Saudi Arabia’s Pain Will Benefit Canada’s Energy Patch

Description

Tensions in the Middle East bubbled over with drone and cruise missile attacks on Saudi Arabia’s oil facilities knocking out roughly half of its production. This was responsible for causing oil prices to surge; the international benchmark Brent rallied to over US$70 per barrel.

The attacks have been linked to Iran and appear to part of the ongoing battle between to the two nations for regional dominance, which sees them fighting a proxy war in Yemen.

Potential for further oil shocks

The attack occurred on the back of Teheran’s threats to close the Straits of Hormuz to tanker traffic in response to the U.S. reinstating sanctions against Iran. These events and escalation in tensions between the two OPEC nations highlights the insecurity associated with Middle East oil supply.

This event has intensified fears of an open war between Riyadh and Teheran occurring with the Saudis aggressively claiming that the attacks originated from Iran. The potential for escalation is being ratcheted up by President Trump, who stated that attacking Iran is an option and additional sanctions were to be implemented.

It is unlikely, however, that the event will create any lasting oil shock, which will support higher oil prices. This is despite speculation by some pundits that the attack would lead to a substantial portion of Saudi Arabia’s production being offline for some time, leading to higher crude.

According to reports from the Saudi energy ministry, around 50% of the total capacity lost during the attacks has already been brought online, and full production will be restored by the end of September.

Despite Riyadh moving quickly to bring production back online, these events stress just how safe Canadian crude is and the ease with which it can be transported to crucial U.S. refining markets, regardless of existing pipeline capacity constraints.

Benefits the energy patch

One company in the oil patch that will benefit from heightened Middle East tensions is integrated energy company **Suncor** (TSX:SU)(NYSE:SU), which has lost 17% over the last year.

Unlike many of its peers in the oil sands, Suncor profited from the wide price differentials between the North American benchmark West Texas Intermediate (WTI) and domestic heavy crude, which impacted the Canadian Western Select (WCS) benchmark price during the second half of 2018.

This is because the integrated energy giant possesses significant refining capacity, with it capable of processing around half of all the crude it produces. Suncor has also been steadily expanding its refinery throughput.

For the second quarter 2019, Suncor refined 399 barrels of crude daily, which was 16% greater than a year earlier and represented 50% of the 804,000 barrels produced on average daily over the period. Suncor is also expanding its oil output, having increased it by an impressive 21% year over year to 804,000 barrels daily for the second quarter.

That can be attributed to a combination of less planned maintenance for Suncor's oil sands operations and improved reliability at Syncrude, leading to less outages.

The energy major is also in the process of ramping up operations at its Fort Hills and Hebron assets which was also responsible for the surge in oil output and will contribute to further production growth. That bodes well for Suncor's earnings, particularly in an operating environment where oil is expected to remain firm because of increased geopolitical risk.

The only issue for Suncor and other oil sands operators is the lack of pipeline exit capacity, although this will be improved by **Enbridge's** Line 3 Replacement Program being completed during the second half of 2020. As discussed, Suncor can also refine a substantial amount of its heavy crude production, further reducing the impact of a lack of pipeline capacity on its operations.

Foolish takeaway

Tensions in the Middle East remain high, and this isn't being aided by the Trump administration's push for further sanctions against Iran or its hostile approach to relations with Teheran. While open conflict or a U.S. invasion of Iran are highly unlikely, it emphasizes that further events could occur triggering short-term oil shocks. That has created a favourable environment for the energy patch with Suncor being a very attractive play on higher crude.

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