



4 Reasons Suncor Energy Inc. Is a Quality Business at a Reasonable Price

Description

Followers of legendary investor Warren Buffett know that his impressive track record of beating the S&P 500 in 47 out of 55 recorded years, with compound annual returns over 20% for the period (vs. roughly 9% for the S&P 500), is the result a simple investment philosophy: buy high-quality businesses for fair prices.

It should be no surprise then that Warren Buffett's **Berkshire Hathaway** increased its stake in **Suncor** ([TSX:SU](#))([NYSE:SU](#)) by 27% in Q2 2014, adding 3,458,330 shares bringing its total position to 16,458,330 shares. Here's why Buffett increased his stake.

Wonderful management

Suncor CEO Steve Williams is focused on returning value to shareholders through a strategy of capital discipline, a focus on profitable growth, and operational excellence. With regards to capital discipline and profitable growth, Steve Williams has marked a huge departure from previous CEO Rick George in ensuring every dollar of the capital budget is spent wisely, with a focus on producing the highest possible value for the lowest possible amount of capital.

Williams has made a commitment to invest only in projects with a return on capital employed (ROCE) of at least 15%, and returning additional dollars that cannot meet this threshold to shareholders through dividend increases and share buybacks. He has been succeeding, reducing the capital budget from \$7.8 billion to \$6.8 billion recently, and improving the ROCE from 10% to 13%, moving towards that 15% goal. This has been done through investing in low-cost and risk, high return projects such as debottlenecking initiatives.

Extra cash has been returned to shareholders with buybacks, and Suncor has been buying back enormous amounts of shares, with 10% of its float being repurchased since 2012, and only at reasonable prices.

A dividend growth champion

Cash that is not used to buy back shares is being used to hike dividends, and Suncor has been

boosting dividends consistently in a sustainable manner. Suncor's yield is currently sitting at 2.17%, and has consistently grown its dividend every year since 2005, rising from \$0.12 per share annually to \$1.12 per share annually today (\$0.28 per quarter X 4). In the most recent quarter, Suncor responded to a drop in earnings by hiking the dividend by a huge 22%. With a current payout ratio of only 33% for the trailing 12 months, plenty of free cash flow, and a CEO focused on returning cash to shareholders, Suncor's dividend will only rise.

An integrated business model

Warren Buffett likes to speak of companies having a strong competitive edge, and Suncor has this with its highly integrated business model. Suncor extracts oil and gas, refines it, and sells it through its retail Petro-Canada chain of gas stations. This allows Suncor to better capture value wherever it presents itself in the value chain, either in its upstream (extracting), midstream (refining), or downstream (selling) operations.

Suncor's sheer size, market control, and diversity provides it a competitive edge, which has allowed more than 90% of the companies production to capture higher International Brent Pricing.

Attractively priced

Finally, Suncor is trading at a reasonable price, with a forward price-to-earnings ratio of 11.1, price-to-book ratio of 1.5, and price-to cash flow ratio of 7.2. Suncor's closest peer, **Imperial Oil**, is currently trading at a forward price-to-earnings ratio of 12.9, price-to-book ratio of 2.2, and price-to-cash flow ratio of 11.8. Much of this discount is due to Suncor's recent quarter, which saw losses due to several one-off impairments, making this a great time to buy.

The bottom line

Suncor is a highly integrated business with a strong competitive edge, careful management, solid growth prospects, and a commitment to delivering for shareholders. Much of this value however has not been factored into the share price, making the company attractively priced.

CATEGORY

1. Energy Stocks
2. Investing

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1. NYSE:BRK.B (Berkshire Hathaway Inc.)
2. NYSE:BRKA (Berkshire Hathaway Inc.)
3. NYSE:SU (Suncor Energy Inc.)
4. NYSEMKT:IMO (Imperial Oil Limited)
5. TSX:IMO (Imperial Oil Limited)
6. TSX:SU (Suncor Energy Inc.)

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Date

2025/08/23

Date Created

2014/09/18

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