Should You Buy Suncor Energy Inc. Now?

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) has increased more than 25% since hitting its mid-December lows and investors are wondering if the stock is still worth buying at current levels.

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

Integrated model

Suncor's integrated business model is a big reason for the stock's strength. Falling oil prices hurt the company's margins on the production side, but they can help drive higher profits in both the refining and retailing operations.

Suncor operates four large refineries. These facilities transform crude oil into a variety of end products ranging from gasoline and diesel fuel to asphalt and lubricating oil.

Low crude prices means low input or "feedstock" costs. In the refining industry, the difference between the price of the feedstock crude and the price of the gasoline and distillates that are extracted from the crude oil is called the "crack spread." For example, the 3:2:1 crack spread refers to the margins generated by transforming three barrels of crude into two barrels of gasoline and one barrel of distillate, such as diesel fuel.

When there is a big spread between WTI and Brent prices, Suncor tends to make more money on its refined products. The price gap between WTI and Brent crude is a factor in the equation because the finished products are normally priced according to the Brent benchmark, even if cheaper WTI feedstock is used.

Crack spreads increased significantly in the first quarter of 2015 and that could turn up as an unplanned bonus in Suncor's refining earnings. I say "could" because refiners use first-in, first-out (FIFO) inventory accounting to determine margins, whereas crack spreads are calculated using real-time feedstock pricing. As such, reported margins can be different from market expectations.

The Montreal refinery is of particular interest in a long-term perspective. In the coming months the facility will begin sourcing all of its crude from low-cost western Canadian sources.

Suncor has been sending increasing amounts of crude to Montreal by rail to limit the amount of foreign oil it has to purchase. With **Enbridge's** reversed Line 9 now approved, Suncor expects to start sending oil through the pipeline to its Montreal refinery by the end of the current quarter.

Suncor also operates a retail and wholesale network of more than 1,500 Petro-Canada outlets. With gas prices hovering around $1 per litre, Canadians will be more inclined to take road trips this summer. This bodes well for retail revenues.

Capital discipline and operating efficiency

Suncor manages its capital very well. In fact, the company spent $300 million less than expected in 2014, and has lowered its 2015 capital program by $1 billion as it adjusts to lower oil prices.

Driving efficiency into operations is also important in the current environment. Suncor reported Q4 2014 operating costs per barrel of $34.45, compared to $36.85/bbl in Q4 2013. The company expects that number to improve again in 2015.

Should you buy?

The company is attracting a lot of energy investors because it is seen as one of the safest plays in the sector. As a long-term holding, Suncor is a solid pick, but the easy money has already been made. A strong Q1 earnings report could move the shares higher, but oil prices are still volatile and investors might see a better entry point in the coming months if crude resumes its slide. At this point, the stock is probably a hold.

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1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

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Date

2025/09/18
Date Created
2015/04/15
Author
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