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THE NORTH ON PINS, NEEDLES AND TWO-BY-FOURS

District of Chetwynd continues to welcome forest industry investments, but liquefied natural gas is the future for the northern town

If you went looking for a single place that defines the challenges, "pure grit" and giddy potential facing northern British Columbia, the District of Chetwynd could be a contender.

Located 1,000 kilometres from Vancouver and 304 kilometres north of Prince George, the remote resource town of 3,100 in many ways reflects the current reality of northern B.C.

Hammered by a decade-long downturn in forestry after the devastation of the pine beetle infestation and a more recent mining slump, Chetwynd, like most of the north, is poised for a big-time payoff when liquefied natural gas (LNG) plants fire up on the northeast coast.

Spectra Energy (NYSE:SE), Shell Canada and Talisman Energy (TSX:TLM) all have natural gas facilities in the area, working the giant gas fields that arc east to Dawson Creek.

Meanwhile, Chetwynd is bracing for the May 26 closure of Walter Energy Inc.'s (NYSE:WLT) Brule coal mine, the latest in a three-mine shutdown that has put close to 700 people out of work since 2013. But it is also welcoming the opening of a shuttered pulp mill as a sign of recovery in the traditional forestry industry.

On the horizon is a share in a proposed $12 billion TransCanada Corp. (TSX:TRP) LNG pipeline that would run east to the ports at Kitimat and Blue Fuel Energy's planned $2.5 billion Sundance Fuels refinery that could someday turn natural gas into gasoline (see "Decision looming on Blue Fuel", page 29).

"We have all industries – oil and gas, farming, saw mills, pulp. West Fraser is just opening a bio-energy plant and a pellet plant is coming soon. There is pure grit here. No matter what happens in the global economy, we can adapt," said Chetwynd economic development officer Ellen McAvany.

Chetwynd Mayor Merlin Nichols said the opening of the old Tembec pulp mill reveals the flexibility of local workers.

"It [the pulp mill] shut down several years ago, and many of the workers went off to the coal mines," Nichols said. "Now the coal mines have shut, many of the workers have gone back to the pulp mill."

Richmond-based Paper Excellence (see story, page 30) officially brought the mill and its 136 workers back to work this month and will ship most of its specialty paper production to Asia.

Canfor (TSX:CFP) announced its plans for its Chetwynd pellet plant last fall. Once operating, the plant is expected to create 16 to 20 full-time positions.

West Fraser Timber's (TSX:WFT) bio-energy plant is part of a complete rebuild of its Chetwynd sawmill.

The company has a 20-year purchase agreement with BC Hydro for the power that the plant will produce by burning waste-wood products.

But Chetwynd and its northern neighbours can't count on the forest industry to reach its once lofty heights, cautioned James Gorman, president and CEO of the Council of Forest Industries (COFI).

The companies with the largest production within B.C. will be heavily affected by the mountain pine beetle infestation.

It peaked a decade ago, but the infestation's impact is now hitting lumber production, as fewer of the dead trees can be manufactured into wood products. Overall lumber production in B.C. dropped in 2014 for the first time in five years, and Gorman said it won't recover for decades.

COFI estimates that B.C.'s total allowable annual timber cut, which once averaged 72 million cubic metres, will drop to 62 million cubic metres this year and 52 million within five years and then level out at 44 million cubic metres per year in 2025 and for the rest of the century.

The annual allowable cut in the Dawson Creek timber supply area, which includes Chetwynd, remains at 1.8 million cubic metres, the same level it has been for 13 years.

Gorman added that falling lumber prices, a slower-than-expected U.S. home-building pace, a slump in the Chinese construction market, increased global competition and the return of duties this month on softwood lumber shipped to the U.S. combine to create a challenging year – and future – for northern wood producers.

It is LNG, therefore, where the long-term hope for Chetwynd and scores of other northern communities resides.

Calendars are being marked for mid-June, when the front-runner, Malaysia-based Petronas, is expected to announce its decision on its $35 billion Pacific NorthWest LNG plant at Prince Rupert. In the wings is a similar-sized bid from LNG Canada, a joint venture that includes Royal Dutch Shell,PetroChina, the Korea Gas Corp. and Mitsibushi Corp. for a Kitimat facility.

The latter includes construction of a multibillion-dollar, 650-kilometre pipeline linking Chetwynd-area gas fields to Kitimat.

TransCanada hopes the pipeline can proceed in 2016 with an in-service date "by the end of the decade." •

IS THIS AS FAR AS THE RALLY CAN GO?

Oil prices have surged to their highest levels to date this year, with Brent trading above $65 per barrel, and WTI close to $60 per barrel. The

EIA reported this week that crude oil storage dropped for the first time in months for the week ending on May 1, falling by 3.9 million barrels. Weekly production has flat lined over the past month as well, and ticked down again this week. With production stalling out and maybe, just maybe, storage flows having reversed into drawdown mode, the supply picture looks tighter in the months ahead. That suggests prices could continue to rise.

While the rally since March has been impressive, it also seems to be running up against its limits for the time being. There are still some underlying fundamentals that point to weakness in the oil markets, perhaps throwing into question the sustainability of the current rally. For example, crude stocks in the United States are still at 80-year highs. There are tens of millions of barrels in the Atlantic basin – from the North Sea to West Africa – that are having trouble finding willing buyers. Demand is picking up, but the International Energy Agency and OPEC both say that the world is still pumping 1.5 million barrels per day more than what the world is consuming. That signals that the glut is not over yet.

Moreover, higher oil prices could bring drillers back to work. With thousands of shale wells sitting on the sidelines waiting for a brighter day, drillers may start to complete those wells now that oil prices are up. Several U.S. drillers including Pioneer Natural Resources (PXD) and EOG Resources (EOG), two big Texas drillers, said that they are considering a return to drilling if oil prices stabilize in the $65-per-barrel range. That, in turn, will bring a new rush of oil to the market, potentially forcing prices back down again.

On top of that, Iran's Oil Minister Bijan Namdar Zanganeh said this week that his country could expand oil production within 10 days of the removal of sanctions, raising the prospect of new Iranian oil sooner than expected. For now, hedge funds and other big traders have been making bullish bets at a near record rate. But with the cracks showing, market sentiment could turn negative once again. Stay tuned.

Another oil train derailed in the United States this week, this time in North Dakota. The train, owned by Hess Corporation (HES), derailed and caught fire on May 6 2015. Fortunately, there were no injuries, but over 300,000 gallons of crude burned. The incident came only days after the federal government released new rules on crude-by-rail safety. On May 1 the U.S. Department of Transportation released new regulations that called for the gradual phase out of the older rail cars, as well as retrofitting cars with tougher brake systems. DOT also issued a speed limit on trains carrying oil. The industry criticized the rules for imposing steep costs, but environmentalists say the rules don't go far enough. Crude loading onto trains in North Dakota also has to comply with state rules that mandate the processing of oil to remove volatile natural gas liquids. Hess stated that its rail shipment was "fully compliant" with those standards.

Tension in the Persian Gulf subsided this week after Iran released the Maersk container ship that it had seized. Iran insists the matter was one over debt, not a power move near the world's most vital chokepoint for the oil trade. Fearing worse, the U.S. Navy sent destroyers to accompany other commercial ships through the narrow Straits of Hormuz. But after Iran released its captured ship, the U.S. Navy backed off. All sides likely breathed a sigh of relief. The tension had threatened to infect the nuclear negotiations, but has now blown over.

Saudi Arabia's King Salman reshuffled the top leadership in his government, consolidating power by putting allies in key positions. King Salman changed the line of succession, which on its face appeared to create some degree of certainty. By making his nephew Mohammed bin Nayef the Crown Prince, and his son Mohammed bin Salman the Deputy Crown Prince, King Salman ensured a smooth transition for the next several decades. However, the moves may have been less about creating certainty in the royal line than about concentrating power within a small circle. Traditionally, the King has been the most powerful figure, but he has also had to bring other princes on board to support a given policy. But now his two successors are in top government positions that reduce the need to bring others into the fold.

The heirs head up matters of security, foreign policy, and the economy. That could reduce dissent for King Salman's intervention in Yemen. In other words, the government reshuffling could allow King Salman a much more aggressive foreign policy. There are even murmurings that Saudi Arabia should pursue nuclear weapons for fear that Iran will eventually build one. Also, King Salman split up Saudi Aramco from the Oil Ministry, putting the state-owned oil company under royal leadership for the first time. It is unclear how that will affect Saudi Arabia's oil policy, but now more than ever, decision making will be in the hands of the King.

In Alberta, a surprise election result is likely making oil Canadian oil executives sweat. The conservative party was ousted after 40 years of rule, and the left-leaning New Democratic Party seized power for the first time in history. The NDP has vowed to be less accommodating to the oil industry, keeping open the possibility of raising royalty rates, participating in climate policy, and dropping support for major pipeline projects. Oil sands producers saw their share prices plummet on the news. The devil will be in the details, but the result is seen as a major setback for the oil-rich province.

On the other side of the Atlantic, the oil industry saw a different result. The Conservative party in the United Kingdom won a landmark victory, surprising the world by winning by a much larger margin than polls had suggested. Prime Minister David Cameron will retain power, winning an outright majority. The results were widely seen as a boon to oil and gas producers in the North Sea as the Conservatives are much friendlier to the industry. Both Royal Dutch Shell (RDS_A) and BP saw their share prices jump after the surprise election result on the prospect that tax treatment will be more favorable than it would under any other British government

ALBERTA HEAVY OIL PRICE UP ALMOST 80% SINCE MARCH

Price of Western Canada Select has risen by much more than other types of oil

The price of heavy oil from Canada's oilsands has quietly rebounded by 77 per cent in the past six weeks, far better than the comeback in other types of crude.

Most of the oil that Canada produces is called Western Canada Select, the benchmark blend of thicker, tarry bitumen-based crude oil that comes mostly from Alberta's oilsands. The price of WCS has stormed back from $29.71 a barrel on March 17, to $52.63 on May 6. That's an increase of more than 77 per cent in a little over 30 trading days.

What's more, it is almost twice as much as the surge seen in the North American benchmark WTI — West Texas Intermediate — over the same time period. And it's almost three times as much as the price surge seen in Brent, which is the type of oil that's the benchmark just about everywhere else in the world.

Why? The answer is a complex mix of factors including more pipeline capacity, increased rail shipments and some seasonality.

But the main one is that certain investments made by the oil industry several years ago when Canadian oil was undervalued are starting to pay dividends.

At certain points following the end of the recession in 2009, heavy oil from Canada traded at a discount of as much as $40 per barrel compared to WTI. That's because, despite being a major source of crude, Canada has very little refining capacity. So the vast majority of Canadian oil is exported to U.S. refineries for processing.

For many years, Canadian heavy oil had to accept a lower price because it was more expensive for those refineries to process.

But over the years refineries spent billions to make themselves better able to process heavier oil, and now the price gap has narrowed from $40 a few years ago to under $10 today with WCS changing hands at just over $51 a barrel on Monday, not much less than the $59 spot price for WTI.

Another factor in the rise of WCS is the many new pipelines, which have made it easier to get Canadian oil to U.S. refineries quickly and efficiently.

Thanks to these new pipelines, past bottlenecks have been washed away, and the situation is closer to a free market.

In addition to new pipelines, many older ones have been upgraded in order to be able to pump oil in multiple directions. That makes it easier to keep the supply and demand of crude in check.

Gasoline analyst Michael Ervin says he thinks the surge in WCS prices "is strongly linked to the increased export capacity afforded by the recent [late December] opening of the Flanagan South pipeline, which can take WCS crude from Enbridge's Canadian 'Alberta Clipper' mainline, and get it to Cushing, Oklahoma."

Cushing is often considered North America's oil hub, so getting your product there is the key to selling it on the global market.

Meanwhile, all those alternative routes to market are adding up. Pipeline company Enbridge last month said its system is moving about 300,000 more barrels of oil per day this quarter than it did in the same time last year, and that this is at a time when prices have cratered.

"The pipelines have provided more export capacity, and that's been helpful to pricing" is how oil analyst Jackie Forrest, with ARC Financial in Calgary, put it in an interview with CBC News.

TD Bank agrees with that assessment, saying in a recent research note: "Although there are likely several drivers of this relative outperformance, we contend that the overall market access for Canadian heavies continues to improve."

On top of pipelines, there's a lot more oil moving by rail than there used to be, too.

The National Energy Board says on average 173,342 barrels of oil were shipped by rail in Canada in the last three months of 2014. That's almost as much as the amount of crude-by-rail shipped in all of 2012. Next year that figure is forecast to jump to 600,000.

All those new ways of bringing oil to market are just another reason why there's increased appetite for Canada's heavy oil.

There's also some seasonality at play. Put simply, oil prices tend to increase in the lead-up to the busy summer driving season, and decline in the colder winter months.

That's happening this year, too. But there's driving-related demand for heavy Canadian oil even outside actual gas pumps.

"Spring is generally considered a period of seasonal strength for heavy oil" as the summer paving season tends to boost asphalt demand, TD Bank pointed out in a recent research note.

While there are lots of valid reasons for Canadian's heavy oil rebound, the billion dollar question is whether it will last.

When you consider factors like quality differences and transportation costs, heavy Canadian oil should be about $15 less than lighter WTI, Forrest says.

Right now the gap is under $10, which is unlikely to last, she says. But thanks to the new transportation systems and refinery upgrades, the days of massive price gaps are also likely a thing of the past.

"But there's going to be some choppiness," she said. "It'll be a see-saw recovery — as prices keep rising, it's likely we see some U.S. producers increase their supply, which will frustrate the price recovery."

Still, as Todd Hirsch, an economist with ATB Financial put it, "Even with the increase we're still in a weak price environment but it does reassure people that those doomsday scenarios in January seem less likely."

DECISION LOOMING ON BLUE FUEL GAS PLANT

A decision could be made this year on a proposed $2.5 billion gas plant near Chetwynd that would generate hundreds of full-time jobs.

Blue Fuel Energy says it hopes to have an environmental assessment certificate granted by mid- to late 2015, and it will make a final investment decision by year's end.

The large natural-gas-to-gasoline and methanol plant planned for a 427-hectare (1,005-acre) site outside Chetwynd is projected to create 1,500 to 2,000 jobs during construction and 250 to 300 full-time positions once it's up and running, according to Blue Fuel CEO Juergen Puetter.

The first phase of the Sundance Fuels project will consist of a plant that will use natural gas, wind and hydro power to produce reduced-carbon gasoline. Canadian Methanol Corp. will lead the second phase and will require a second plant on the site, using the same natural gas to produce methanol, which will be sold overseas to develop plastics, lubricants and gels.

All told, the capital cost of the Sundance Fuels facilities is projected to be in the range of $3 billion to $4 billion.

Two hurdles remain for the project: a shortage of local labour and the lack of a secure source for the natural gas.

Blue Fuel's communications director, Alan Bryce, admits the company doesn't have any firm plans yet on a natural gas source.

The plant is in the permitting stage with the provincial government, and Blue Fuel is working closely with the BC Oil and Gas Commission, the Agricultural Land Commission, Canadian National Railway and the District of Chetwynd. Plant construction is estimated to take two and a half years. Initial production is projected to start in late 2018.

WESPAC MIDSTREAM GETS NEB NOD

The Canadian National Energy Board (NEB) has approved WesPac Midstream's application for a 25-year natural gas export licence.

The licence has a maximum term quantity of 116.44 billion m3, and has been issued subject to the approval of the Governor in Council.

When evaluating natural gas and LNG export licence applications, the NEB considers if the quantity of gas proposed to be exported is surplus to Canadian requirements.

As such, the NEB has determined that the quantity of gas proposed for export by WesPac is surplus to Canadian needs.

The approved export points are the outlet of the loading arm at the WesPac LNG Marine Terminal in Delta, British Columbia (B.C.); the marine cargo terminals in Vancouver, B.C.; and the highway border crossings along the international boundary between B.C. and the US.

12-May-15				
	Active	Down	Total	% Active
Western Canada				
AB	53	472	525	10%
SK	8	124	132	6%
BC	20	62	82	24%
MB	-	15	15	0%
WC Total	81	673	754	11%
Eastern Canada				
QC	-	1	1	0%
Canada	81	674	755	11%