Why Suncor Energy Should Be in Every Investor's Portfolio

Description

Despite ongoing infrastructure constraints affecting the ability of players in Canada's oil patch to move their crude to market, integrated energy giant **Suncor Energy** (TSX: SU)(NYSE: SU) continues to report record results.

For the first quarter 2014, Suncor reported its best financial quarter on record, underpinned by a solid though unimpressive operational performance. These results, plus some attractive valuation metrics and a further dividend increase, make it a core addition to any portfolio.

Record quarter
Suncor reported an impressive first-quarter 2014 result, its best on record. Revenue popped 5% in comparison to the same period in 2013 and 3% compared to the previous quarter. But more importantly, cash flow from operations – a key measure of an energy company's financial and operating performance – shot up an impressive 26% year over year and 23% quarter over quarter.

Suncor was left with a bottom line of $1.5 billion or $1.01 per common share, a solid increase of 36% year over year, and a massive 2.5 times quarter over quarter. These strong results were achieved despite daily crude production falling for the first quarter 2014 by 8.5% when compared to the same quarter in 2013 and by 2.3% compared to the previous quarter. The record financial results can be attributed to higher crude prices coupled with a narrowing price differential between Canadian heavy and light crude blends to the West Texas Intermediate benchmark price.

Suncor also reported stronger performance from its oil sands and refining business segments for the quarter, which saw a production record set for synthetic crude production of 312,200 barrel daily. Synthetic crude has a lower price differential to West Texas Intermediate than heavy crude and bitumen, making its production an important revenue driver.

However, even more impressively, Suncor boosted its return on capital employed for the fifth successive quarter to an impressive 12.6%, a whopping 5.5% increase over the same period in 2013 and 1.1% compared to the previous quarter. This makes Suncor one of the most efficient employers of capital in the patch. It is only marginally lower than the 12.9% reported by **Imperial Oil** (TSX: IMO

)(NYSE: IMO) – considered to be the most efficient — for the fourth quarter 2013.

2014 guidance remaining on track
On the back of such a strong quarterly performance, Suncor reiterated its 2014 guidance in late April 2014, with management expecting the company to achieve average daily crude production of 525,000 to 570,000 barrels. This is roughly equal to full year 2013 average daily production, but with the company able to access higher prices, it bodes well for an improved full year 2014 financial performance.

For the year-to-date, Canadian light crude or Edmonton Par is up by 4% and Canadian heavy crude or West Canadian Select is up a massive 27%. The particularly solid growth in the price of Canadian heavy crude is a boon for Suncor with oil sands production expected to make up 75% of Suncor's total 2014 production, boding well for a continuing strong financial performance through 2014.

All of these factors bode well for another dividend hike
Currently Suncor pays a quarterly dividend of $0.23 per share, giving it an annualized dividend yield of just over 2% and a conservative dividend payout ratio of 28%. This low payout ratio coupled with the company's record first quarter 2014 financial results and the potential for it to continue that trend throughout 2014, makes it highly likely that a dividend hike is on the table at some stage during the year.

When the potential for a dividend hike is considered in conjunction with Suncor trading with an enterprise value of a mere 5 times EBITDA and 8 times its oil reserves, the company appears attractively priced. These ratios also make it appear cheaper than many of its peers, being lower than Imperial Oil's enterprise-value of 9 times EBITDA and **Canadian Natural Resources** (TSX: CNQ)(NYSE: CNQ) enterprise-value of 7 times EBITDA.

Suncor's dividend yield is also double Imperial Oil's 1% and equivalent to Canadian Natural Resources 2%, making its valuation ratios appear even more attractive for investors.

Foolish bottom line
After many years of reporting poor financial performances and seeing operations languish primarily due to the inefficient employment of capital, Suncor is starting to fire on all cylinders. Yet the market hasn't fully priced this into its share price, making the company attractively priced at this time, especially when the likelihood of yet another dividend hike is considered.

CATEGORY

1. Investing

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2. NYSE:SU (Suncor Energy Inc.)
3. NYSEMKT:IMO (Imperial Oil Limited)
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6. TSX:SU (Suncor Energy Inc.)

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