Soaring oil prices may not be enough to draw investment back to Canada's oilpatch

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A push for cleaner energy and memories of past boom and bust cycles, is creating reticence among investors and producers

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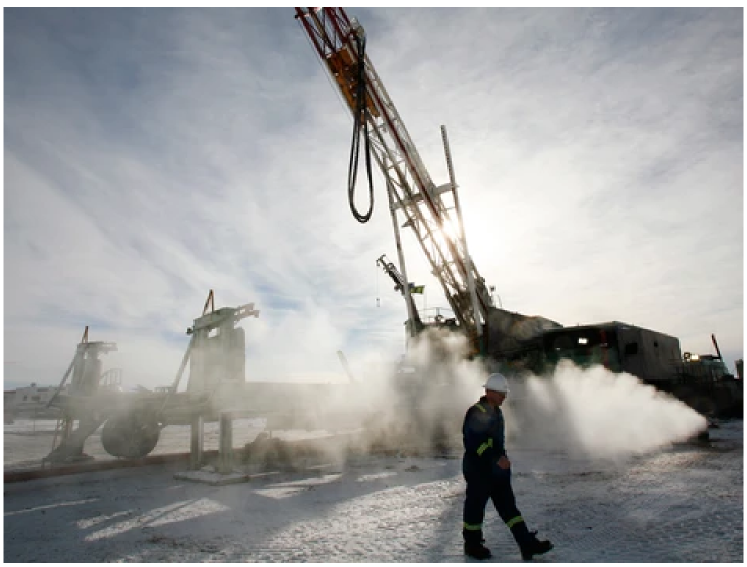

Canada's prospects of stepping up to fill the global energy gap have been dampened by years of underinvestment. Photo by REUTERS/Todd Korol

Article content

The spike in oil prices driven by Russia's invasion of Ukraine and the sanctions imposed by Western nations in response has revived the debate over building up Canada's energy sector. But while the commodity lift has energy stocks soaring, it may not be enough to draw investment back to the oilpatch.

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"If we ramp up production here, you're going to have an issue of getting it out to the world market," said Tom Pavic, president of Sayer Energy Advisors in Calgary.

"We still don't have Trans Mountain (pipeline) up and running, so that's going to be another year. And Keystone got kiboshed, so you just don't have enough ability to export all the oil and gas that we produce right now because of a lack of pipelines."

While politicians in Alberta are pushing Canada's oilpatch as a solution for the United States and parts of Europe looking for alternatives to Russian oil, sector observers say Canada's prospects of stepping up have been dampened by years of underinvestment. Combined with a push for cleaner energy and memories of past boom and bust cycles, this is creating reticence among investors and producers.

"The United States is clearly looking for alternate sources of crude oil, as indicated by the talks with Iran and Venezuela," said Kristina Hooper, chief global market strategist at Invesco. "Given Canada's close alliance with the United States and its robust production of crude oil, it would be a natural source of increased production," she added, noting that Canada increased its exports to the U.S. last year.

The challenge, however, is how quickly Canada can meet demand, given the geopolitical risks and alliances now driving business and trade decisions, she said.

There is also the challenge of attracting fresh, patient capital to fund long-term projects.

"A lot of funds are not investing in companies that are producing fossil fuels, so you're not seeing a lot of that capital flowing in," Pavic said. "And because of that … you're seeing a lot of discipline by the producers here where they're not — even though commodity prices are shooting up — they're not increasing their capital expenditure budgets."

He said that even if they were to change course and ramp up production — rather than pay down debt or return money to shareholders through share buybacks and dividends — the cost of getting the oil to the U.S. and European markets without the availability of additional pipelines would render it less competitive than alternatives.

"Typically, our oil trades at a discount to West Texas Intermediate … and then once our supply builds up, and we're not able to get it out to market, that differential widens," Pavic said.

J. Ari Pandes, an associate professor of finance at the University of Calgary's Haskayne School of Business, said countries such as Venezuela and Iran have an edge in that they have spare capacity and an ability to export their product, which has been hampered only by past sanctions.

Canada, on the other hand has a bit of spare capacity "on the margin, which will no doubt be in demand," he said.

"But we can't immediately ramp up production to satisfy a major loss in Russian oil …. Part of this has to do with the lack of investment over the last eight years, plus limited take-away capacity."

Investment capital would be expected to come from players in private equity, which tend to take a patient view on investments, he said. However, private equity funds are holding back because of the environmental, social, and governance movement driving a push away from fossil fuels, Pandes said.

"At the end of the day energy investments are long-term, and so they, too, will be reluctant to invest in long-term traditional energy projects unless the companies can demonstrate and have a plan that fits in with the energy transition," he said. "This is why energy companies are returning cash to shareholders instead of reinvesting."

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