



What Investors Need to Know About Canadian Crude

Description

Canada has the world's third-largest oil reserves after Venezuela and Saudi Arabia, though much of these reserves are locked up in bitumen and oil sands. There are two main types of crude produced in Canada: West Canada Select, or heavy crude, and Edmonton Par, or light crude.

A primer on Canada's crude blends

Both of these crude blends have their price per barrel benchmarked to West Texas Intermediate, which is U.S. light crude. These two crude blends typically trade at a discount to WTI, with West Canada Select trading at a deeper discount than Edmonton Par.

At this time, West Canada Select trades at a discount of around 26% to WTI, while Edmonton Par trades at a discount of around 12%. But over the last year, West Canada Select's price has gained the most of the two blends, up almost 19% over that period, while Edmonton Par's price has remained relatively flat.

This can be primarily attributed to growing U.S. light tight crude production driven by the shale oil boom, which will see the country overtake Saudi Arabia by 2020 to become the world's largest oil producer. The shale oil boom and improved fracking and other oil extraction technology will continue to drive higher light tight crude production in the U.S., allowing the country to reach energy self-sufficiency by 2035.

As a result, U.S. demand for Edmonton Par has continued to decline. Since the U.S. is the key export market for Canadian crude, this is applying downward pressure to its price. This will have its most significant financial impact on those operators in the patch focused on light crude production, including **Crescent Point Energy** (TSX: CPG)(NYSE: CPG), **Whitecap Resources** ([TSX: WCP](#)), and **Lightstream Resources** (TSX: LTS)(NYSE: LTS).

A number of industry analysts are also expecting waning U.S. demand and infrastructure constraints to cause the price differential between Canadian heavy crude and WTI to grow.

Conventional Canadian light and medium crude makes up around 26% of the country's total oil

production and 25% of total crude exports. When combined with condensates and other light petroleum liquids, total light and medium oil production makes up 58% of Canada's total oil production. Heavy crude and bitumen make up 42% of Canada's total oil production and 53% of total exports.

This underscores the patch's dependence on heavy crude and bitumen production and the threat that the widening price differential between West Canada Select and WTI poses to the patch.

What does this mean for investors?

All of these factors highlight the need for Canada to boost pipeline capacity and for the patch to concentrate on accessing other export markets. The most important is the Asian energy market, with China now overtaking the U.S. to become the largest net importer of crude globally.

There will also be a surge in demand from other emerging Asian economies as their own processes of industrialization and economic growth gain momentum.

Already, midstream company **Enbridge** ([TSX: ENB](#))([NYSE: ENB](#)) has embarked on a strategy to access these markets with its proposed Northern Gateway pipeline, which connects the patch to Canada's west coast, moving closer to approval. It has also been granted a license by U.S. regulators to re-export Canadian crude from the U.S. and is among the first companies to be granted such a license.

Another player in the patch that is well positioned to access alternative energy markets with diversified crude production is **Husky Energy** (TSX: HSE). Not only has it already tapped into China's burgeoning energy market through its Liwan gas project in partnership with China's **CNOOC** (TSX: CNU)(NYSE: CEO), but it has a geographically diversified range of heavy oil and light oil assets that are currently producing material. Some are located in the Atlantic, allowing Husky to obtain Brent pricing and take advantage of the premium price at which Brent trades over WTI.

Interestingly, **Suncor Energy** ([TSX: SU](#))([NYSE: SU](#)), the largest player in the patch, is increasingly finding itself in a similar position to Husky. It is increasingly able to access European refining markets by virtue of its globally diversified asset base, seeing it grow the amount of its crude sold indexed to Brent and taking advantage of Brent's premium over WTI.

The company also continues to maintain a competitive advantage with its industry-leading oil sands assets, which allow it to maximize any further gains in the price of West Canada Select and bitumen. These factors and higher realized crude prices over the first quarter of 2014 saw Suncor report its best financial quarter on record.

There is a range of options available to investors to take advantage of the narrowing price differentials between Canadian crude blends and WTI while minimizing downside risk should crude prices fall. Key among these is choosing to invest in those companies with diversified asset bases that allow them to access Brent pricing and energy markets other than the U.S.

Investors also need to choose companies that have their eye on the future and are implementing projects that allow them to cope with waning U.S. oil demand. The companies listed above are among some of the best in the patch for allowing investors to achieve those goals.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ENB (Enbridge Inc.)
2. TSX:SU (Suncor Energy Inc.)
3. TSX:VRN (Veren Inc.)
4. TSX:WCP (Whitecap Resources Inc.)

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