Buffett Isn't the Only Smart Investor Jumping into the Oil Sands

Description

Recently it was revealed that Warren Buffett's **Berkshire Hathaway** (NYSE: BRK-B) had taken a $500 million stake in Canada's **Suncor Energy** (TSX: SU) (NYSE: SU). However, it should also be noted that he is not alone as well-known investors like T. Boone Pickens and Steven Cohen have also recently been buying shares of the oil sands developer. The question investors need to be asking is…why Suncor?

The Buffett connection

What's interesting, at least from a Berkshire Hathaway standpoint, is that there are some intriguing synergies with Suncor. Berkshire's rail subsidiary, Burlington Northern Santa Fe, is actually a key logistics provider to oil sands producers. Due to pipeline constraints, the oil-by-rail business has been booming and Berkshire's subsidiary currently holds a 40% market share in hauling petroleum products by rail.

The boom isn't showing any signs of letting up and it is estimated that North American crude oil shipments will grow by another 42% by 2017. While that's a much slower pace than the astounding 28,000% over the past five years, it is also off a much larger base. What is clear is that over the past few years Buffett has gained direct knowledge of Suncor's oil sands business by shipping that oil on his railroad. He must really like what he sees.

What Buffett and other smart investors are seeing is the production growth potential of Suncor. However, that oil sands production had been trending down all year as the company has had issues with **Enbridge's** regional oil sands pipeline system. In fact, aggregate production in June and July were reduced by almost three million barrels due to temporary derating and shutdowns. This has caused Suncor's average daily production per month to slip from 346,000 barrels per day to start the year to a year-to-date average of 328,000 barrels per day as of last month.

Sunny growth plans

That being said, despite a million barrels of oil production being cut from its July production numbers due to the aforementioned issues with Enbridge's system, Suncor delivered a monthly average of

390,000 barrels of oil per day for the month from its oil sands business, which was its best month of the year. Looking ahead the company has enough planned growth projects to add another 350,000 barrels of oil per day to its production by 2020. That would represent 64% growth over its 2012 overall base production of 549,000 barrels of oil equivalent per day. It's this visible oil rich growth that these smart investors are looking to capture.

On top of all that growth, Suncor has done a solid job of managing its capital. Its leverage is low with a total debt to capitalization of just 22%, and the company has had enough money left over after investing in growth to pay an increasing dividend by a compound annual rate of 30% over the past 5 years while also buying back 5% of its shares outstanding since 2011. Visible growth while also returning cash to shareholders is a recipe for market-beating long-term returns.

Final Foolish thoughts

Suncor is a solid company with a dominant position in the oil sands region, which is what has attracted these smart investors. While its stock might be a bit pricy at 19 times earnings, it is rare to get a premium company without the premium price tag. If the company can deliver on its growth plans, and Buffett can continue to give its oil a ride in order to bypass the pipeline issues, the stock should do very well over the long-term.

The way to play Canadian energy that even the smart investors are missing

The oil sands have really taken the energy spotlight in Canada, however, there is another way to play Canada's energy resource dominance. Uranium – the key ingredient in nuclear power – has the potential to be *the* energy source of the next 100 years.

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Fool contributor Matt DiLallo is long Jan 2014 $70 calls on BRK-B and short Jan 2013 $97.50 calls on BRK-B. The Motley Fool owns shares of Berkshire Hathaway.

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mdilallo