THIS SHIP HAS SAILED :

Maritime vessels abandon heavy oil in favour of cleaner alternatives

DOMINIQUE BARKER, CFA,
Portfolio Manager, Senior Analyst
ESG and Real Estate

At CIBC Asset Management, we strive to be at the forefront of active money management. Every decision we make is based on how to make money for our clients and we believe strongly in incorporating Environmental, Social, and Governance (ESG) factors in our analysis. This provides us with better tools and insight into existing opportunities and risks, and enables us to make better investment decisions.

We recently published an article about how the demand for oil is being disrupted by the coming electric vehicle revolution (refer to "Oil–Will It Go the Way of Salt?"). In addition to the falling demand for oil from the electrification of the vehicle fleet, it's worthwhile to point out a second source of demand destruction—the maritime vessels fleet. The International Maritime Organization (IMO) recently reconfirmed the timing of its rules to cut the amount of sulfur emissions from ships worldwide, from 3.5% (current level) to 0.5% by 2020. These emissions come from the burning of bunker fuel, which contain SOx, NOx and particulates[1].

While maritime demand for oil may seem like a niche market, the global shipping industry currently consumes around 5 million barrels per day[2] (bpd) of bunker fuel. Given that total oil demand globally is around 100 million bpd, the shipping industry is a material consumer of oil.

> "the global shipping industry currently consumes around 5 million barrels per day[2] (bpd) of bunker fuel"

To decrease sulphur emissions, shipping vessels have three options: switch to low-sulphur fuel, install scrubbers on the ships (an expensive option), or use alternative fuels such as LNG (liquid natural gas), methanol and biofuels. These cleaner alternatives will eventually displace the demand for bunker fuel, the fuel that is sourced from heavy oil.

Unfortunately, Canada produces mostly heavy oil[3]. The price of heavy oil is already discounted, as measured by the differential between WCS (Western Canadian Select) and the lighter oil standard benchmark price set by WTI in Texas. The wider the differential, or price difference, the less money Canadian producers make. As demand for heavy fuel oil is impacted by these new IMO regulations, Canadian heavy oil producers will likely feel the crunch more than light oil producers. We are already seeing an impact in the futures market, which is indicating wider differentials as a result of this rule.

The reason we raise these issues is to reinforce the concept of *sustainability* when making investment decisions. As we move towards a more carbon-constrained world, it is inevitable that demand for oil will fall. The IMO is implementing these regulations to reduce global emissions—evidence that supports our view that ESG factors are important to measure in the investment management process.

A final point on the eventual waning interest in oil—on March 15, 2018, Statoil, Norway's biggest petroleum company (market cap US$77b), changed its name to Equinor, thereby relinquishing the inclusion of *oil* in its name. In the press release announcing the change, Chairman Jon Erik Reinhardsen said, "The biggest transition our modern-day energy systems have ever seen is underway, and we aim to be at the forefront of this development."

At CIBC Asset Management, we feel much the same way about the investments we make.

For more information, visit: www.cibcam-institutional.com

[1] Sulphur Oxides (SOx), nitrogen oxides (NOx) and particulate matter are emissions that can have a significant negative impact on air quality.
[2] Source: Morgan Stanley, "*Compliant Fuel Favoured for Shipping Sulphur Regs*", March 8, 2018
[3] Canada's oil production totals approximately 4 MMbpd, 60% of which is from oil sands—which is heavy oil.