THE GLOBE AND MAIL

June 2, 2014

# The message of the Joslyn oil sands shelving: Higher prices needed

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*When Total SA deferred the Alberta development, the primary cost issue was labour. But other big oil companies are also reducing investment and the only cure may be the lure of higher revenue*

Last week Total SA and their consortium partners shelved the $11-billion Joslyn oil sands project. Predictably, the belt-tightening announcement triggered the usual self-flagellating notions like, "Canadian oil and gas isn't competitive," and "The future of the oil sands is dim." But it's folly to get boxed inside cardboard perspectives that are so thin. Joslyn's halt is symptomatic of smouldering global oil supply problems that transcend Canadian issues.

Over the next couple of years, we are likely to see more mega oil projects axed around the world.

Already, cutting back on oil and gas developments is a fashionable theme among large independent oil companies (IOCs). The bottom line is that the bottom line is too thin. A barrel of oil priced at $110 (U.S.) in world markets sounds high, but paperwork filed by chief financial officers is not convincing shareholders that investing ten-plus billion dollars into far-flung oil fields is worth the growing risks. Too often, the long-term prize for developing elephant-sized projects has been disappointing returns that have been wiped out by one or more of: 1) Cost overruns; 2) Excessive corruption; 3) Civil unrest; 4) Geopolitical sanctions; 5) Domestic impediments; 6) Outright expropriation of assets by bandits in foreign governments; or 7) A smorgasbord of other known unknowns that are parasitic to stable investment.

To illustrate the reluctance to spend more for less, our feature chart this week [1]shows the annual upstream capital expenditures of seven large independent producers between 1995 and 2014 (expected). Notwithstanding the abnormalities of the 2009 financial crisis, year-over-year spending by these biggest publicly traded IOCs in the world will be down in 2014 for the first time in more than a decade. The collective budget cut is not loose change; it's $17.1-billion or 8.8 per cent. In the context of historical behaviour, such wallet tightening by IOCs is unusual at a time when the global economy is showing signs of strengthening.

The awakening started last calendar quarter, the first quarter of 2014. Flipping through publicly disclosed materials from the seven big players – Exxon Mobil, Chevron, Shell, Total SA, ConocoPhillips, Statoil and BP – was sobering. Recurrent themes in the presentations could be distilled into a simple missive: Production down, costs up, profits too thin.

Cutting through jargon like "increasing capital efficiency," the future shareholder directive for the seven IOCs that represent 10 per cent of global oil production is pretty straightforward: Shift the emphasis from growing production at all costs to try making money by controlling costs. The capital expenditure cuts in our feature chart clearly shows this sentiment, and the Joslyn story is part of this much bigger dynamic. Note that the consequences of the 2014 spending cuts will lag, because the impact on world oil fundamentals of today's investment typically takes a few years to be felt.

Exhibit 8026

Yet the cost of developing large oil fields is unlikely to come down, given the long list of antagonizing factors that have been mentioned above. Overseas, the scourges of geopolitics, corruption and banditry are getting worse not better. Technology is improving rapidly, but the costs of developing deep offshore oil fields are multiplying. As well, tightening safety and environmental standards will only get tighter – and costlier.

In Canada, the primary cost issue is labour constraint. In this regard, the withdrawal of Joslyn eases future demand for thousands of skilled workers and therefore increases the probability that peer competitors will realize stable costs with their megaprojects. So, Joslyn's departure is not an indictment of the oil sands resource as a whole.

The trend of reduced spending by the most innovative oil companies in the world has many profound implications. For one thing, if the marginal cost of oil production can't be controlled, then the price of a barrel will have to rise to rekindle investment. Joslyn holds a message that goes far beyond Canadian issues.

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## References

1. www.theglobeandmail.com/report-on-business/upstream-capital-expenditures-for-seven-big-independent-oil-companies/article18954753/#dashboard/follows