Not All Oil Is Equal

When the financial press references the price of a barrel of oil it usually refers to West Texas Intermediate (WTI) but for Canadians this is not the most significant standard. The price a producer receives for a barrel of oil depends on the type of oil, where it's produced, and where it is purchased.

WTI, also known as Texas light sweet, is produced in the U.S. and is described as medium crude oil because of its relatively low density, and sweet crude oil because of its low sulfur content. The other major benchmark oil is "Brent"; its name refers to oil fields in the European North Sea, where it originates. Many oils produced in the Middle East, Africa and Europe, all trade in relation to Brent oil. Brent is a light crude oil with low sulfur content. Because it is inexpensive to move oil in large tankers the price is fairly similar anywhere tankers can load or unload. As light, sweet oil that can be widely transported, Brent oil currently receives some of the highest prices.

The price of the heavy type of oil that comes out of Alberta's oil sands is known as Western Canada Select (WCS). Lighter oils generally receive higher prices than heavier oils, because they are easier and cheaper to process in refineries. Since the oil in WCS is much heavier than WTI, and further away from main markets, WCS is priced at a discount to WTI. It's also important to note that price discounts are also impacted by Alberta's access to markets. Other global heavy grades trade much closer to WTI. The easier it is to move our oil to refineries around the world, the less the price discounts will be.

According to the Canadian Association of Petroleum Producers, Canada is the largest foreign supplier of oil to the US at over 40 percent of all US imports. This is more than all OPEC producers combined and roughly 3 times what Saudi Arabia itself supplies. Almost all Canadian oil production goes to the US. Despite being a major oil producer, Canada actually refines little crude oil, which means most of what the country produces has to get shipped to refineries on the U.S. Gulf Coast which is now the world's largest heavy oil refining cluster.

Per a JP Morgan Global Commodities Research February 2018 Report, "Canadian Crude is extremely important for the refineries in the Gulf Coast of the US. With the declining supplies from Mexico and Venezuelan heavy crude…the need for Canadian Crude will only increase further." Oil is moved from Canada to the US by pipeline or rail at significant cost ($8-$21 per barrel). Canadian oil shipments by rail rose to a record 198,788 barrels of oil per day in May, but capacity is not rising fast enough to offset tight pipeline space. The cheapest method of oil transport is by oil tanker at only a few dollars per barrel but this raises concerns in the event of a spill. Canadian oil producers have to sell their product to refineries at a discount, to offset the difficulty and cost of getting it there.

The price gap between WCS and WTI has risen to its widest level in more than five years; at the time of writing WCS is trading $33.00 US a barrel below WTI. This means Canadian producers are getting far less for their oil than others do. This of course affects the earnings and cash flow of Canadian companies as well as the price level that stocks trade at.

The ability to increase the transportation capacity of WCS is likely to result in substantially higher prices for crude oil from Canada and higher stock prices for Canadian producers; although implementation is clearly not an easy task.