

Benefits of Canadian Crude Oil Production Remain Untapped

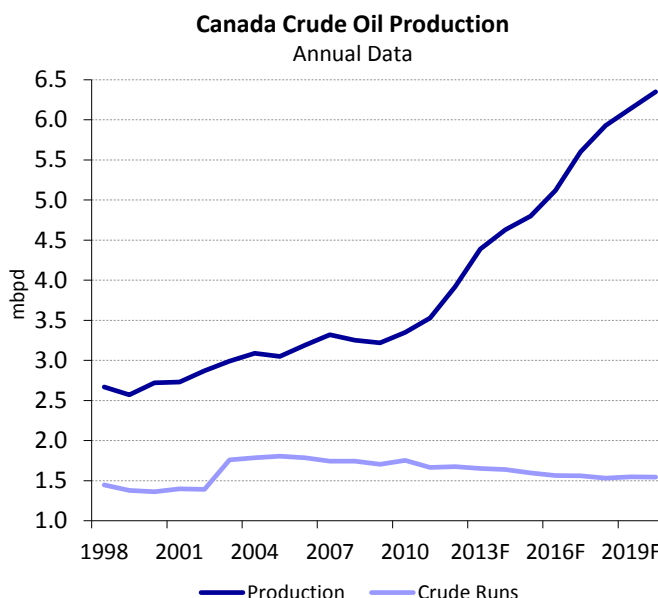
Keystone XL regulatory review trapping crude oil export potential from Canada

Canada has recently seen substantial growth in crude oil production, and consensus forecasts portray even larger volumes of near-term production capacity due to developments in and around Alberta. However, the possibility of these newly unlocked reserves being sold into more profitable markets is questionable. The Keystone XL pipeline, a political lightning rod for different reasons in both the United States and Canada, is still pending due to regulatory review, but is viewed as necessary relief to producers with few export options. Regardless of the project's eventual approval by President Obama, Canadian producers will need more export diversity in order to fully reap the benefits of newly accessible reserves.

Canadian crude oil production surging and continuing to grow

Canadian production is indeed in the midst of rapid growth, rising by approximately 22% – to 3.92 mbpd – since 2009. IEA forecasts this number to continue to grow rapidly, reaching an estimated 6.35 mbpd in 2020. Domestic crude runs, which are around only 1.7 mbpd, are not expected to gain on refinery capacity additions in the foreseeable future, leaving the remainder of production gains to be available for export.

Majority of new production available for export



Sources: IEA, Poten

Heavier grades from synthetic crude and bituminous sands have accounted for the majority of production gains, and forecasts anticipate these grades to capture an even

Primary crude grades marketable not only in United States

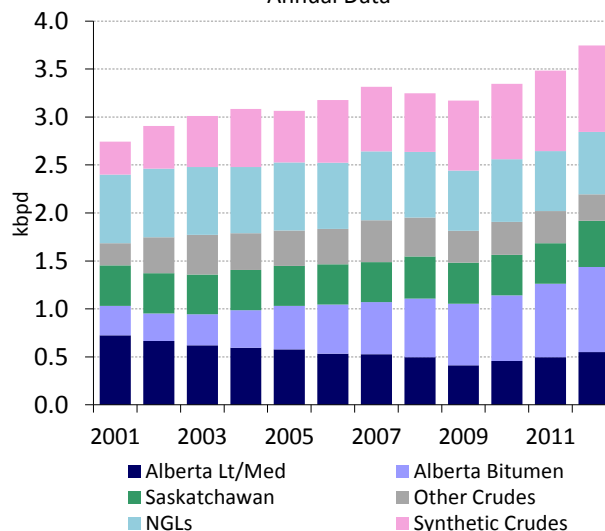
larger share of Canadian production going forward. Though these grades are desirable to US Gulf Coast refineries, they are becoming acceptable to a larger number of Asian refineries as well.

Heavier grades account for much of production growth

Canada essentially a captive producer to a country with declining need for the product

Canadian Crude Production by Type

Annual Data



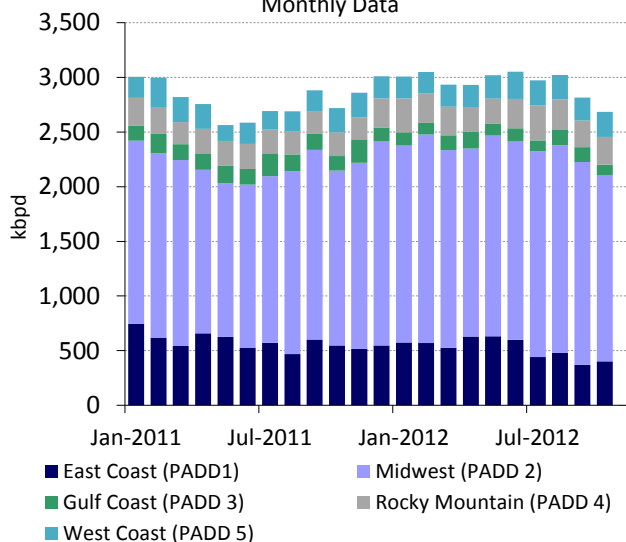
Source: IEA

IEA data indicates that, in many months, exports to the US make up 100% of Canada's total crude oil exports. In other months, the amount sent elsewhere is generally negligible. Most of these exports to the US are land-based via pipeline or, in some instances, rail. Such a reliance on exports to the United States puts Canadian producers in an unenviable position though, as crude oil production continues to increase in the United States as well.

Majority of US imports from Canada are land-based

US Crude Oil Imports ex-Canada

Monthly Data



Source: EIA

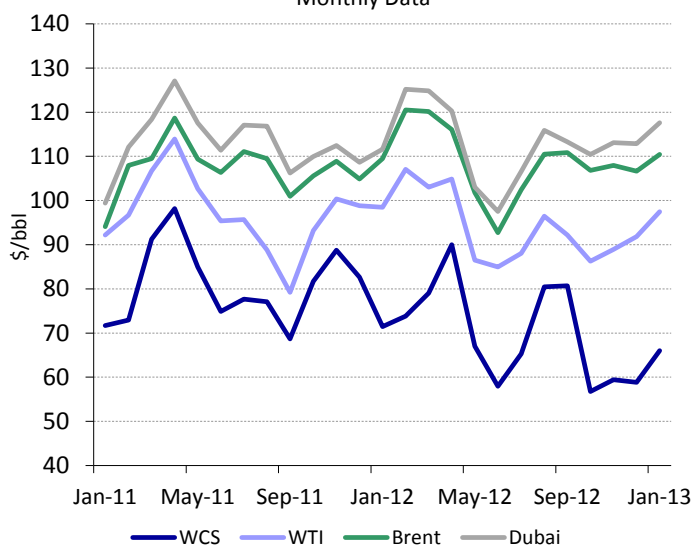
Price situation has gone from bad to worse for Canadian producers

Increasing North American production, joined with limited pipeline capacity between Canada and the United States, has somewhat expectedly caused a further widening of the spot spread between the West Canadian Select and the West Texas Intermediate benchmarks. The spread, which stayed below \$20 for much of 2011 and narrowed to as little as \$10 in September of that year, has widened to over \$30. The difference in price is even more pronounced when comparing WCS against benchmarks in Europe and Asia.

Large differential between Canadian benchmark and benchmarks in US, Europe, and Asia

Crude Oil Benchmark Spot Prices

Monthly Data



Source: Bloomberg

Canadian economy missing substantial value, but Keystone XL anticipated by many to be approved

The Canadian Imperial Bank of Commerce notes that Canadian producers currently lose approximately \$32.9 billion a year due to lack of access to the global oil market. The approval of Keystone XL would no doubt be a positive development for these producers. Secretary of State John Kerry's disclosed equity positions – the liquidation of which were brought about by his recent confirmation process – were widely speculated to be indicative of his read on the likelihood of the approval of the Keystone XL. Comments made by TransCanada CEO Russ Girling to Bloomberg earlier this week likewise reflected confidence about the project's chance of coming to fruition.

While this approval would be a welcome development, it is not a panacea

Such a win for TransCanada would not solve all of the future issues associated with limited export optionality, though. The project – with a capacity of up to approximately 590 kbpd – would not meet the totality of forecast export needs. Furthermore, with aforementioned North American production growth making the US Gulf market less favorable since the project was first undertaken, access to Asian markets may be preferable. Regardless of the ultimate Keystone XL decision, pipeline projects such as Enbridge's Northern Gateway, Kinder Morgan's Trans Mountain, and TransCanada's expansion east – possibly as far as Saint John – are crucial to the country's broader ability to optimally access markets for their increasing crude oil production.

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