Dividend Investors: Is it Still Safe to Own Suncor Energy Inc.?

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) has been extremely resilient over the past year, but dividend investors are starting to wonder if Canada's largest integrated oil company is still a safe bet.

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

Balanced revenue stream

Suncor generates revenue all along the hydrocarbon value chain.

The upstream operations are primarily centred on the company's extensive oil sands facilities, which make up 6.9 billion of Suncor's 7.7 billion barrels of reserves and another 18.8 billion of the 23.2 billion in contingent resources.

Long-term oil bulls look at the massive cash flow potential and see decades of value lying in the ground. The appeal for investors is the fact that all the reserves are already in place. Suncor doesn't have to gamble a ton of money every five years to buy new land to replenish its supply.

Oil bears say the reserves are worth nothing if they can't be mined profitably or end up being abandoned due to new carbon rules.

Suncor's midstream business includes its four large refineries. The drop in crude prices can actually benefit Suncor because it lowers the company's input costs on the refining end.

The refineries take the feedstock crude and turn it into end products like gasoline, diesel fuel, asphalt, and lubricating oils. This division is viewed as a good hedge when oil prices falter and that is a big reason why Suncor's shares have held up so well. However, investors shouldn't look at this group as a no-brainer cash cow.

Margins in the refining operations tend to be volatile as they are impacted by variances in the "crack spread," or the price differential, between the WTI-based input price and the Brent-based final product price. Refineries are also maintenance intensive and the plants can be out of commission for weeks at a time due to planned shutdowns. As such, profits often vary widely from one quarter to the next.

The third part of the revenue puzzle comes from Suncor's downstream retail group. The company operates more than 1,500 Petro-Canada service stations that tend to do well when fuel prices are low.

Dividend growth

Suncor has a strong history of dividend growth. Since 2010 the quarterly dividend has almost tripled, and shareholders now get a solid 3.4% yield.

With WTI oil prices trading below $50 per barrel, it is unlikely that investors will see an increase to the dividend in 2015, but the existing distribution is very safe.

Strong balance sheet

Suncor finished the first quarter with about $5 billion in cash and cash equivalents. This means the company has ample funds to pay the dividend, and investors could see the company start to use the war chest to pick up top assets from struggling competitors.

Should you bet on Suncor?

Volatility looks set to continue in the global energy space as Saudi Arabia remains determined to defend its global market share and new supply from Iran could hit an already oversupplied market.

Back at home, Suncor is dealing with pipeline delays. Energy East and Keystone won't be in service for at least five years, if ever, and the Line 9 reversal, which will send cheap western Canadian oil to Suncor's refining operations in Quebec, continues to face unexpected holdups.

At this point, the investment decision depends on your outlook for crude prices. If you are worried that oil is headed lower for an extended period of time, it is best to avoid all the producers.

On the other side of the fence, oil bulls see the short-term challenges as mere speed bumps, and existing investors who still believe in the oil story can simply collect the dividend and wait for better days. If you are planning to start a new position in Suncor, I would at least wait until the Q2 2015 results come out before buying the stock.

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