

Daily Oil Bulletin

How To Be Small: The Role Of Juniors In The Current Oilsands Ecosystem

DOB OILSANDS REVIEW AUG. 30, 2017



Osum Oil Sands's Orion SAGD project in the Cold Lake region. Image: Deborah Jaremko

By Carter Haydu

Gordon Holden, chief operating officer of **Surmont Energy Ltd.**, has a pet peeve: people suggesting higher oil prices alone will automatically save the oilsands industry for smaller operators.

Such a suggestion is simply not true, he says. Thanks to the shale revolution in the United States, unlike five years ago oilsands juniors must now compete for previously-assumed investor dollars, and the investment attractiveness of shale producers does not magically disappear as the value of crude increases.

“If you think about the competition having a lower breakeven full-cycle cost base or profitability level or West Texas breakeven price, or however you want to express that, because theirs is so much lower at any oil price, they should logically over time get more and more and we should get less and less of the available capital.

“Capital is pretty smart, and projects like theirs seem less risky, because they are faster to pay out, they learn faster, they produce faster and so on. I’m always really careful to try to bring to the floor that higher oil prices really aren’t the solution to the problem we have in the oilsands business.”

In the beginning, SAGD basically offered a lower point of entry for juniors into the oilsands. The early 2000s saw projects such as **MEG Energy Corp.**’s Christina Lake come to light, notes **IHS Inc.** oilsands dialogue director **Kevin Birn**, and companies proved out the technology to unlock much of the bitumen resource.

“During that period, those early movers basically obtained scale,” he says. “They built their base plants, like Christina Lake, and they built the subsequent phases over the next 10 to 15 years.”

Around 2005, adds Birn, many smaller players started moving into the SAGD space, with even more coming in after the 2009 recession. However, many of those smaller players struggled to obtain the scale of the earlier movers. And for those who entered the oilsands post-2010, lower commodity prices have meant they never enjoyed a long period of high prices to pay down depreciated capital, whereas the larger, established producers grew their scale and cash base.

“Small producers are more subject to capital markets,” Birn says. “And capital markets are, quite frankly, a bit more skeptical of oilsands right now when they can look down south in their own backyard for the most part and see tight oil. That is the situation we are seeing right now.

“And so you have the big guys able to obtain scale, more readily able to grow from cash flow, when the smaller guys are more beholden to the capital markets, which are a little bit more on the fence still with price volatility and prices not coming back up to where they really need to be for SAGD [project] sanctions to happen.”

John Festival still sees a role for junior companies in the oilsands, but financing will be difficult and only selective projects will receive financial backing.

“I think the investors might have lost their appetite for junior players who don’t quite have the financial capabilities to carry on past a setback, and also the inferior resource that most junior companies had,” says the president and chief executive officer of **BlackPearl Resources Inc.** “Although the junior sector participated in the big rush to get land and projects built and financed, the business is going to be a bit more cautious with oilsands juniors.”

When commodity prices were high a decade ago, companies rushed to “get a piece of the action” in the oilsands, notes Festival. As such, there was indiscriminate development and spending. Underperformance accompanied many assets, which low prices have exacerbated. As a result, the oilsands scope is shrinking from previous expectations.

“The oilsands is a much smaller place than many people envisioned it 10 to 12 years ago, and only the successful projects with low steam-oil ratios and good productivity are rising to the forefront.”

He adds: “Going forward, you are going to see a lot more development around the legacy assets that have been successful. Companies will be very careful with new project developments, because we have seen a lot of failures, and there will be some more consolidation, because it isn’t that big of a playground.”

According to Surmont’s Holden, transformation is necessary and possible for the greenfield business and properly-motivated junior companies to prosper in the future oilsands. “The technology is coming, and all different sizes of companies are important to deploy that rapidly enough for everyone to benefit — those themes are there, and the technologies and willpower are coming together finally in the next few years.”

He adds: “I know that five years from now our business will look radically different, and we will be able to say that we are not ‘dirty oil’ anymore. For that matter, we may be able to deliver physical product to tidewater by then, as well as a variety of other things.”

For their part, Surmont’s Wildwood and BlackPearl’s Blackrod SAGD developments are among three in situ projects the Alberta government approved last year in the Athabasca oilsands region, along with **Husky Energy Inc.**’s Saleski cyclic steam stimulation (CSS) bitumen carbonate pilot project (DOB, Sept. 16, 2016 (<http://www.dailyoilbulletin.com/article/2016/9/16/alberta-government-approves-three-oilsands-project/>)).

Wildwood and Blackrod: promising future projects

Surmont currently intends to build and operate a 12,000 bbl-per-day project with a central processing facility, two initial well pads (six to seven well pairs per pad), and several water source wells along with associated infrastructure such as roads and pipelines. This first phase project will develop roughly 22 per cent of Surmont’s Wildwood leases.

Finding an investment group that sees what the company sees in the resource and incoming technological changes is an important near-term factor for the project, says Holden. He is confident Surmont will have necessary financing within a year or two, with the project coming onstream by 2020-21.

“We will be deploying some of these improvements that we were just talking about in our first phase, and then it is our intention to have a second phase after that, and a third, and so we will build in more of the improvements over time as they come into reality, once they have been de-risked enough.”

BlackPearl has operated its Blackrod pilot since 2011. While it has received regulatory approval for a commercial 80,000 bbl per day project, for the next couple of years the company is tied up financially with its Onion Lake thermal project in Saskatchewan, building its 6,000 bbl-per-day second phase, says Festival. After completion, the company will look for ways to finance Blackrod (DOB, May 5, 2017 (<http://www.dailyoilbulletin.com/article/2017/5/5/blackpearl-ceo-confident-oilsands-joint-venture-in/>)).

“In the interim we could find a partner who could just go ahead with Phase One without any contribution by us. We could actually get it going right away, because we have everything in place — a successful pilot, regulatory approval, and a plan for how to develop it.

“We could get going right away if we had the right partner, but I don’t think with oil below \$50 that there will be lots of partners lining up to do it. Once it gets up past \$50 and closer to \$60, then I think we will see a lot of interest.”

Keys to success

The successful oilsands juniors will be those with financial strength and more than a “one-off project,” notes Festival. For its part, BlackPearl has interests beyond Blackrod, such as at Onion Lake.

“We have one other project of primary production, and ones that are successful, and we have a good financial base of production,” he says, adding successful oilsands juniors will also be those who simply build successful projects. “There has been too much experimentation — too many projects being sanctioned that didn’t have pilots.”

Given the current industry environment, successful juniors also will be those with patient investors and strong balance sheets, says **Ben Brunnen**, vice-president of oilsands, fiscal and economic policy at the **Canadian Association of Petroleum Producers** (CAPP). He suggests there must be some reasonable cash capabilities so companies have longer-term ability to weather market fluctuations.

“From the juniors’ perspective, good strategic decision-making, recognizing this is a challenging financial period, and a good eye to the balance sheets is definitely important.”

The role of juniors

As part of the “oilsands ecosystem,” junior companies develop generally smaller scale projects in new areas of the basin and prove different technologies, finding ways to reduce costs and increase efficiencies, says Brunnen.

“The upside to the juniors is that they get to prove some technology or play that then a larger company might take an interest in and [the juniors] may be able to sell that technology. That is a bit of the dynamic with the juniors. There continues to be that role for them, but it is a harder and harder environment for them to be operating in.”

Challenging junior oilsands companies is the long-term investment nature of the oilsands, he notes, which requires an ability to sustain capital investment in good times and bad — something easier for bigger companies to achieve.

“Generally speaking, what we need is to ensure we have an environment for all oilsands companies to be able to be successful. Both junior and large companies are going to be critical to the oilsands ecosystem going forward, and so making sure we are in tune with the specific challenges so we can address them will be key. We need to work with governments and [CAPP] members to find that space.”

According to Birn, the current industry environment is not one that supports new project sanctioning for companies that do not have the scale of earlier oilsands movers who grew to cash flow. For smaller producers to succeed, he says, they need strengthening oil prices and confidence in those prices for their investors.

“They need to see more certainty. That includes oil prices, but it also includes what is going on in regards to the potential for crude-by-rail and infrastructure to bring crude to market. Any other regulatory initiatives underway basically need closure on that.”

Despite the challenges, Birn believes juniors have a continued role in the oilsands, as they had during those early days of proving out SAGD. “If you look at what the smaller companies did for the oilsands, they delivered technology and innovation and potential.

“I think that is the role they played in the beginning, and that is probably the role they will continue to play.”

Taking the ‘smaller-is-better’ approach

One major challenge for the oilsands sector is that, when compared to U.S. shale, the projects are very large, very expensive, and they take much longer to conduct and to get feedback on and to learn from than their shale counterparts, says Holden. If the oilsands sector can do smaller

projects more rapidly, then that is a big part of the juniors' solution.

“If you look at a typical in situ oilsands project in recent years, the smallest you've probably seen is \$500 million for some 12,000 bbl-per-day one that someone put on. Most of them were bigger than that — \$1 billion was not really much money to spend, and \$2 billion was not unheard of, and it goes on from there.”

If projects could decentralize steam generation, he suggests, it would enable companies to “high grade” resources, and that would be a huge benefit for oilsands juniors. He says a smaller steam facility placed only at the best resource, with a wellpad accommodating up to a dozen wells, could generate 5,000 or 10,000 bbls per day of production, which would be enough for companies to high grade their best resource.

“Obviously we make more money if we produce the highest-quality resource, but it also comes with lower steam needed and lower carbon. It is this virtual circle where everything gets better if you can break down to a smaller, more controllable scale than the way we have been doing it.”

He adds: “Clearly, if the economics are not that much worse, then it is a lot easier to raise \$200 million than it is \$500 million or \$1 billion. It is just less risky in the eyes of the investors. If we can break these things down to smaller projects, then we can do more of them faster when times are good, and we can slow down when prices are down. Also, they are easier to finance.”

There is still some technology development necessary for companies to make steam really well at small scale, notes Holden. For the most part, industry has taken the “big plant” approach to oilsands development. “There are some fairly critical technologies just being developed now — piloted in the next year or two, hopefully successful, and then deployable three to five years out — where we could get to this ‘smaller-is-better’ world.”