How Prepared Is Suncor Energy Inc. for Sub-$50 Oil?

Description

On Monday, oil producers received yet another round of bad news. This time, the benchmark oil price in the United States fell below US$50 per barrel. And the news could easily get worse. Countries such as Canada, the United States, Russia, and Iraq have been increasing production even as prices fall. Meanwhile, Saudi Arabia is unwilling to cut production, no matter how low prices go. Analysts generally expect a six-month lag before the oil market corrects itself.

Until then, Canada's energy producers are affected in different ways. The high-cost producers, as well as those with stretched balance sheets (or otherwise in need of funding) are particularly hard hit. On the other hand, those with lower-cost operations and little debt are better prepared to ride out the storm.

On that note, below we take a look at **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), whose shares dropped by more than 4% on Monday. Just how will low oil prices affect Canada's biggest energy producer? Below we take a look.

Luckily, Suncor has a strong balance sheet…

A little over two years ago, Suncor had plans to grow oil sands production to one million barrels per day by 2020. Those plans are now long gone, as high-cost projects (such as the $11.6 billion Voyageur upgrader) have been abandoned. Now the priority is on discipline and cost containment.

That shift has benefited Suncor and its shareholders immensely. As of September 30, the company had just $6.6 billion in net debt, compared to nearly $42 billion in shareholder equity. This is one of the lowest debt ratios in the industry.

…fairly low-cost operations

In the most recent quarter, Suncor continued to wean costs out of its operations, with oil sands operating costs totaling $31.10 per barrel. In 2013, that number was up at $37.00. With oil sands crude trading just below $35, these cost savings make a big difference.

Granted, this does not mean Suncor is making enough money to cover its capital costs. But it does mean the company can survive as it rides out the storm.

…and a thriving downstream business

Through the first nine months of 2014, Suncor made nearly as much money from Refining & Marketing (which is best known for the Petro Canada gas stations) as it did from the oil sands. And as oil prices decline, Refining & Marketing will account for an even bigger share of earnings.

This is yet another blessing for Suncor and its investors, as it provides some much-needed diversification. It should thus surprise no one that the company's shares have declined by only 25% since their peak in June. Meanwhile, many of Suncor's peers have seen their shares decline by more than 50%.

So should you buy the shares?

At this point, buying any Canadian energy company is very speculative. I would wait at least six months to see if the picture gets any clearer. But if you insist on getting exposure to the sector, Suncor is certainly one of the safest ways to do so.

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