As Crude-By-Rail Shipments Plunge, Rail Companies Offer Price Discounts to Woo Shippers

Description

The oil market downturn has derailed the growth of what was once a major oil boom in North America. The impact of that slowdown has been felt far and wide, including by major Canadian railway companies **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP).

The duo had been enjoying a boom in oil-by-rail shipments, with expectations of more of the same in the years ahead. However, those shipments have plunged, leading both to slash shipping rates in an effort to win back their customer's volumes.

Volume growth derailed

Prior to oil prices heading south late last year, there was an expectation that crude-by-rail volumes out of Canada would balloon to 700,000 barrels per day by the end of next year. For perspective, that's roughly the size of the projected Canadian crude oil volumes that would have been shipped on the stalled Keystone XL pipeline. However, due to the oil-price plunge, rail shipments this year only averaged just 112,000 barrels per day in July, a third lower than last year.

In order to recapture this volume, both Canadian National and Canadian Pacific are reportedly offering volume discounts of up to 25% to customers in an effort to lure their volumes back on the rails. In a report by *Reuters*, Canadian Pacific was said to have offered discounts of 15-25% to some of its customers in exchange for a firm volume commitment of one 70,000 barrel unit train per month for three months.

Falling rates = higher netbacks

This is great news for oil companies because falling rail-shipping rates help them capture more of the value of each barrel they produce. Earlier this year the average shipping rate to send a barrel of crude from Alberta to refineries on the U.S. Gulf or East Coast was $15-17 a barrel; however, those costs have slipped some and are now down to $13-15 per barrel.

Still, that's a steep cost made even steeper given the plunge in crude prices. So, by cutting rates further, producers will be able to mitigate the sting of the nearly $50 plunge in oil prices over the past year. Further, when combined with other cost reductions, the rate cut will help these oil companies to better manage the downturn by improving the netbacks earned on each barrel.

We've seen major crude-by-rail shippers like **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE), which has struggled under the weight of the lower oil prices, seek ways to reduce its costs at every level. That's one reason why the company purchased its own unit train-loading terminal in Alberta, so it could cut out the middleman, so to speak, and capture a higher value per barrel when shipping oil by rail.

That ability to capture incremental value would only accelerate if it could grab a steep price discount on its volumes shipped by one of the major rail companies.

Investor takeaway

With lower oil prices derailing the boom in oil shipments, Canadian Pacific and Canadian National have no choice but to lower their prices. The hope is that they will make up some of the lost revenue on volume instead of margins. In doing so, they'll also help struggling oil producers capture higher value per barrel to take a little bit of the sting out of low oil prices.

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mdilallo