Why Are Suncor Energy Inc.'s Shares So Expensive?

Description

Over the last couple of years, the decline in oil prices has seriously damaged the bottom lines of energy producers. **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) is no exception.

Back in the first quarter of 2013 the WTI oil price averaged US$94.35 per barrel, and Suncor raked in $1.4 billion in operating earnings. Fast forward to 2015 and WTI averaged below US$50 in the first quarter. To no one's surprise, Suncor's operating earnings took a big hit, coming in at only $175 million.

Most companies would see their stock prices fall if this happened, but not Suncor. Its share price has *increased* by 16% over the last 24 months. So, what exactly is going on? Are Suncor's shares wildly overpriced? Or is there more to the story?

Some important steps

First, it's important to give Suncor some credit. The company has taken some big steps to cut costs, spend money more wisely, and be more shareholder friendly. At the same time, production continues to grow.

Its efforts are showing up in its oil sands operations. Back in the first quarter of 2013 the oil sands produced 389,000 barrels per day, at a cash cost of $34.80. Two years later, the oil sands operations produced 475,600 barrels per day, at a cash cost of $28.40.

Along the way, Suncor has showed it can be disciplined. It cancelled the $11.6 billion Voyageur upgrader project. Its 2015 capital budget was cut by $1 billion in January. And the company is taking a more focused approached to growth than ever before.

Suncor has also been returning more cash to shareholders. Its share count has decreased over the last couple of years, and its dividend has more than doubled. Arguably, the company has never been more liked by its shareholders.

Why is Suncor so expensive?

Let's face it: Suncor has accomplished a lot in the last two years, but that doesn't justify an increase in the company's stock price. The fall in earnings has simply been too great. So, why are Suncor shares so pricey?

To set some context, the energy sector accounts for about 20% of the TSX. Equity portfolio managers typically must hold at least some energy names. Big clients often demand it.

At the same time, portfolio managers want to give the impression they only hold quality companies. It's a message that makes attracting clients easier. And in the energy sector, Suncor is a quality name.

Why is all this important? Well, it's easy to imagine portfolio managers switching some of their energy holdings into Suncor, and driving up the company's stock price in the process. After all, no one wants to be caught holding **Penn West Petroleum Ltd.** or **Lightstream Resources Ltd.** Clients aren't drawn to those names.

The verdict

Luckily, the rest of us don't have to hold energy names. So, why on earth should we hold Suncor? Instead, if you're looking to bet on quality companies, you should look at other sectors. You can find some help with this by looking below.

CATEGORY

1. Energy Stocks
2. Investing

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