Primary Growth Drivers

Volume growth will be primarily driven by expansions to existing oil sands projects with a handful of projects (Kearl, Surmont, Horizon, Foster Creek, AOSP, Sunrise) accounting for ~60% of the estimated 2014-2017 production growth. While mining techniques account for ~20% of recoverable oil sands in Alberta, the near-term production growth profile is well-represented as Kearl, Horizon, and AOSP represent 3 of the 5 largest production contributing projects through 2017. Longer-term growth (2017+) will be driven by end of decade projects like Fort Hills and Hebron/Ben Davis.

Primary Risks

With falling oil prices accelerating a decline in capital spending (with some operators announcing reductions in excess of 75% to their budgets from 2014); the longer-term (2017+) production impact resulting from subsequent project delays represents in our view the primary risk. However, we would not want to underscore the risk to production that stems from a regulatory/political environment in which efforts to resolve infrastructure bottlenecks have been challenged. We view the near-term risk to production from the commodity to be mostly contained as US production-roll off in 2H15 alongside seasonal demand uplift to support a moderately constructive view on crude prices.

1. Near-term risks to production are likely contained as US production rolls-off and seasonal demand improvements are expected to support a moderately constructive view on crude prices. At current prices/differentials rail economics remain challenged to the Gulf Coast (the most visible remaining demand market for oil sands growth) affecting smaller oil sands producers that are mostly levered toward manifest rail. However, production shut-ins are unlikely. During the previous cycle the reservoir integrity at the Great Divide project was significantly damaged as a result of operator shut-in amid low crude prices.

2. Long-term risks to production delays are likely. Intuitively, the most likely candidates for a reduction are those for which not a significant amount of capital has been invested. Companies have announced expansion delays to many of such projects including CNRL's Kirby North, MEG's Christina Lake, Husky's Sunrise and Suncor's Mackay River. Of remaining potential project delays we see greatest downside risk to project expansions at Cenovus' Christina Lake, Narrows Lake and PetroChina's MacKay River.

3. Long-term, the infrastructure bottleneck needs to be addressed. As mentioned previously, the Gulf Coast represents the last remaining market (as Western Canadian crude is for the most land-locked) that is capable of absorbing heavy crude. While recent pipeline start-ups (Marketlink and Flanagan South) have increased capacity to transport WCS bbls into the Eastern Gulf Coast, the Western Gulf Coast is not readily accessible via pipeline while rail and Jones-Act compliant vessels remain expensive particularly at a lower commodity. The Western Gulf Coast contains ~60% of the entire Gulf Coast coking capacity, a lucrative reward no doubt. In fact, TransCanada has recently announced plans to investigate the economic viability of building pipe from Houston to Louisiana, we can only hope that they will have more success than they've had with a certain other proposed pipeline