Why Enbridge Inc.'s Northern Gateway Is Next on the Chopping Block

Description

The 850,000 b/d Keystone XL pipeline was one of four major pipelines proposed to export Canadian crude and the first to be rejected. The Keystone XL rejection is historic because it is the first major pipeline to be rejected for largely climate change reasons.

It now looks like Keystone won't be the only pipeline rejected because of climate change. A recent move by new Canadian prime minister Justin Trudeau to ban oil-tanker traffic off the coast of British Columbia could effectively eliminate the chances of **Enbridge Inc.'s** (TSX:ENB)(NYSE:ENB) Northern Gateway pipeline being built.

Given that Northern Gateway represents a large capital project and growth opportunity for Enbridge, shareholders may be wondering what the odds are of the pipeline not going through. If the pipeline is rejected, what will it mean for Enbridge's future returns and growth? Here are all the important details.

An oil-tanker ban would likely kill Northern Gateway

Northern Gateway is a proposed pipeline that would transport 525,000 b/d of crude oil from Alberta to Kitmat, British Columbia, where it could then be exported by oil tankers to Asian markets. Justin Trudeau stated in 2014 that if he were to become prime minister, Northern Gateway would not happen, and the recent move to ban oil tankers off the coast of British Columbia should bring this promise to reality.

In a recent letter to his transportation minister, Trudeau directed the minister to formalize a moratorium on crude oil-tanker traffic off the north coast of British Columbia (where Northern Gateway would terminate). While such a ban would still allow **Kinder Morgan** to build their Trans Mountain pipeline to export crude oil off the south coast, it would make Northern Gateway impossible.

Enbridge issued a statement claiming that a moratorium would require the support of the First Nations people, since they would receive some economic benefit from having the pipeline built, but so far these communities have largely opposed the pipeline.

What does this mean for Enbridge?

Fortunately, the $7.9 billion pipeline is not a critical part of the company’s overall capital program. Enbridge is currently in the midst of a massive $44 billion capital program. $34 billion of this program is commercially secured and set to be in service by 2018. Northern Gateway is a part of the small portion of Enbridge’s capital program that was at risk, and while it would have represented upside for the company, it was not a critical driver of the company’s growth over the next several years.

Enbridge is expecting to grow its earnings per share by an 11-13% compound annual growth rate through to 2019, and this earnings growth will be driven by the $34 billion in secured projects that Enbridge is currently executing.

Enbridge has identified new growth prospects

Even if Northern Gateway does not happen, this does not solve the problem of inadequate pipeline capacity. Enbridge and the Canadian Association of Petroleum Producers estimate that between 800,000 and one million b/d of new oil sands production will be coming online through 2020.

This production is highly likely as it represents key growth projects for well-funded integrated players with strong balance sheets. This new oil sands growth will require about 450,000 b/d of new pipeline capacity by 2020. After 2020, an additional 500,000 b/d could be required by 2025 if oil prices improve and if new oil sands projects are added.

Fortunately, Enbridge has a plan to meet this demand without Northern Gateway and has identified a series of low-cost expansions and additions that could add as much as 800,000 b/d of capacity, without requiring overly complicated political approvals (since the projects would be built by expanding pipelines that already have approved right of ways).

These projects could include further low-cost expansions to Enbridge’s mainline as well as using the additional capacity that will be available on the mainline, and then twinning and expanding some of the downstream pipelines that connect the mainline to the Gulf Coast.

These low-cost expansions should allow Enbridge to provide the capacity that it would lose should Northern Gateway be formally rejected. While such a rejection may be a negative for Enbridge, it should not affect the company’s five-year growth outlook, and the company still has access to the upside Northern Gateway would have offered through the previously mentioned expansions.

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