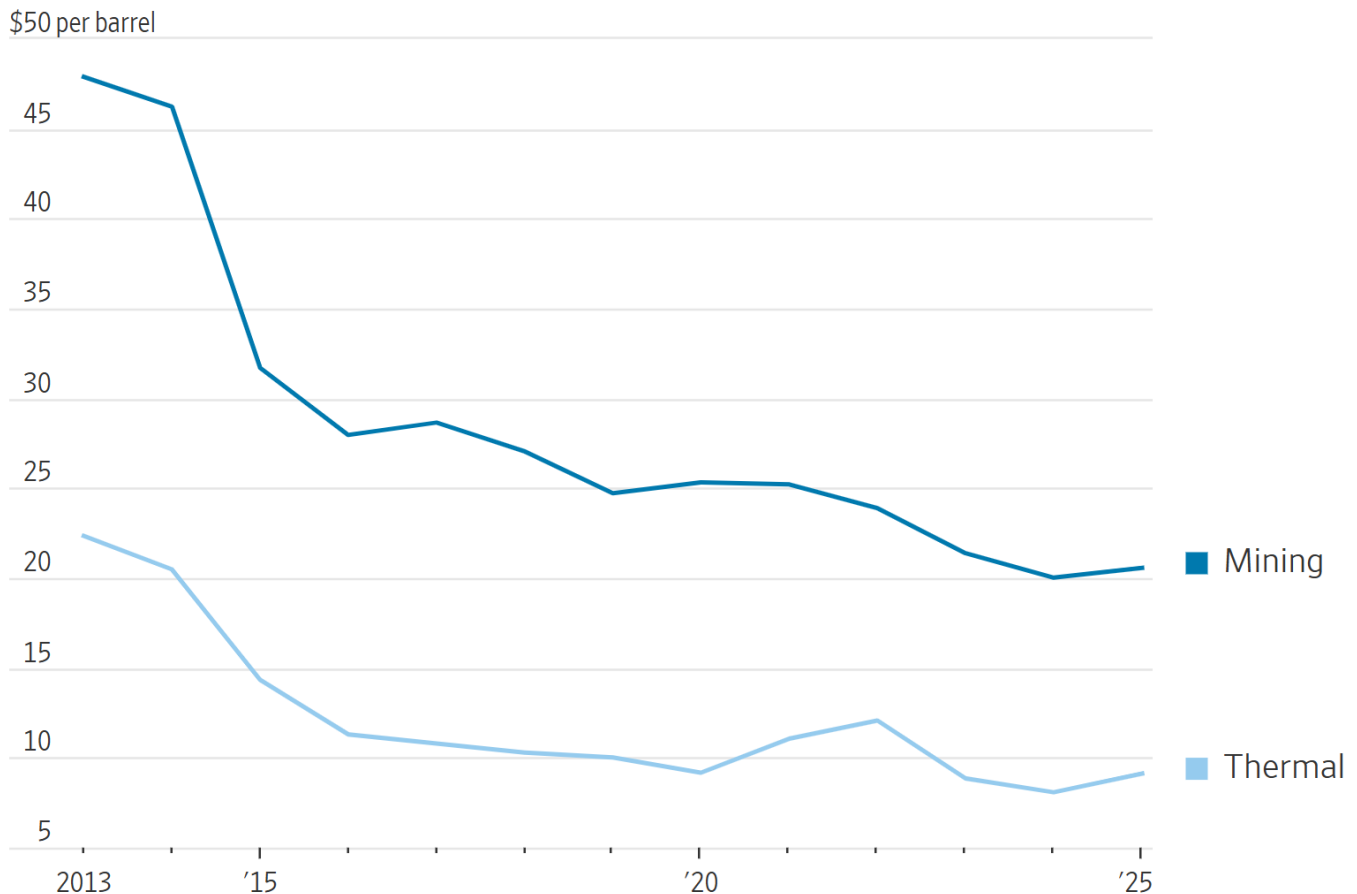
It turns out their justifications were built on sand. On May 1, the pipeline bottleneck eased with the 590,000 barrel-a-day expansion of the Trans Mountain pipeline. The additional capacity [should be more than enough](#) to support Canadian exports for years, according to S&P Global Commodity Insights. In May, Western Canadian Select was on average 12% cheaper than the West Texas Intermediate, or WTI—narrower than the 19% discount seen in 2022 and 2023, according to data from S&P.

The long wait and negative publicity might not have been worth the trouble for supermajors, but a similar move was a lot more consequential for oil and gas producer [Ovintiv OVV -1.14% decrease; red down pointing triangle](#), which used to

be called Encana. It thought it was following the smart money when it spun off its oil-sands producer, focusing its attention on booming shale. Since the spinoff, shares of the unit left with oil sands—[Cenovus CVE 0.27%increase; green up pointing triangle](#)—has outpaced Ovintiv by 63 percentage points. Over the same period, the four largest Canadian oil-sand producers have appreciated about 84% on average, outpacing an index of the largest U.S. energy companies by 25 percentage points.

In addition to being able to export more, operating costs per barrel for Canadian oil sands have declined about 19% over the last five years, according to estimates from energy research firm Wood Mackenzie. Oil-sands production didn't reach scale until the early 2000s, which means the industry is still fine-tuning the amount of steam and solvent needed to coax oil-like bitumen out of oil sands.

Canadian oil sands operating costs, excluding transport tariffs



Note: Includes fixed and variable lifting costs (extraction, gas purchases for steam and carbon levies) but excludes cost to dilute and transport.

Source: Wood Mackenzie

More recently, some companies have started replacing human-operated trucks with autonomous ones. [Suncor Energy SU -0.42%decrease; red down pointing triangle](#) sees room for even more efficiency: On a call with analysts last month, the

company said the WTI crude-oil price at which it can reach corporate break-even could come down by \$10 a barrel, or about 19%, by year-end 2026.

For long-term investors, signs that production from prolific U.S. basins such as the Permian [might be nearing a plateau](#) is another reason to look north. The advantage of oil sands is that, while the upfront cost is high, it keeps producing oil at a steady rate for decades. The opposite is true for shale which, like a shaken-up bottle of soda, releases a lot of oil in the beginning but quickly declines.

“Oil sands are costly to produce, but there’s no shortage of the resource,” said [Wells Fargo](#) equity analyst Roger Read.

Analysts at BMO estimate that Canadian oil-sands producers on average need U.S. benchmark oil prices of \$43.50 per barrel to fund sustaining capital and base dividends, compared with about \$57 a barrel required for large-capitalization U.S. peers that have invested heavily in shale. Most oil-sands projects are now expansions that can piggyback off existing infrastructure, translating to lower capital expenditures per incremental barrel, noted Wood Mackenzie analyst Mark Oberstoetter.

Oil-sands producers also offer generous cash returns. Canadian Natural Resources reached its net debt target last year and is now returning 100% of its free cash flow to shareholders in dividends and repurchases, up from 50% in 2023. Suncor began allocating 75% of its post-dividend free cash flow to share buybacks. Analysts at BMO expect Cenovus to start returning 100% of free cash flow in 2025.

The caveat is that Canadian oil sands remain among the most carbon-intensive sources of oil. The industry is, however, making progress: It reduced methane emissions by 45% from 2014 levels in 2022, [three years ahead](#) of the target set by the province of Alberta, according to the government website. Technological progress on solvent-based extraction and carbon capture are further-out solutions but could ultimately help reduce emissions in the long term.

The energy industry’s onetime ugly duckling suddenly looks more like a beauty.