Is Suncor Energy Inc a Good Bet for Dividend Investors?

Description

Dividend-based income investing certainly has its attractions, especially in an era of super-low deposit rates. Apart from initial yields that may be considerably higher than the available deposit rates at the major banks, investors may also be looking forward to growth in dividends over time.

However, this approach does not come without its risks, as the primary concern is the ability of the company to sustain and grow its dividend year after year. I have written several times in the past about the characteristics of true “dividend champions” — those companies that are unlikely to disappoint their dividend investors.

Suncor Energy Inc (TSX: SU)(NYSE: SU) used to be a rather miserly dividend payer, and very few investors would have held the stock for income purposes. However, over the past four years the company pushed ahead with a more liberal dividend policy, improving the annual dividend from $0.40 in 2010 to its current value of $0.94 per share, which equates to growth of 135%. The 2014 yield on the current share price is still fairly low at 2.4%, but it could become very interesting for income purposes with further growth in the dividend.

The key question for income investors is whether Suncor would be able to sustain and grow its dividend over time. The analysis below follows my standard “dividend champion” methodology.

A track record of consistent and growing dividend payments

Suncor certainly scores well, having paid and increased its dividend consistently over the past 20 years.

However, the company is faced with volatile product and input prices, which can result in considerable swings in profitability. Oil prices have been consistently high and rising for the past 10 years, creating a favourable climate for the company, but that may not always be the case.

A rock-solid balance sheet

Suncor has only a modest level of debt and its debt to equity, assets to equity, and interest cover ratios are well within reasonable limits. This provides some degree of comfort that the dividend can be maintained should the profitability of the company come under pressure in future years.

A payout ratio that leaves room for unforeseen events

The cyclical nature of the company’s profits, especially its free cash flow, is an important factor to consider. For a company with Suncor’s profile, it is preferable to see a payout ratio of less than 50%, which would provide some wiggle room should the company face an extended period of low product prices.

Suncor has been paying around 30% of free cash flow as a dividend over the past few years, but it has to be noted that free cash flow was negative between 2007 and 2010, when the company substantially increased its capital expenditure program. Over the past five years the company spent on average more than $6 billion per year to sustain and expand its production capabilities. Capital expenditure is expected to be sustained at this level for the next few years.

Will Suncor be able to sustain and grow its dividend payments?

Suncor has a solid track record of dividend payments, a declared willingness to continue with regular payments, a sound balance sheet, a relatively low payout ratio, and ample current free cash flow to support its dividends.

It is very likely that the company will be able to continue to pay and grow its dividends for the foreseeable future, but the high level of sensitivity of the company's profits to volatile and unpredictable commodity prices creates a level of uncertainty regarding the sustainability of its dividend payments during periods of prolonged oil price weakness. I therefore don't consider Suncor a true dividend champion and do not recommend it for investors dependent on constant and growing dividend income.

CATEGORY

1. Investing

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1. NYSE:SU (Suncor Energy Inc.)
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Date
2025/08/20
Date Created
2014/08/05
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