



Suncor Energy Inc. and Canadian Natural Resources Ltd. Outperform Their Peers

Description

As painful as major price declines may be—especially for shareholders directly involved—they nonetheless represent strong learning opportunities. The recent oil rout is no different, and now that prices have seemingly suspended their free fall, it's a good time to step back and see how Canada's major producer's share prices responded to the decline.

An analysis of 12 major energy producers revealed that during the oil price collapse—which began approximately at the start of September 2014 and bottomed in mid-December 2014—**Suncor Energy Inc.**(TSX:SU)([NYSE:SU](#)) and **Canadian Natural Resources Ltd.**([TSX:CNQ](#))([NYSE:CNQ](#)) saw the lowest share price declines.

Suncor saw its shares decline approximately 26%, whereas Canadian Natural saw its shares decline about 30%. This is in comparison to a 42% decline for the IShares TSX Capped Energy benchmark index (which tracks 57 Canadian energy names). More notably, however, since oil bottomed in mid-December, Suncor shares have rebounded an impressive 17.86% compared to the 15% for the benchmark index.

What is underlying the better price performance? There are a few major factors involved, all of which spell continued performance going forward.

It's all about the assets

At the core of Suncor and Canadian Natural's good performance is their portfolio of high quality, long-life, low-to-no decline assets. Low-decline assets means that companies have the ability to continually produce oil without seeing a decline in their production due to reserves being quickly depleted. This translates into far lower sustaining capital expenditures over time, since these companies do not need to constantly spending money to maintain production levels.

Typically, mining and in situ oil sands projects are long life and low decline compared to tight oil plays, for example, which cost much less initially but decline very rapidly. Therefore, companies that are weighted more heavily towards oil sands projects will typically note lower declines.

In this regard, Suncor and Canadian Natural are best in class. Canadian Natural currently has a fairly low decline rate of 15% annually, which is expected to drop to 13% in 2018, giving Canadian Natural a top five decline rate amongst the largest Canadian producers. This drop in decline rates is occurring as Canadian Natural transitions its asset base to a long-life, low-decline base by ramping up production at its Horizon oil sands project.

Suncor fares even better in this regard. Currently, Suncor has a decline rate of 7%, and this will remain unchanged through to 2018. This puts Suncor in the top three of Canadian producers, and is largely due to Suncor's heavy oil sands weighting.

Low decline assets leads to high free cash flow & capital budget flexibility

This is the major reason having a low-decline asset base is so important. Low declines means low sustaining capital expenditures, which in turn results in two things. First, it results in a much higher free cash flow. This means companies have far more money to invest in new opportunities, buyback shares, or pay dividends, and stay afloat during periods of price weakness without creating debt.

Analysts at **TD Bank** found that by 2018, Canadian Natural will have an impressive free cash flow yield of 13%, whereas Suncor's will sit at 11%. This type of cash flow gives investors confidence, and explains why they were less likely to let go of their shares during the price decline.

Second, in addition to more free cash flow, low-decline assets means a more flexible capital program, stemming from low capital expenses. For Suncor and Canadian Natural, the majority of capital expenditures are towards growth, rather than maintenance, and as a result, there is tremendous flexibility with regards to reducing a capital budget when prices fall, without needing to cut production.

Suncor and Canadian Natural are in the top three in the industry for sustaining capital as a percentage of cash flow, with both spending between 50-60% of cash flow on maintaining production, leaving plenty of space. Once again, this provides confidence to investors, since they can be certain the business model and dividends are safe, even at low prices.

With low debt (in Suncor's case, the lowest in the industry), and solid, secure dividends, Suncor and Canadian Natural should not only outperform in the bad times, but in the good times as well.

CATEGORY

1. Energy Stocks
2. Investing

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1. Editor's Choice

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2. NYSE:SU (Suncor Energy Inc.)
3. TSX:CNQ (Canadian Natural Resources Limited)
4. TSX:SU (Suncor Energy Inc.)

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