



Suncor Energy Inc.: Difficult Times Ahead?

Description

For better or for worse, the share price of **Suncor Energy Inc.** ([TSX: SU](#))([NYSE: SU](#)) is dependent on the price of oil. With the price of oil now down by more than 20% from the June peak, Suncor's share price has followed suit, dropping by a similar margin.

While the quarterly results already reflected some impact of lower oil prices, the market is already focused on an environment where the oil price will be considerably lower than in the recent past.

A reasonable third-quarter financial result

Suncor announced earnings per share of \$0.62 for the third quarter, which was 45% lower than the comparable quarter last year. Operating earnings per share and cash flow per share, which are better measures of financial performance for Suncor, declined by 6.3% and 7.7%, respectively. Revenues fell only slightly but expenses increased by 10%, mainly as a result of an unrealised foreign exchange loss on U.S dollar debt, resulting in the sharp drop in net income and earnings per share.

The star performer for the quarter was the refining and marketing section (including Petro-Canada), where net income and operating cash flow jumped by 22% and 35%, respectively. Scheduled maintenance work at three refineries decreased refinery utilisation to 94% from 98%, but improved refining margins made up for the shortfall in refined product sales.

Total upstream oil production decreased by 13% to 519,300 barrels of oil equivalent per day compared to the same quarter last year. This was the result of the sale of the conventional natural gas business, planned maintenance in the exploration and production division and reduced production from Libya. The oil sands operations increased production by 4% to 411,700 barrels per day compared to last year mainly due to the ramp-up of production at the Firebag facility.

Healthy cash flow and a sound balance sheet

The cash flow of the business remains strong, with 28% of revenues converting to operating cash flow while free cash flow (that is, operating cash flow minus capital expenditures) amounted to \$1.9 billion for the first nine months of the year. The balance sheet is still in good shape, with net debt of \$6.6

billion representing a very manageable 22% of total capital.

The company paid a \$0.28-per-share dividend during the third quarter, which was 40% higher than the previous year. Suncor also purchased 53.3 million shares (3.7% of current outstanding shares) from the market for cancellation over the past year and renewed the purchase authorisation for another \$1.1 billion until August 2015.

Outlook for the full year unchanged

The full-year 2014 production, sales, operating costs, and capital expenditure outlook as previously provided by company management remains unchanged except that oil and gas prices are now expected to be somewhat lower than previously estimated.

It all depends on the direction of the oil price

Numerous factors play a role in the profitability of the Canadian integrated oil producers, including production volumes, benchmark oil prices, the price differential between benchmark oil prices and the price received for locally produced oil, refining margins, and the movement in the Canadian dollar exchange rate.

However, Suncor's profit is highly sensitive to the price of oil. The company estimates that based on the 2013 financial sensitivities, a US\$1.00 decline in crude oil prices would detract roughly 2.5% from annual profits, assuming that all other factors including refining margins and the exchange rate remain unchanged. Based on an oil price lower by \$10/barrel in 2015 compared to 2014, and assuming all other factors remain unchanged, Suncor's profits could be 25% lower in 2015.

The average West Texas Intermediate price so far in 2014 was \$97 per barrel compared with the current spot price of \$82 per barrel. Should this become the new price level for 2015, the profits of Suncor and those of other oil producers will be seriously affected.

Despite Suncor's obvious qualities, I would sit on the sidelines until the oil price settles.

CATEGORY

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2. Investing

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