3 Reasons Why Warren Buffett Is Buying Suncor Energy Inc.

Description

It's 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, the Oracle of Omaha bumped up his stake in the energy giant. As of December 31, his total position was valued at US$710 million.

Now, a big investment in the oil sands might seem like an odd purchase for Buffett. So, what could he possibly see in the stock? Here are three reasons why the Oracle might be betting on Suncor.

1. It's well run

When considering a new investment, Buffett looks very hard at the quality of management. Companies must be operated by honest and competent executives whom he can admire and trust.

"We do not wish to join with managers who lack admirable qualities, no matter how attractive the prospects of their business," he said. "We've never succeeded in making good deals with a bad person."

Of course, evaluating management isn't easy. However, Suncor executives have proven to be exceptional stewards of shareholder capital.

Since taking the helm in 2011, CEO Steve Williams has implemented the following policy: Every dollar reinvested back into the business must earn a sufficient return for investors. If management cannot find enough profitable projects, extra cash will be returned to shareholders.

This might sound like common sense, but such discipline is rare. Most managers prefer to guide over a larger business empire, even when that policy might not be in the best interest of shareholders. But healthy executive egos never funded anybody's retirement.

2. It's gushing dividends

This new philosophy has also freed up an enormous amount of capital for investors.

Since 2011, Suncor has more than doubled the size of its dividend. Today, the stock pays out a quarterly distribution of $0.28 per share, which comes out to an annual yield of 3.1%.

But dividends are just one part of this story. Suncor also has a ravenous appetite for its own shares. And when the company repurchases (or buys back) its own stock, it shrinks the number of shares outstanding.

Here’s how it works. Let’s say in 2011, you purchased 16 million Suncor shares. Back then, the company’s total share count was 1.6 billion, which means you own 1% of the total investor pie.

Since then, Suncor has bought back more than 10% of its outstanding shares. That has taken the total share count down to about 1.4 billion. You still own 16 million shares, but your position now represents 1.14% of the company.

It’s like a “secret dividend.” Without lifting a finger, you were able to increase your stake in the business. And because no cash is being paid out, the entire transaction is *tax free*.

3. It’s cheap

“A good business isn’t always a good purchase.” Buffett said. That’s because even the most wonderful company can deliver lousy returns if we overpay for the stock.

That said, the recent drop in oil prices has clobbered energy shares. Since July, Suncor’s stock price has plunged by more than 20%.

Time to bail? Hardly. If you believe in buying wonderful businesses when they’re on sale, then there has never been a better time to scoop up this stock on the cheap. Today, Suncor shares trade at about 16 times forward earnings, well below the stock’s historical average.

Of course, no one can predict where oil prices are going next. However, Suncor shareholders will almost certainly be rewarded with growing production, dividends, and a stock price that—though unpredictable in the short term—should slowly rise over time.

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