Should Suncor Energy Inc. Be Your Top Oil Pick?

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) is often touted as the best pick in Canada's beleaguered oil patch.

The stock has a number of big-name fans, the most famous being Warren Buffett, but many investors are hesitant about buying the company when oil markets remain so volatile.

default watermark

Let's take a look at Suncor to see if it deserves to be in your portfolio.

Assets

Suncor is Canada's largest integrated oil company with assets that include oil sands properties, refining facilities, and retail stores. This diversity is a big reason why the company is better positioned than its peers to navigate through the current crisis.

The oil sands portfolio holds roughly seven billion barrels of proven reserves and another 19 billion barrels in contingent resources. Investors in Suncor generally have a long-term perspective because these assets have the capacity to deliver significant production and cash flow for *decades*.

Suncor also operates four large refineries. Profits from refining operations are affected by the difference between the cost of the feedstock crude that comes into the plant and the price of the products that are extracted from the crude oil. This differential is called the "crack spread."

The 3-2-1 crack spread refers to the refining margins generated by converting three barrels of WTI crude oil into two barrels of gasoline and one barrel of diesel fuel.

Suncor's refining operations could deliver better-than-expected margins in the next earnings report because the Chicago 3-2-1 crack spread increased significantly during the first quarter. However, investors have to be careful about reading too much into the price gap due to the way margins are reported and the variations in crack spreads in different locations.

In its Q4 2014 report, Suncor said, "Crack spreads are based on current crude feedstock prices, whereas actual refining margins are based on first-in, first-out (FIFO) inventory accounting."

On the retail side, the company's nation-wide network of 1,500 Petro-Canada gas stations should benefit from lower gas prices. Drivers are starting to feel more comfortable about buying bigger cars and many will be planning more road trips this summer.

Capital management

Suncor does an excellent job of managing capital. The company spent $300 million *less* than its revised 2014 capital guidance of $6.8 billion and recently reduced 2015 capital spending by $1 billion. The 2015 capital program is set at $6.2-6.8 billion.

The company also continues to reduce its oil sands cash operating cost per barrel, which came in at $34.45/bbl in Q4 2014, down from $36.85/bbl in the previous year. Suncor expects a further reduction in 2015.

Shareholder returns

Suncor has a strong history of returning cash back to its shareholders through dividends and share buybacks. The share-repurchase program is currently on hold, but the company continues to pay a dividend of $1.12 per share, which yields about 3%.

default watermark

Should you buy?

Suncor's integrated business model helps provide cash flow and earnings diversity during volatile times in oil markets. Analyst predictions for year-end oil prices are all over the map. Whether oil finishes 2015 at $50 or $90 is anyone's guess, but the general consensus is that oil won't remain at $50 forever.

Suncor's shares currently trade at 26 times forward earnings and 1.3 times book value. The stock isn't cheap but it's one of the safest long-term plays you can make if you believe oil prices will eventually move back toward $80.

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
2025/09/18
Date Created
2015/03/30
Author
aswalker

default watermark

default watermark