1 Reason Warren Buffett Is Buying Suncor Energy Inc.

Description

This is my favourite way to invest in the oil patch — and apparently Warren Buffett agrees with me.

The company is **Suncor Energy Inc** (TSX:SU)(NYSE:SU), the country's largest oil producer. Last quarter, Buffett bumped up his stake in the energy giant. According to SEC filings, his total investment stake was valued at US$710 million as of December 31.

Now Suncor might seem like an odd investment, especially for Buffett. After the drop in oil prices, the company's profits have plunged. And the stock is not necessarily cheap, given that shares trade at a premium relative to peers.

So what does the Oracle see in Suncor? Two words. Capital allocation.

What Warren Buffett can teach us about investing

OK, I know some readers might be rolling their eyes. Throwing around financial jargon like that is enough to put some people to sleep.

But wrapping your head around this concept is key to understanding Buffett's brilliance… and potentially finding similar Buffett-like investments on your own.

In the case of Suncor, the company isn't the fastest growing or the cheapest. But management at the Calgary-based company are exceptional stewards of shareholder capital. And that can make a huge difference in investor returns over the long haul.

Since taking the helm in 2011, new CEO Steve Williams has dialed back the company's growth ambitions. Suncor's new policy is as follows: Every dollar reinvested back into the business must earn a sufficient return for shareholders. If management cannot find enough profitable projects for investment, extra cash will be returned to investors.

This policy has freed up an enormous amount of capital. During his tenure, Williams has more than doubled the size of the company's dividend and repurchased over 12% of outstanding shares.

suncor

Image not found or type unknown

Source: Suncor Investor Presentation

But while this policy might sound like common sense, such discipline is rare in the oil patch. Most oilmen prefer the thrill of drilling new wells. But while guiding over a larger business empire might stoke executive egos, a healthy self-esteem never funded anybody's retirement.

Growth for the sake of growth is a bad policy from a shareholder's point of view, especially when you consider Suncor's main business is in the Alberta oil sands. These are enormously capital intensive projects that run on thin profit margins. That's not exactly the hallmark of a wonderful business.

If you were approached by a friend or family member to invest in a private oil sands deal, you would probably demand a healthy double-digit rate of return. But at today's commodity prices, a new oil sands project is a breakeven proposition at best.

Nothing changes just because Suncor is a public company. Why plough earnings back into these low-return ventures? It's a far better idea to give profits back to investors where they can earn better returns elsewhere.

Unlike most of his peers, Mr. Williams isn't pushing for growth at the expense of shareholders. Sure, that means he will have to guide over a smaller company. But this policy is a much better deal for investors.

Warren Buffett's No. 1 tip for investing success

And it’s not just Suncor that has a ravenous appetite for its own stock. **IBM, Coca-Cola, American Express** — many of Buffett’s holdings have long track records of buying back shares and paying out dividends, even if that means slower growth.

When you’re looking for great investments, check to see if executives are on your side. Short of a polygraph test, these are the surest signs of a shareholder-friendly management team.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

Category

1. Energy Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/07/03
Date Created
2015/02/20
Author
rbaillieul