



The One Oil Sands Chart You Have to See

Description

What's the single biggest issue facing the Canadian energy industry? Is it commodity price volatility? Rising operational costs? Regulatory hurdles? Nope – none of the above. The biggest issue is just shipping the product to market.

Alberta heavy oil, as measured by Western Canadian Select, now trades at over a \$30 per barrel discount to other North American benchmarks. There simply isn't enough transit capacity to handle surging production and crude continues to pile up in storage. When you multiply that discount by the 2.3 million barrels the industry produces daily, you start to understand the importance of this problem.

The question on investors' minds, 'Is it going to get worse?'

What does the future hold for the oil sands?

Fortunately for investors, futures contracts from Canadian Western Select are actively traded on the Chicago Mercantile Exchange. This allows us to see what Alberta crude is being traded for delivery in the future. Here's what's being priced in as of October 30. (*click chart to enlarge*)

oil futures
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Source: Chicago Mercantile Exchange

There were two observations I made from the above graphic. First, the discount for Alberta crude looks like it will remain a permanent feature of the industry for a long time to come. Second, the situation is expected to get better. If you look out to late 2015, the discount for Alberta bitumen falls by almost half. This means that the market is expecting transit capacity to catch up with production at least to some degree anyway.

Does this make sense?

The current \$30 per barrel discount is masking an impressive midstream buildout in the Canadian energy industry.

Enbridge (TSX: ENB, NYSE: ENB), Canada's top pipeline shipper, has been quietly expanding its system. Some of its major projects include eliminating bottlenecks of heavy oil to the Chicago area, twinning it Seaway and Spearhead pipeline to increase shipments to the Gulf coast, and reversing its Line 9 route to transport Canadian oil to Quebec refineries by the end of next year. These initiatives are expected to increase capacity 50% to three million bpd by the end of 2015.

Much has been made of **TransCanada's** (TSX: TRP, NYSE: TRP) Keystone XL pipeline. But the project is becoming less relevant by the day. The company is already proposing alternatives most notably the Energy East pipeline which would ship over a million barrels daily to coastal refineries in Quebec and New Brunswick.

The railroad industry has also stepped up to support the oil patch. [Crude by rail shipments have more than tripled in the past two years](#). And with the backlog of rail cars seen earlier this year now being delivered, the industry could repeat that accomplishment again.

Big oil sand players are increasingly turning to rail shipments as well. This quarter **Cenovus** (TSX: CVE, NYSE: CVE) reiterated its target to ship 30,000 bpd by rail by the end of next year. That represents a sevenfold increase from current levels and 10% of the company's marketable production.

Changes downstream should also increase the demand for Alberta bitumen. **BP** has finished retrofitting its Whiting, Illinois refinery to handle heavier crude blends. The new coker expansion is expected to be in commission by the end of November and could increase demand by 330,000 bpd by within six to nine months.

Foolish bottom line

Regardless of what the futures market is pricing in, it will be a bumpy ride for Canada's oil sand producers. The most recent spread blowout was due to new production from **Imperial's** Kearl project and a maintenance issue on a TransCanada pipeline – a short term issue. While transit capacity should be able to keep up over the long run, there's no guarantee it will meet supply month to month.

While the oil sands tend to dominate Canada's energy space, there is another source of power that Canada is rich in that currently is flying under the radar. [Click here now](#) to download "**Fuel Your Portfolio With This Energetic Commodity**", our special **FREE** report that outlines the case for this potential energy source of the 21st century.

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