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**MARK MILNE**  
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Just how much is the oil price drop hurting oil sands projects?

Despite the plunge in prices, the oil sands are a lot better off than you might think

Over the past few weeks the price of crude has dropped significantly, and with it we've seen significant discussion of the continued viability of oil sands projects. Much of this discussion was centered around the Keystone XL pipeline debate over the past week, and was informed by analysis in the State Department's Final Environmental Impact Assessment (PDF) for the pipeline. In particular, the State Department report speculated that, at West Texas Intermediate oil prices between \$65 and \$75 per barrel, the savings in transportation costs implied by pipelines versus rail could be material in terms of future oil sands growth.

636 Devonian Avenue, Kelowna - \$1,190,000



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The centerpiece of this stunning home is a specially imported water feature spanning two floors. This incredible piece of living art is representative of the three cornerstones of this home's unique appeal and amazing value: quality, functionality and harmony with nature. The materials and colours for 636 Devonian were painstakingly selected to blend the inside of the property with the natural beauty of the Okanagan. The waterfall at the front of the home and the pond in the back tie in with the interior feature to help complete the feeling of balance between the outdoors and indoors. Functionality in all of its guises awaits the most discerning of buyers. This home is built for the chef, the entertainer and the lover of the outdoors. Quality craftsmanship is a hallmark of the Quarry subdivision, and nowhere is it more apparent than at this stunning address. Go to BerggHomes.com for more photos or call 250-575-1432 to book a private showing.

## The Bergg Homes Team



Steven Bergg Allen Epp Annette Jensen-Bergg

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Based on MLSB Active Listings Taken & Sold Units as Reported by CMREB in 2012 for Central Okanagan.

Above approximately \$75 per barrel (West Texas Intermediate [WTI]-equivalent), revenues to oil sands producers are likely to remain above the long-run supply costs of most projects responsible for expected levels of oil sands production growth. Transport penalties could reduce the returns to producers and, as with any

increase in supply costs, potentially affect investment decisions about individual projects on the margins. However, at these prices, enough relatively low-cost in situ projects are under development that baseline production projections would likely be met even with constraints on new pipeline capacity. Oil sands

production is expected to be most sensitive to increased transport costs in a range of prices around \$65 to 75 per barrel. Assuming prices fell in this range, higher transportation costs could have a substantial impact on oil sands production levels—possibly in excess of the capacity of the proposed Project—because

many in situ projects are estimated to break even around these levels. Prices below this range would challenge the supply costs of many projects, regardless of pipeline constraints, but higher transport costs could further curtail production. The State Department analysis



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 MLSR486853



**Sunset View**  
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**Horseshoe Bay**  
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**Turtle Lake Lodge**  
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**Sunset View**  
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is based on what are commonly referred to as supply costs, or the WTI oil price, usually reported in \$US terms, at which a new project would expect to achieve a minimum, acceptable rate of return on capital deployed. Usually, the rate of return chosen for this is in the range of 10 to 12 percent, after-tax. The State Department used a series of references to construct a project supply curve – basically a view of how much oil sands development is likely to occur as a function of expected oil prices – which is shown below. If you looked only at this figure and the recent slide in WTI prices, you'd conclude that we've moved from a situation in which 6+ million barrels per day of oil sands production is well in-the-money to a new outlook where a lot of that forecast new production is only marginally profitable. The slide in oil prices has hurt, but to really understand the impact of recent price changes on oil sands, you need to look a little deeper.

For an oil sands project, there are four key factors which determine supply costs – the costs of building and operating the project, the discount between light oil and diluted bitumen, the costs of diluents, and the Canadian dollar exchange rate. While oil prices have dropped significantly, and have commanded much of the news coverage, the other factors in this calculation have changed significantly as well.

To give you some context, one of the studies cited by the State Department in developing their supply cost estimates is the May 2013 Canadian Oil Sands Supply Costs and

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Development Projects (2012-2046). This study assumes that oil sands projects will not be built if they yield less than a 10% real (12% nominal) rate of return, and shows (see the Figure below) that the linos share of new oil sands projects would require a WTI-equivalent price, in Canadian dollars of between \$78 and \$100 per barrel to earn a that level of return.

The CERI study assumed, to get these figures, that natural gas prices would increase above inflation, from \$3.50/GJ initially and rising to \$6/GJ in real dollar terms by 2040. The study also assumed that heavy crudes trade at a discount of \$US 15 to light crude, and a 5% premium over the value of light oil for diluents. Most importantly, they assumed that

the Canadian dollar would trade at parity with the US dollar over the study period, so supply costs in Canadian dollar terms convert directly to US dollar WTI prices.

Now, consider what has happened since this report was released – yes, oil prices have dropped significantly, with WTI front-month contracts closing Wednesday at \$US 74.53, but the Canadian dollar has followed and closed at 88.14 cents US per Canadian dollar, meaning that WTI in Canadian dollar terms was worth \$84.55. In terms of heavy oil, Western Canada Select, the Canadian benchmark heavy crude, was posted Wednesday at C\$71.67 (US\$ 63.36), a differential to WTI of only a little more than \$11,

while lighter condensates traded Wednesday at C\$83.62 (US\$73.93), a slight discount to WTI. Combine all of these factors together, and the differences are stark.

Taking today's WTI price of US\$74.53, using the assumptions in the CERI (2013) study, you'd have heavy oil trading at C\$58.53, but containing 30% of a barrel of condensate worth C\$23.48, leading to an implied bitumen value of approximately \$50 per barrel in Canadian dollar terms. Take the same WTI price, with today's exchange rates and other oil prices, and you've got a barrel of bitumen which is worth significantly more: about C\$66.55 per barrel.

If you compare C\$66.50 bitumen prices to the plant gate supply costs

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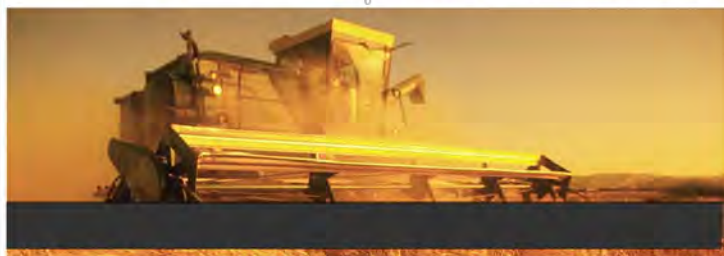
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in the left-hand column of the Table above, you can see why there's less panic than you might expect from the oil sands sector based solely on older estimates of WTI-equivalent supply costs such as those reported by the State Department. Even a more expensive new mine such as Suncor's Fort Hills currently under development, would expect to earn a reasonable rate of return on invested capital if the effective bitumen price remains at today's levels of C\$66 – not quite 12% if you used CERI's numbers, but still well above traditional mining hurdle rates of 9-10%. In fact, when Suncor approved the project, they stated that returns would exceed their cost of capital with bitumen prices in the \$50-\$60 per barrel range. New in-situ facilities, such as those from Cenovus, claim supply costs in lower still – in the \$35-

\$60 WTI range given adjustments for these new market realities.

If you are looking at a Canadian bitumen project, your pricing outlook has no-doubt taken a hit over the past 6 weeks, just as all other oil projects have, but it's by no means clear that the relative position of oil sands projects has suffered that much, nor is this the most difficult period for oil sands pricing in recent history. If you consider the graph below, in which all the factors relevant to oil sands production are agglomerated, you'll see that in Canadian dollar terms, implied bitumen prices have fallen significantly in recent weeks, but have also been significantly below their current levels 78 weeks out of the previous 5 years – 30% of the time – in Canadian dollar terms.

So, don't assume that just because WTI prices have decreased that you

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can apply these so-called break-even costs assuming all else is equal – it isn't. While oil prices have certainly moved against oil sands production, other factors which are just as important have moved favourably. There's still a point where oil sands projects would be sensitive to increased transportation costs, and there will always be a marginal project, but it's hard to see how, at this point, you're likely to see oil sands production constrained in such a way as to leave Keystone XL under-utilized were it to be constructed.

### CANADIAN OIL PRODUCERS FINDING WAYS TO DEAL WITH KEYSTONE XL DELAY

Canadian producers are diligently working on options to ship additional volumes of crude to the US Gulf Coast following delays in approving the northern leg of the TransCanada-backed Keystone XL oil pipeline, industry officials said Wednesday.

A bill to approve the stalled Keystone XL failed in the US Senate Tuesday evening by a 59-41 vote, one

vote short of the 60 needed to overcome a filibuster and reach President Barack Obama's desk. The White House, however, had indicated Obama would likely veto the bill had it passed the Senate.

At present, about 90,000 b/d of Western Canadian crude flow to the USGC, but the construction of Keystone XL's northern portion could increase that to 830,000 b/d.

Oil sands producer MEG Energy has been relying increasingly on a "portfolio" of pipelines, rail and barges for its Access Western and Cold Lake blends to reach the Houston area, company spokesman Brad Bellows said.

"Our biggest market has been the US Midcontinent, but we are now at the initial stages of not only shipping crude to USGC refineries, but also re-exporting from there to international markets," he said.

The company is also relying on the startup in December of the Enbridge-operated Flanagan South pipeline that will allow it to ship additional volumes of crude from Alberta to the USGC.

MEG has booked capacity of 25,000 b/d on Flanagan South, Bellows said.

Peter Howard, CEO of the Canadian Energy Research Institute, said changes being made to yet another Enbridge-operated line will also facilitate incremental shipments of Western Canadian crude to the USGC.

"They are installing some 70 new pumps on the Canadian Mainline that could potentially allow for an incremental 500,000 b/d of crude to move from Alberta," Howard said.

In the meantime, Canadian National and Canadian Pacific railways have provided Canadian producers with a way to move their crude south.

"Some four years ago, crude by rail was not imagined," Howard said. "But today some 120,000 b/d is being loaded onto rail cars in Western Canada."

By 2016, the loading capacity of rail cars in Alberta and Saskatchewan is projected to reach 1.35 million b/d, Howard said.

"We may not be able to load those volumes due to operational and safety reasons," he said. "But assuming an 85% efficiency level, that would translate into 1.1 million b/d or the equivalent of KXL capacity."

Using rail as an "interim" solution to transport crude from Alberta to the USGC has also been an option that TransCanada looked into. But Paul Miller, the company's president of liquids pipelines, said

it is unlikely to go down that route. "Loading crude into tank cars and using rail to cross the border before injecting that crude into the southern leg of the Keystone pipeline will not make much sense," he said on a webcast Wednesday from Toronto during the company's Investor Day.

"Rail allows you to develop new [marketing and distribution] hubs," Miller added. "But our aim is not to do that. We remain optimistic of KXL being approved."

CERI's Howard said there is a "strategic" reason for Keystone XL to be built because of Alberta's growing oil sands production.

"Even if 1 million b/d were to be moved on rail cars and the Energy East, Northern Gateway and TransMountain Expansion get done, by 2019-2020 we will back up against capacity constraints. KXL will be back in focus," Howard said.

Alberta's producers will need all options, including export pipelines to the east, west and south, Steve Laut, president of Canadian Natural Resources, said November 6 on a third-quarter earnings webcast.

"The USGC is short of heavy oil that's now being bridged by rail from Alberta," Laut said. "However, in 2015 there will be a need to move more heavy barrels to the Houston area."

CNR has taken 120,000 b/d capacity on Keystone XL.

Fellow oil sands producer Cenovus has booked 75,000 b/d on Keystone XL, but has also subleased 199 tank cars to overcome restricted pipeline takeaway capacity.

**EXXONMOBILE CANADA LTD. JOINS B.C. LNG ALLIANCE**

An international energy giant has joined an alliance of companies that is promoting the development of a liquefied natural gas industry in northern British Columbia.

ExxonMobile Canada Ltd., a subsidiary of U.S.-based energy giant Exxon Mobil Corp., says it has joined the British Columbia LNG Alliance.

Current members include key international players like Chevron Canada, Shell Canada Energy, PETRONAS, and Petroleum BRUNEI.

The alliance says ExxonMobile has a licence to export as much as 30 million tonnes of LNG annually and the company has entered an option agreement with the City of Prince Rupert for a site at Tuck Inlet.

ExxonMobile says it's the world's largest publicly traded oil and gas company, and spokesman Richard

Guerrant says it's looking forward to working with government to develop a world-class LNG in Canada's west.

In October, the provincial government dropped its proposed goal of a seven per cent income tax on the province's liquefied natural gas industry to 3.5 per cent for the next two decades.

**KINDER MORGAN PIPELINE PROTESTERS ON BURNABY MOUNTAIN NOW 'ARRESTABLE', SAY POLICE**

Protesters have remained on the site despite a court injunction ordering them to move out

Police have told pipeline protesters camped out on Burnaby Mountain they are now "arrestable" for continuing to defy a court order to remove their camp.

On Wednesday morning, two Burnaby RCMP officers arrived at the camp to speak to the protesters around 8 a.m. PT, but they did not arrest anyone or say when any arrests might take place.

On Wednesday morning, RCMP told some protesters on Burnaby Mountain that they are arrestable if they remain within boundaries described in a court order document. In reply, some protesters told police they couldn't tell where the physical boundaries were, on the ground. (Tim Weekes/CBC)

"After the injunction anyone that is in there is arrestable...right now," said Const. Mike Kalanj.

Last Friday, a B.C. judge gave the protesters until Monday afternoon to take down their camp and make way for Kinder Morgan crews to continue their survey work in the Burnaby Mountain Conservation Area.

Kinder Morgan is proposing to route its Trans Mountain pipeline under the mountain as part of its proposed expansion of the oil pipeline.

But as Monday's 4 p.m. deadline to leave arrived, the protesters defied the

court order and staged a rally instead. Many vowed to stay and block the company's access to the work areas, despite the risk of arrest.

Kinder Morgan pipeline protesters on Burnaby Mountain now 'arrestable', say police

**PROTESTERS HAVE REMAINED ON THE SITE DESPITE A COURT INJUNCTION ORDERING THEM TO MOVE OUT**

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<b>Western Canada</b>				
AB	314	249	563	56%
SK	90	58	148	61%
BC	49	18	67	73%
MB	16	10	26	62%
<b>WC Total</b>	<b>469</b>	<b>335</b>	<b>804</b>	<b>58%</b>
<b>Eastern Canada</b>				
QC	-	1	1	0%
<b>Canada</b>	<b>469</b>	<b>336</b>	<b>805</b>	<b>58%</b>