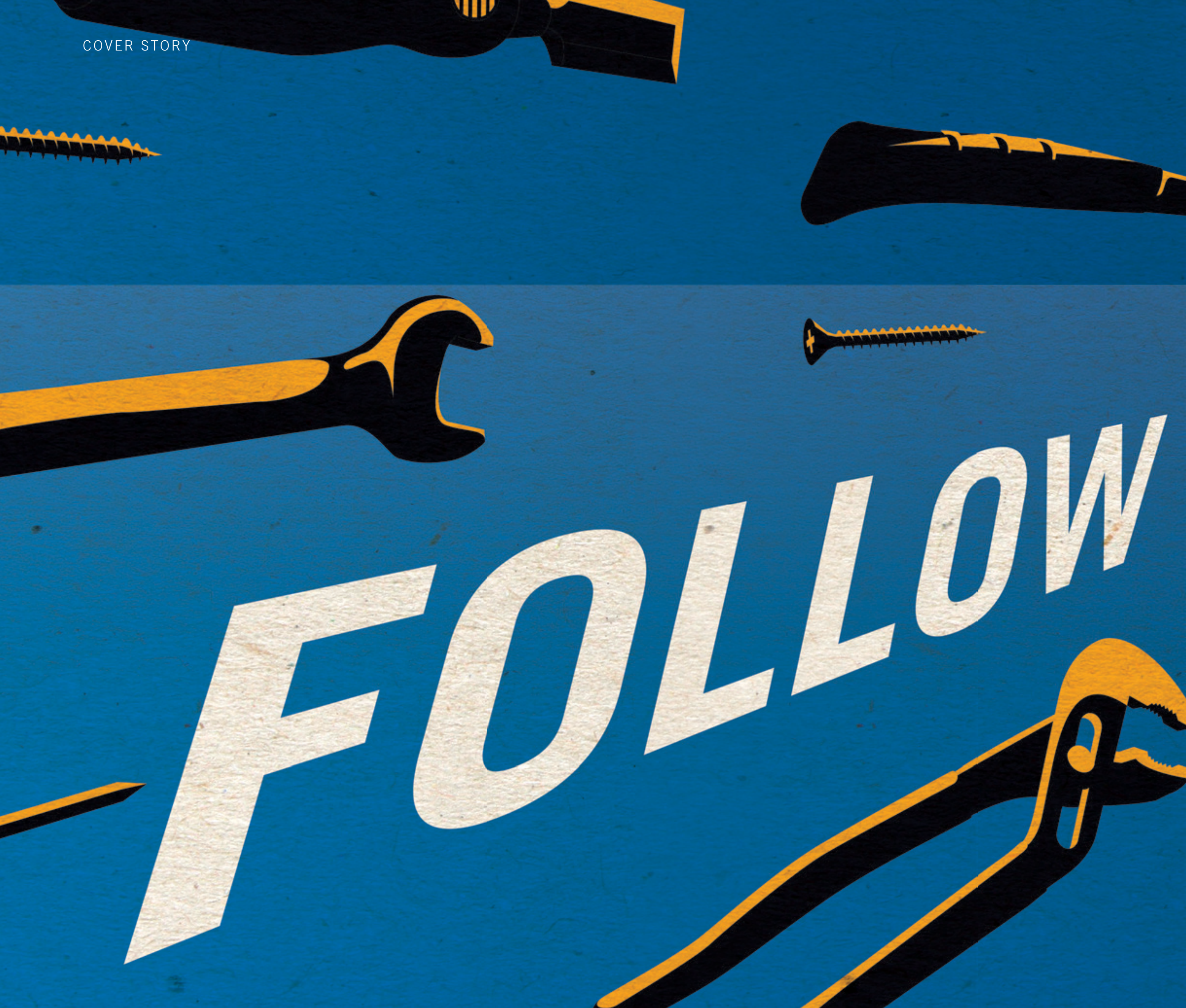


DESPITE A STALL IN GROWTH CAPITAL, PRODUCERS ARE EXPECTED TO SPEND MORE ON MAINTENANCE AND OPERATIONS THROUGH 2017 AS NEW PROJECTS COME ONLINE

By Jim Bentein and Deborah Jaremko

In the words of Rich Kruger, chief executive officer of Imperial Oil, there has been a "giant screeching sound" of projects being slowed or deferred as low prices exacerbate the oilsands industry's market access and social licence challenges.

Kruger was speaking at this year's PricewaterhouseCoopers Energy Visions event, where he warned about becoming preoccupied with short-term issues while losing sight of long-term goals.

Imperial is, of course, known for its steady hand in capital deployment, even running counter-cyclical with major investments, such as its sanction of the Kearl oilsands mine during the bottom of the Great Recession in

2009. The expansion to that 110,000-bbl/d plant, which the company is currently building, is one of a handful of major projects that is contributing to a shift in the way oilsands producers spend—and, by extension, the opportunity structure for their suppliers.

Producers are recognizing this shift in their business. Chris McInnis, Cenovus Energy's Christina Lake field development manager, noted at a recent *Oilsands Review* Speaker Series breakfast that the sustaining costs of a SAGD project will be quite large, even compared to the capital cost of the central processing facility.

"A lot of people are starting to recognize that there is a huge amount of money that is going to be invested in the sustaining side of our business," says McInnis, who started in Cenovus' capital projects group, but is now tasked with applying the cost-saving lessons learned from its manufacturing approach to operations.

A new report from CanOils predicts that even though producers are dramatically reducing the growth capital into the oilsands market, spend will increase in the areas of small and sustaining project capital and maintenance, repair and operations (MRO).

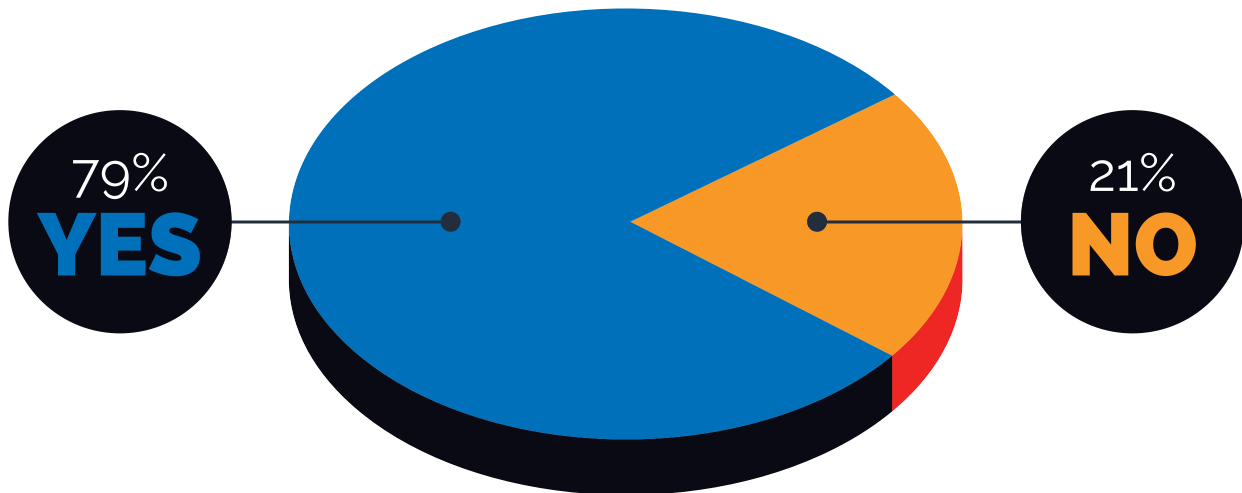
"Despite delays in new project development, this market is expanding," CanOils analysts write, indicating that about 750,000 bbls/d of new capacity is expected to come online by 2017. Correspondingly, CanOils predicts that spend on operational efficiency will increase by several billion dollars.

"It is not expected that the renewed focus on per barrel cost reduction will cause a significant decrease to the addressable MRO spend [for suppliers] as production volume growth will outpace any newly achieved cost savings."

CanOils notes that while producers are expected to spend more in aggregate on small and sustaining capital and MRO, the focus on cost control will be increasingly important.

"Service and supply companies will have to refine their own pricing and cost structures to find ways to maintain margin while

Does your company see sustaining capital/maintenance projects as a growth opportunity in the oilsands?



In *Oilsands Review*'s 2015 Oilsands Industry Outlook Survey, sponsored by KPMG, respondents were asked whether they viewed sustaining capital and maintenance projects as a growth opportunity. The result was an overwhelming yes.

stripping out up to 30 per cent of costs as mandated by some producers," the analysts write. "A number of strategies exist to meaningfully move this needle."

Scott Sharabura, Calgary-based associate principal with international consulting firm McKinsey & Company, says the company is seeing a growing focus on decreasing spending requirements for oilsands projects.

"There is a very big focus on capital cost reduction now," he says, adding that focus is also clear for MRO.

While there are currently new capital projects continuing, Sharabura says that if lower oil prices prevail, that's unlikely to be the case beyond 2017.

Meanwhile, producers are taking a "back to the basics" approach to their operations, he says, with moves such as eliminating discretionary work.

Sharabura, a chemical engineer who is a veteran of the oil and gas industry—his first job was at Imperial Oil's Sarnia refinery in the 1990s—says producers are developing closer relationships with service providers to hone in on cost reduction and efficiency.

"That makes sense because a lot of the technical know-how lies with the service providers. They look to you to be part of the solution."

John Norcross, vice-president, Canada, with Houston-based consultancy Evolve Partners says the industry—and oilsands operators in particular—need to move away from "boom and bust" mentality.

"They need to design their operations independent of the commodity cost cycle," say Norcross, who has a degree in industrial sociology from Carleton University, followed by more than 17 years working with senior managers internationally in developing human resources, systems and process capabilities to improve productivity and efficiency.

Norcross says oilsands producers and suppliers can learn from the experience of other industries, pointing to the auto sector, with moves ranging from developing a more efficient supply chain to the use of robotics to drive down costs, as a prime example.

"We [need to] understand how the auto industry has made its supply chain more efficient, otherwise we'll continue with this boom-bust cycle."

There are also examples within the energy industry of operators who have dealt with commodity price volatility by improving their efficiency and cost structure, he says, singling out natural gas–focused companies like Peyto Exploration & Development, which has remained profitable in a low gas price environment.

"They're used to it," he says, adding that oilsands operators need to develop sustainable solutions to make their operations cost efficient and productive for the long term.

Sharabura also says there is much to learn about cost control from other industries that have navigated tough competitive environments, such as the mining sector.

One of the problems he is finding is that many of the younger engineers and other managers in the oilsands industry today have seen mostly good times, with the exception of the brief 2008-09 downturn. As a result, they don't have the same flexibility as older managers.

"Anybody who lived through the 1980s knows how to be a cheapskate," Sharabura says.

Roger Keglowitsch, senior vice-president of Edmonton-based MRO specialist Melloy, a division of PCL Construction, says that although this could be a good time to deploy capital because of lower supply costs, most oilsands producers are doing only what is absolutely necessary.

Melloy does pipe fabricating and builds modules for oilsands plants. Keglowitsch says that end of the business, plus its shutdown and turnaround-focused divisions, have continued to be busy. But that is unlikely to be the case in the future, especially in its module and fabricating areas.

"We'll have less to bid on in 2016 and 2017," he says, adding that, to adjust, Melloy will "err on the side of being lean" with regard to staffing.

Melloy currently employs about 700 people, down from about 1,000 at the same time in spring 2014 during peak shutdown season. Keglowitsch anticipates the fall season will be busy too, although somewhat less so than last year.

The company's MRO business will be sustained by the fact there are simply many more oilsands mines, thermal projects, upgraders and other related infrastructure in place than ever in the past, he says.

"The maintenance and turnaround work will carry on. That's the difference from 15 years ago."

However, Melloy is being asked to play a key role in reducing MRO costs.

"They want the same amount of work done with fewer people," he says, adding that it's helping to reduce costs by making turnarounds more repeatable by using the same crews.

The company is also working more closely with operators in the planning phases of shutdowns and turnarounds.

"We have our people there six to 10 months before the turnaround," Keglowitsch says. "In the past, it was two or three months."

Another change is that producers have more specific and detailed targets in mind for projects than was the case in the past.

Keglowitsch says operators are also making it clear they want the cost reduction to be more sustainable than in the past.

As Imperial Oil's Kruger noted at the recent PricewaterhouseCoopers event, it is unclear where oil prices are headed, but Imperial is "looking at this as if we could be in for a sustained period of lower prices, and we'll be operating and planning our business on that basis." OSR

To access the CanOils report, *Hunting opportunities: Following the producer spend in a bear oilsands market*, please visit canoils.com.

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