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Quick Hit — Keystone XL a good "next step" for Alberta. Agreed

"A good next step." That was how the Alberta Premier labelled yesterday's 3-2 decision by the Nebraska Public Service Commission in favour of a proposed alternate route for TransCanada's Keystone XL Pipeline. We tend to agree. In much the same way that my colleague Patrick Kenny deemed the overall impact of this announcement a "positive" for TRP valuations, it's likewise a longer-term plus for the provincial credit, subject to a few caveats of course. [We'd direct you to the NPSC website for the 65-page certified *KXL Pipeline Final Order* and related information, and of course there's load of additional detail on TransCanada's official KXL website.]

Before we get too carried away, note that there remain established avenues to protest KXL's alternative routing. As we understand it, opponents have 30 days to appeal the NPSC decision, with court challenges also seemingly likely. So it's not like we just cut the ribbon on a new, major expansion of oil pipeline capacity. Fact is, TransCanada expects that it will take about two years to get KXL in service *after* getting a full regulatory green light. And as my equity and corporate credit research colleagues rightly point out, contracted supply and medium-term utilization rates will need to be closely monitored.

In the meantime, a late-2017 surge in Alberta oil production—as new supply comes on stream and/or maintenance at some projects runs its course—has filled existing pipeline infrastructure to the brim. That's necessitated a rationing of pipeline space and driven the light-heavy differential to wider levels (in absolute and relative terms). As we type this, Western Canada Select (WCS)—Alberta's benchmark crude oil price—trades at a roughly US$16/bbl discount to West Texas Intermediate (WTI) (Chart 1), a hair's breadth away from the widest levels observed since summer 2015. If you prefer to think of the differential in proportionate terms, an approach that makes sense to us, then WCS currently trades at a 28% discount. That may be largely in-line with the average differential registered over the past couple of years, but it's the deepest relative discount since Alberta's 2017-18 fiscal year kicked off.

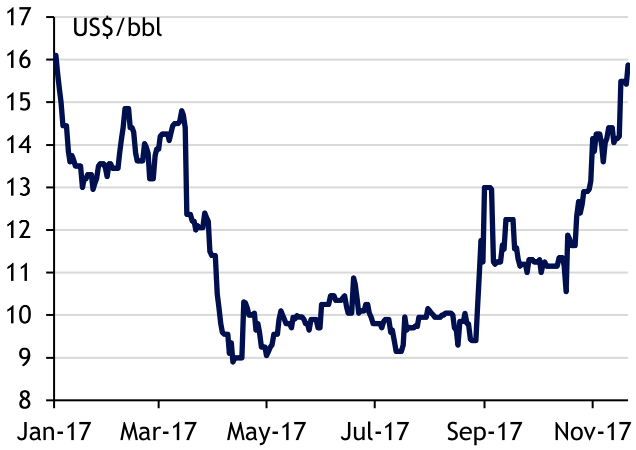
And from a provincial credit perspective, this differential is a big deal. As per official sensitivities, each US$1/bbl change in the light-heavy differential is worth $285 million to Alberta's bottom line, *all else equal*. So it's not exactly a stretch to say that the future trajectory for the differential will notably influence whether Alberta is able to secure the growth in non-renewable resource revenue currently built into its medium-term fiscal plan. For reference, Alberta's non-renewable resource revenues, last estimated at $3.4 billion for 2017-18, were expected to jump to $6.6 billion by 2019-20, growth almost exclusively linked to bitumen royalties.

Put another way, anything that increases efficiency in and/or lowers costs for Alberta's oil sands producers—and that's precisely what KXL could do longer-term—in turn lends support to what remains one the of the province's most vital own-source revenue streams. Notwithstanding a recent spill, pipelines can be viewed as the safest way to move oil around, certainly relative to an alternative of railing marginal barrels to market. Call that an intangible, but it's a non-trivial consideration, particularly given the projected long-term growth in non-conventional oil production in Western Canada (Chart 2). Refer to the table on page 2 for detailed analysis of oil production and pipeline capacity, illustrating the need for expanded pipeline capacity longer term.

In the end, yesterday's decision may have done little to *immediately* collapse the light-heavy differential, but seeing this project clear an important hurdle offers a glimmer of hope for Alberta oil producers that have struggled to get burgeoning supply to market in an efficient manner. As is natural, yesterday's KXL headlines also refocused attention on *other* pipeline projects or critical importance to Alberta's economic and fiscal well-being. Of note, getting the proposed TransMountain pipeline expansion done would provide another important outlet to get more Alberta crude to tide water. That pipeline, which previously had received the NEB's blessing, has faced its own heated resistance, including a federal court challenge where a decision is still forthcoming. Stay tuned.

Chart 1: Differential has widened of late

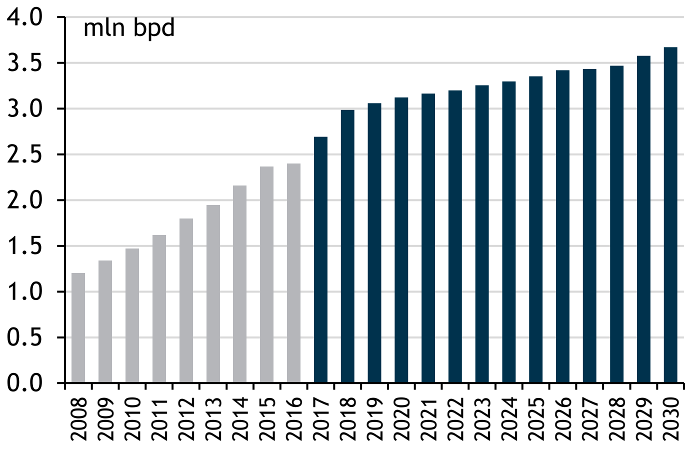
Light-heavy crude oil differential: WTI less WCS (spot)



Source: NBF, Bloomberg

Chart 2: Pipelines needed given extra production

Long-term oil sands production forecast

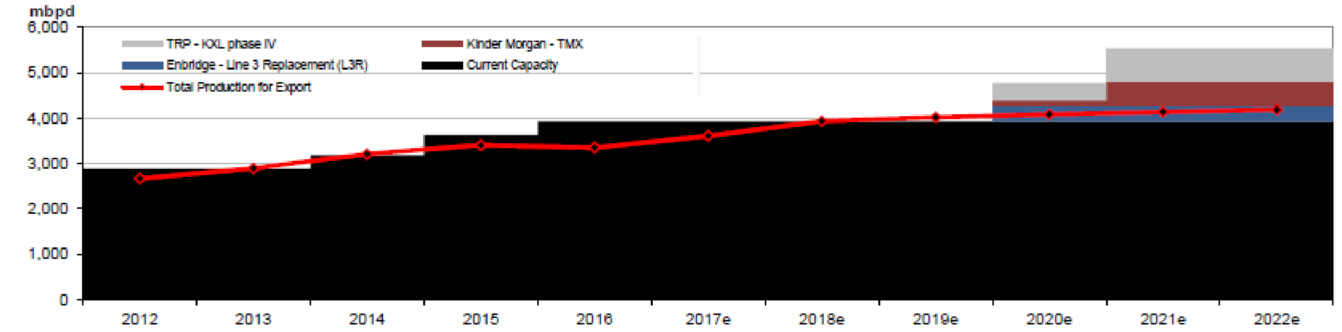


Source: NBF, CAPP (Jun-2017 forecast)

Table: Detailed analysis of Western Canada pipeline capacity/utilization

Courtesy of Patrick Kenny, NBCFM Research

WESTERN CANADA - PIPELINE CAPACITY / UTILIZATION[1]



mbpd	2012	2013	2014	2015	2016	2017e	2018e	2019e	2020e	2021e	2022e
Supply - WCSB (CAPP Forecast - June 2017)											
Conventional	1,037	1,099	1,127	1,019	901	855	812	797	786	785	786
Oil Sands	2,184	2,352	2,672	2,963	3,014	3,347	3,710	3,809	3,889	3,943	3,989
Total Production	3,222	3,450	3,799	3,982	3,915	4,202	4,522	4,606	4,675	4,728	4,776
Less: Local Refining	(559)	(559)	(591)	(583)	(567)	(596)	(592)	(592)	(592)	(592)	(592)
Total Production for Export (A)	**2,663**	**2,891**	**3,208**	**3,399**	**3,348**	**3,606**	**3,930**	**4,014**	**4,083**	**4,136**	**4,184**
Export Pipeline Capacity - Current											
Enbridge - Mainline	1,800	1,800	2,100	2,550	2,850	2,850	2,850	2,850	2,850	2,850	2,850
TransCanada - Keystone Phase I & II	591	591	591	591	591	591	591	591	591	591	591
Spectra - Express	280	280	280	280	280	280	280	280	280	280	280
Kinder Morgan - Trans Mountain	300	300	300	300	300	300	300	300	300	300	300
Inter Pipeline - Bow River	30	30	30	30	30	30	30	30	30	30	30
Pipeline Capacity - Existing	**3,001**	**3,001**	**3,301**	**3,751**	**4,051**	**4,051**	**4,051**	**4,051**	**4,051**	**4,051**	**4,051**
Utilization - Existing [1]	**99%**	**107%**	**108%**	**101%**	**92%**	**99%**	**108%**	**110%**	**112%**	**113%**	**115%**
Pipeline Capacity - Potential Expansions											
Enbridge - Line 3 Replacement (L3R)									370	370	370
Kinder Morgan - TMX									148	590	590
TransCanada - KXL									415	830	830
Utilization - Existing + L3R + TMX + KXL [1]								**110%**	**91%**	**79%**	**80%**
Total Operational Export Pipeline Capacity (C)	**2,701**	**2,701**	**2,971**	**3,376**	**3,646**	**3,646**	**3,646**	**3,646**	**4,485**	**5,257**	**5,257**
Pipeline Capacity Available	**38**	**-190**	**-237**	**-23**	**298**	**40**	**-284**	**-368**	**402**	**1,121**	**1,073**

(1) Assumes operational capacity of 90% nameplate capacity.

Source: CAPP, Company Reports, North Dakota Pipeline Authority, NBF Estimates

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