What the Pipeline Crunch Means for Energy Players in the Patch

Description

With China fast shaping up as a critical energy market for Canada's oil producers, the completion of **Enbridge's** (TSX: ENB)(NYSE: ENB) Northern Gateway pipeline after its recent approval is becoming increasingly important.

Existing pipeline constraints are already costing Canada's economy dearly, with some estimates going as high as $50 million daily, increasing the urgency behind approving new pipelines. However, this estimate only takes into account losses from exporting to export markets and not the untapped potential that exists if the patch can access Pacific Rim and Asian emerging markets, including China.

Surging U.S. production will cause demand from Canada's largest export market to fall

If these constraints are addressed through greater pipeline capacity, it would allow Canada to sidestep a critical issue for energy growth. The U.S. is fast approaching energy self-sufficiency on the back of the shale oil boom, which has seen U.S. crude production grow exponentially. This would see a significant fall in demand for Canadian petroleum exports, with the U.S. being Canada's single most important export market, accepting around 76% of all crude produced and 98% of all crude exported.

Furthermore, the growing importance of China can't be ignored, with the country passing the U.S. to become the largest net importer of oil and other petroleum liquids globally. It is also set to be a key driver of global energy demand with its economy still one of the world's fastest-growing — it's estimated by the World Bank to surpass the U.S. economy this year and become the world's largest.

As a result, China and Asia's emerging economies will become key markets for producers of crude.

How can players in the patch access this lucrative market?

However, the political uncertainty surrounding the approval of **TransCanada's** (TSX: TRP)(NYSE: TRP) controversial Keystone Pipeline, as well as the activists threatening a legal blitz on the Northern Gateway pipeline since its approval, makes it imperative for players in the patch to find alternative methods of accessing this lucrative market.

Husky Energy (TSX: HSE) has taken a big step forward in this regard with its Liwan gas project in the South China Sea, which sells natural gas to China at a premium to the spot price.

However, the key is getting crude and non-gas liquids from the patch to export terminals and refineries where it can be exported to China.

According to the International Energy Administration, players in the patch are still capable of accessing important Asian, European, and Pacific Rim markets if the Northern Gateway pipeline is not completed.

This is partly because of the sharp rise in the amount of crude now transported by rail and the ability of Canadian producers to now re-export Canadian crude from the U.S. Despite crude being more expensive to transport by rail than by pipeline at around $5 to $8 more per barrel, the volume transported has exploded, growing more than 270 times since 2009 to be over 140,000 car loads in 2013. This is expected to continue surging as pipeline capacity fails to keep up with production growth in the patch, which is expected to grow 14% between now and 2016.

All of this bodes well for Canada's major railways, **Canadian National Railway** (TSX: CNR)(NYSE: CNI) and **Canadian Pacific Railway** (TSX: CP)(NYSE: CP), to grow their revenues, cash flow, and bottom lines, with demand for crude by rail expected to continue growing at an exponential rate as a range of pipeline projects remain mired in controversy.

Re-export licenses from the U.S. facilitate access to other refining markets

Another key player in the patch, Enbridge, has been granted a license to re-export Canadian crude from the U.S. **Crescent Point Energy** (TSX: CPG)(NYSE: CPG) is also investigating this option. Such licenses give both companies access to lucrative Asian and European refining markets.

This can be seen with Spanish integrated oil major Repsol in May this year having bought and exported 600,000 barrels of Canadian heavy crude from U.S. Gulf Coast refineries to be used in its Spanish refineries. This emphasizes the importance of accessing European refining markets, with many European nations seeking to reduce their dependence on Russian energy imports in light of the Ukrainian crisis.

Clearly, Canada needs to address its pipeline and crude transportation bottlenecks if the petroleum industry is to be equipped to access key non-U.S. refining markets. These constraints are already costing Canada's economy dearly and forcing players in the patch to think outside of the box when it comes to accessing alternative markets. However, it is the larger oil producers and midstream operators that are best positioned to overcome these constraints, while smaller operators with less cash will continue to be impacted by them.

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1. TSX:CNR (Canadian National Railway Company)
2. TSX:CP (Canadian Pacific Railway)
3. TSX:ENB (Enbridge Inc.)

4. TSX:TRP (TC Energy Corporation)
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