



Sorry Warren: Why I'm Not Adding Suncor Energy Inc. to My Portfolio

Description

Perhaps Warren Buffett's best-known Canadian holding is **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)), the largest integrated oil company in Canada and one of the largest in the world.

Although nobody really knows why the Oracle of Omaha chose to buy more than 22 million shares in the energy giant, I think I have a pretty good idea. Over the next few decades, dependable energy supplies are going to become more and more important, especially those in politically stable areas. Thus, Suncor's oil sands reserves are going to become more and more valuable as time goes on.

There are other reasons to own Suncor, too. The company has solid downstream operations, including refineries, a liquids business, and one of Canada's largest networks of gas stations operating under the Petro Canada banner. Those other assets do a nice job of smoothing out earnings during times like now when crude takes a hit.

Plus, Suncor's management has a recent history of being very friendly to shareholders. Since 2011 the company has bought back more than 120 million shares and boosted the quarterly dividend from just a dime per share to today's level of \$0.28. That kind of performance is music to a dividend-growth investor's ears.

And yet, it's still not enough for me to add this producer to my portfolio. I think Buffett has the right idea, but the wrong execution.

Suncor isn't cheap

Don't let anyone fool you into thinking Buffett is still a value investor. He still has value tendencies, but he's definitely evolved into more of a GARP (growth at a reasonable price) guy.

A year ago crude traded at more than \$100 per barrel. Suncor's price was \$42 per share. A year later crude has fallen all the way to below \$60—a 40% decline—but Suncor's share price has remained surprisingly resilient, only falling to \$36. That's a decline of only 15%.

What gives?

As far as I can tell, investors are selling lower quality energy names and moving into names like Suncor. Some are probably even following Buffett specifically into the name. While oil is depressed, this looks like a smart move. But when crude moves higher, these same investors will leave Suncor, tempted by the better potential from some of the riskier names in the sector.

Is there a better way?

I certainly think Buffett is onto something if he thinks the oil sands will become more and more important as time goes on. But I've chosen a different way to invest in this trend.

Canadian Oil Sands Ltd. (TSX:COS) owns 37% of the Syncrude project, one of the largest producers in the region. (Suncor owns 12%.) But unlike every other producer in the region, Syncrude has a pretty interesting competitive advantage. It upgrades all of its bitumen into something that's pretty darn close to light sweet crude, which allows it to get a much better price on the open market.

Yes, upgrading does add costs to the process, but in times of attractive crude prices, it's well worth it. It costs Canadian Oil Sands approximately \$60 to produce one barrel, which does make it a relatively high-cost producer. But that's balanced with absolutely no exploration risk. There's no need to be constantly replacing reserves when you've got more than two billion barrels in the ground.

That's enough to keep the company busy until the 2040s based on current production. And yet, investors are only paying around \$4 per barrel for all that untapped bitumen. Sure, there are costs associated with bringing that up to the surface, but most of the large capital outlays are already paid for. It just has to maintain the machinery and hope for higher oil prices, which will eventually happen. The commodity always bounces back.

Buffett may be a billionaire, but he's not always right. While I think Suncor will end up being a pretty solid performer, I'm much younger than the octogenarian, and pretty comfortable taking a little more risk. That's why I've chosen a different way to invest in the long-term future of oil, and I suggest that investors explore other non-Suncor alternatives for their own portfolios.

CATEGORY

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2. Investing

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1. NYSE:SU (Suncor Energy Inc.)
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