Why You Shouldn’t Let the Rout in Crude Stop You From Buying Suncor Energy Inc.

Description

The oil rout has brought the viability of Canada’s energy patch into question, triggering a savage sell-off of oil stocks in recent months. This makes now the time to invest, with the current share prices for many still-profitable companies being ridiculously cheap. One company that stands out for all the right reasons is **Suncor Energy Inc.** (TSX:SU)(NYSE:SU).

So what?

Suncor is Canada’s largest integrated energy company, and over the past six months, its share price has plunged 24%, giving it some attractive valuation metrics. These include an enterprise-value (EV) of five times EBITDA and seven times its oil reserves.

Nonetheless, investors should not base their investment decisions on valuation ratios alone. So let’s pop the hood on Suncor and see what makes it a good opportunity in the current environment.

Suncor has a globally diversified portfolio of quality conventional and non-conventional oil assets, with reserves totaling 7.7 billion barrels. This ownership of international oil assets is important because it allows Suncor to access international Brent oil pricing. Since 2010 Brent has traded at a premium to the North American benchmark price, West Texas Intermediate (WTI). This premium is now a massive 19%, giving Suncor a pricing advantage over those companies that can only access WTI prices.

I expect this premium to remain at this level for some time. This is because North American crude inventories have hit record levels and U.S. crude production continues to grow, despite the U.S. rig count falling to its lowest level since early 2010.

One of the greatest concerns among analysts is the high breakeven costs of oil sands production. These costs can be as high as $90 per barrel for new projects, making them uneconomical in an environment where WTI is trading at US$50 per barrel.

In Suncor’s case, its portfolio of existing oil sands projects have an average breakeven cost of around US$30 per barrel, among the lowest in the patch. This is far lower than the current price for WTI and highlights that Suncor can remain profitable, even in the current environment.

Another edge that Suncor has over many smaller oil producers is its downstream, or refining, business. This gives it a degree of operational flexibility that allows it to boost operating profits and more effectively manage crack spreads when crude prices fall. As a result, Suncor can boost its refinery throughput and utilization rates in order to generate additional operating earnings. These can then be used to offset those earnings lost from its upstream business.

Now what?

I believe that Suncor offers investors considerable value at this time. It is a solid levered play on a rebound in crude prices, particularly as it's able to "clip the ticket" on almost every part of the oil production value chain. This explains why Warren Buffett boosted his holdings in Suncor by almost 21% during the fourth quarter of 2014, and why you should do the same.

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