2 Reasons to Avoid Suncor Energy Inc., and 1 Stock to Buy Instead

Description

When looking at professionally managed Canadian equity funds, **Suncor Energy Inc.** (TSX: SU)(NYSE: SU) is often one of the largest holdings. This should not be surprising: Suncor is Canada's largest energy company, and also the fifth-largest publicly traded company in the country. Even Warren Buffett holds shares.

But there are reasons to avoid adding Suncor to your portfolio, and two of them are shown below. Then we take a look at a stock you should consider instead.

1. Poor economics

Energy is a very capital-intensive sector to be in, and this leads to challenges. In plain English, energy companies must constantly spend money just to maintain current levels of production. Companies that have the best assets, and the best economics, thus have a big advantage.

And Suncor does not appear to be one of those companies. This came to light very recently, when partner Total pulled the plug on its $11 billion Joslyn oil sands project, in which Suncor owns a 36.75% interest. The two companies, however, are still developing the $13.5 billion Fort Hills project. And there's some bad news: Fort Hills has marginal economics as well, with a cost of $75,000 per flowing barrel, one of the highest in the industry.

It should be telling that Suncor is going ahead with this kind of project; evidently, it doesn't have better uses for its money, and that should be very concerning for long-term shareholders.

2. Too spread out

We all know that investors should seek out diversification. And with Suncor, you can get diversification with just one holding. The company has operations in Alberta, Eastern Canada, the United States, Europe, and even in Tripoli. In addition, Suncor has a big refining and marketing business, best known for the Petro Canada gas stations. So what's not to like?

Well, you usually don't want to see one company involved in so many business lines. It often means it lacks focus and just wants to be as big as possible. Students of history may remember the 1990s, when Suncor sold its gas station business to focus on producing energy. Then, in 2009 it reversed course with the $17 billion acquisition of Petro Canada.

Such actions are by no means awful, but it's usually better to find companies that do just one thing, and do that thing very well.

1 stock to buy instead: Canadian Natural Resources Ltd.

Canadian Natural Resources Ltd. (TSX: CNQ)(NYSE: CNQ) is Canada's second-largest energy company, with a market capitalization of nearly $50 billion. It also has some big advantages over Suncor.

First of all, its projects typically have better economics, especially when compared to Fort Hills. For example, its latest Horizon project expansion costs less than $20,000 per flowing barrel.

Secondly, it is more focused than Suncor — while there are some international operations at CNRL, they are very minor. And there is no gas station business.

Finally, CNRL has shown to be very good at what it does, which is deploying capital and controlling costs. Investors have been richly rewarded thus far, with a 17% annual return over the past 15 years. Meanwhile, Suncor shareholders have earned 13%. So when choosing between the two companies, the choice should be clear.

CATEGORY

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