2 Numbers Every Pipeline Investor Needs to Know

Description

Pipelines, be it natural gas or oil, make money largely based on the production and transportation needs of its shippers. Higher production levels means there is a need for more infrastructure, and it also means pipelines that operate on a cost-of-service basis can successfully recover their costs and earn a solid return.

This is why current or potential investors in companies such as **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) or **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) need to look at the long-term demand for key products like natural gas and oil. They also need to make sure to have exposure to pipeline names that are planning and building infrastructure that's aligned with where the future demand growth is.

Where is the future demand growth? There are two numbers, which were outlined in **BP's** recent long-term energy outlook, that explain this well. Through to 2035, natural gas demand will grow by 1.9% annually, making it the fastest-growing fossil fuel, whereas oil demand will grow at a rate of only 0.7% annually from 2020-2035. This is down from 1.2% in the current 2013-2020 period.

The key takeaway is that natural gas is where the growth will be.

Why natural gas is becoming the fastest-growing fossil fuel

The BP report states that natural gas will not only outgrow oil over the long term, but it will also outgrow coal, which will see the slowest growth of the three fossil fuels. Natural gas will see demand growth greater than both coal and oil combined, and the report estimates that one-third of the demand growth between now and 2035 will be satisfied by natural gas, with another one-third satisfied by coal and oil, and the final one-third satisfied by non-fossil fuels.

The growth in natural gas will largely come at the expense of other fossil fuels as the natural gas market expands. By 2035 all of the fossil fuels will have about the same market share of the total energy market, something that has not been true since the industrial revolution.

What is driving the increased use in natural gas? Population and income-per-person growth over the next 20 years will result in a 37% increase in energy consumption. The source of this increase in consumption will largely be from the power generation sector as a wealthier and growing population requires more electricity. Power generation is expected to grow from 42% of total consumption to 47% by 2035.

Power generation is an area where all of the fossil fuels compete, and natural gas is set to win in this competition, which is why natural gas is increasing market share at the expense of other fossil fuels.

One of the trends driving this is the gradual reduction of coal-fired power plants, which will largely be replaced by much cleaner natural gas-fired power plants. Alberta, for example, recently committed to ending coal-fired power generation. The U.S. has committed to do the same by 2030, and the U.K. has pledged to shut down their plants by 2025.

Natural gas will replace coal in many cases. Burning a unit of natural gas produces about half the CO2 that coal does. Not only that, but it is also more energy efficient than coal. As China grapples with its pollution problem, it is also likely to begin utilizing cheap natural gas at a greater rate.

How to play natural gas demand growth

Most of the natural gas demand growth will be coming from Asia and China, according to both BP and other sources. While China, for example, will see a large increase in their own natural gas production, there will need to be a rapid increase in imports to meet the demand growth.

These imports will largely come from North America, which is seeing rapid growth in shale gas supplies. North America is set to be a net exporter over the next few years, and much of this supply will reach Asia through liquefied natural gas.

TransCanada is positioning itself perhaps better than any pipeline company to profit from this trend. Currently, TransCanada's proposed Prince Rupert natural gas pipeline project is poised to connect the abundant Montney natural gas supply to a the proposed Petronas LNG facility on the coast of British Columbia, and their Coastal Gaslink pipeline is poised to connect the same supply to Shell's proposed LNG facility near Kitimat, B.C.

TransCanada represents an excellent long-term opportunity that could continue to provide growth.

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