



How to Profit From the Re-Emergence of Canada's Crude-by-Rail Strategy

Description

The price of Canadian heavy oil has become [heavily discounted to U.S. benchmarks](#) since the end of last year.

While that may not be welcome news for oil sands producers such as **Cenovus Energy Inc.** ([TSX:CVE](#))([NYSE:CVE](#)) and **Baytex Energy Corp.** ([TSX:BTE](#))([NYSE:BTE](#)), what it has done is make transporting crude oil by rail a viable option again.

That is very good news for Canada's two rail companies, **Canadian National Railway** ([TSX:CNR](#))([NYSE:CNI](#)) and **Canadian Pacific Railway** ([TSX:CP](#))([NYSE:CP](#)).

Understanding what makes a crude-by-rail strategy work

The U.S. energy market happens to be a lot bigger than Canada's, partly because of the number of people and also because the economy there is a lot larger than Canada's.

On top of all that, there are more refineries in the U.S. than there are in Canada.

Refineries are an essential part of the energy market, as it's the refineries that ultimately convert crude oil into consumable products, like gasoline, diesel fuel, and certain chemical products.

All this means that a large percentage of Canada's energy output needs to make it into the U.S. in some way or another.

The cheapest way to accomplish this is by transporting crude liquids via pipelines — like the ones owned by companies like **TransCanada Corporation** ([TSX:TRP](#))([NYSE:TRP](#)), **Pembina Pipeline Corp.** ([TSX:PPL](#))([NYSE:PBA](#)), and **Enbridge Inc.** ([TSX:ENB](#))([NYSE:ENB](#)).

Because pipelines are the cheapest mode of transportation, they are the first choice for producers.

But right now, there is so much excess oil being pumped out of Canada's oil sands that the pipelines simply [don't have the capacity to handle it all](#).

It's times like these that when the crude-by-rail strategy becomes a viable option.

Reports suggest that when the discount to Canada's heavy oil, as measured by the Western Canadian Select (WCS) benchmark, exceeds \$15-20 per barrel versus the U.S. benchmark, West Texas Intermediate (WTI), it then becomes economical to ship by rail.

Today, that gap between WCS and WTI sits just shy of \$29 per barrel, so it's easy to envision a scenario where Canada's producers may be shipping product through Canada's two railways for some time.

Canada's pipelines are already at capacity

There are several projects underway right now that could help address the capacity issue, but none of them are expected to come online in time to deal with the problem in 2018.

Kinder Morgan Canada Ltd. (TSX:KML) is planning its \$7.4 billion Trans Mountain expansion, but that project isn't expected to be completed until 2019.

TransCanada has big plans for its Keystone XL project, and Enbridge is planning its biggest expansion project ever with the Line 3 replacement plan, but both of those still need to get past regulators.

Meanwhile, on its fourth-quarter conference call, Enbridge CEO Al Monaco said that even after its Line 3 project is completed, the company expects its pipelines to be at full capacity through 2020.

Bottom line

The railway industry has been on a "roll" for the past decade, raking in records sales and profits and handsomely rewarding shareholders along the way.

So, it's not as though they even needed a boost, but 2018 may be as good a time as any to add to your holdings in rail companies.

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