ENERGY

Heavy trucks approach the Syncrude Canada oil sands upgrader facility. A drop in steel and natural gas prices have helped the industry's efforts to reduce operating costs. LARRY MacDOUGAL FOR THE GLOBE AND MAIL

FALLING COSTS REVIVE OIL SANDS

Alberta's oil sands producers are hopeful a rollback in labour and material costs will breathe new life into a sector struggling with the freefall in crude prices

BY NATHAN VANDERKLIPPE CALGARY

After months of upheaval, Alberta's energy companies are rolling out new project cost estimates low enough that the hard-hit province could see a spending revival worth billions of dollars.

The dramatic retreat in oil sands development, forced by last year's oil price freefall, punished the Alberta economy and resulted in thousands of layoffs.

Now, labour and material costs have been lowered enough that the prospect of new life in the oil sands has become a topic of discussion in a province that just a few months ago watched as more than $200-billion in oil sands projects were either shelved or outright cancelled.

The downturn was so dramatic that reversing it will take time. But the very fact that a revival is being discussed marks a significant change in oil patch optimism.

"Rather than needing $80- to $100-a-barrel [U.S.] to make projects work, all of a sudden you're looking at these and saying maybe they are economic in a $60 world, and fairly competitive globally," said UBS Securities analyst Andrew Potter. "I think we are kind of nearing the bottom in terms of negative sentiment towards oil sands. It's not going to happen right away, but later in the year you'll see more of these projects come back on the table and begin to be advanced."

The rollback in costs has been achieved through hundreds of meetings in recent months hosted by major producers seeking to trim their own expenses – and strong-arming contractors to do the same.

The extent of the savings has come to light in the recent weeks, as the oil patch began its round of first-quarter results. **Suncor Energy Inc.** is targeting a drop in operational expenses of 10 to 15 per cent over the next 12 months. **Petro-Canada** has crunched new numbers for its proposed Fort Hills oil sands mine, and came up with a drop of more than 30 per cent – from more than $14-billion to under $10-billion. The price tag on **Husky Energy Inc.'s** Sunrise project has nearly fallen in half, from $4.5-billion to $2.5-billion. **Royal Dutch Shell PLC** expects oil project development costs worldwide to fall by 50 per cent.

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CUTTING COSTS

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IMPERIAL OIL
Has trimmed enough that it believes it can achieve a standard rate of return– most notably at its proposed Kearl mine, which will still cost more than its $8-billion price tag from a half-decade ago.

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The cycle has turned

Huge escalations in the price of labour and material had nearly quadrupled the cost to design and build an oil sands project early in the past decade. Operating costs substantially increased, too. Now the oil patch is striking back.

"This is a systematic, broad-fronted attack on costs," Suncor chief operating officer Steve Williams said in an interview. "Over a four- or five-year period, it was a very high-inflation world and difficult for us to push back on. Now the cycle has turned and this is our opportunity to get some of that stuff back. And we're making real and substantial progress."

Part of the industry's work has been done for it, through the fall in steel prices, a major input that has come down by about a third since last summer, and energy, in particular natural gas. But dramatic increases in labour productivity combined with a far more competitive bidding environment are creating a new world order in the oil sands.

Imperial Oil Ltd. has trimmed costs enough that it now believes it can achieve a standard rate of return on its projects – most notably its proposed Kearl oil sands mine – at an oil price range "that's similar to what you see today," chief executive officer Bruce March said last week. The company was set to approve Kearl late last year, but held off to give it time to "really work the cost thing hard," Mr. March said.

To save costs, Imperial delayed bidding out some of its large equipment orders, and sat down with existing contract-holders to "ask them to reconsider their pricing terms in the environment of the global downturn," he said.

Kearl will still cost more than its $8-billion price tag from a half-decade ago but Imperial is not apologizing for waiting on the project. Though the project was never cancelled, Mr. March said the company has made enough progress on costs that "we should have something exciting to share with you in the next several weeks here.

"I guess the snail is going to win the day here, at least in the next four or five years."

At Suncor, which is merging with Petro-Canada, the push on costs started 18 months ago, just before the height of the boom. The company sat its employees down in meetings to figure out ways to chip out efficiencies. It smoothed out roads so that mining trucks could travel at more constant speeds. Its mechanics substantially shortened the time it took for maintenance tasks like changing engines. The effort has grown more pointed in recent months. International travel has been largely suspended, while wages have been frozen.

Thanks also in part to reliability gains, Suncor's cost to produce a barrel of oil has declined from $41 in the fourth quarter to just over $33 now, and the company is targeting a further 10- to 15-per-cent improvement in the coming year.

The mechanics of how companies are cutting fat from big capital projects is similar to what Suncor has done on operating expenses, but the impact of those efforts is highly dependent on what stage projects are at. Suncor, for example, has already bought much of the equipment for its Voyageur bitumen upgrading plant, whose construction has been halted.

At Shell, 8,000 employees are working toward a late 2010 deadline to complete the $13.7-billion expansion of its Athabasca Oil Sands project. Shell has "had many difficult conversations with vendors around cost and cost performance," said Shell spokeswoman Janet Annesley. Still, any change in costs at its current construction projects "has not been material," she said.