Why Suncor Energy Inc. Has a Rising Dividend

Description

Falling energy prices have been painful for every one of Canada's oil producers. But some have been affected far more than others.

Suncor Energy Inc. (TSX:SU)(NYSE:SU) is a perfect case in point. The energy giant has had to cut back on spending plans, and profits are down for the first half of this year. But the company just recently raised its dividend, which is remarkable considering the dividend cuts we're seeing from other producers.

So, what separates Suncor from the rest? We look at the three biggest factors below.

1. A more resilient business

In 2015 we have seen low oil prices crush—or eliminate entirely—the profitability of most oil producers. But Suncor's profits have held up quite nicely. In fact, the company's free cash flow was only 10% lower in Q2 2015 than it was a year earlier. What exactly is going on?

Well there are two big factors. First of all, Suncor has done an excellent job reducing costs. This is most evident in its oil sands operations, where cash operating costs fell to $28 per barrel, a decline of 18% year over year.

Second, Suncor's refining and marketing business—which consists of four refineries and a network of Petro-Canada gas stations—has benefited from favourable crack spreads. In plain English, the price of refined products hasn't declined as much as oil has. Consequently, this business unit saw its operating profit more than double year over year. Most other oil companies don't have such operations, and thus haven't gotten the same lift.

2. A stronger balance sheet

If you look at which companies have been the most damaged by falling oil prices, you'll find most have very poor balance sheets.

But Suncor's balance sheet is very strong. The company's net debt totals $9.2 billion, equivalent to only 17% of its market value. By comparison, many producers have a net debt greater than their market value.

Going forward, Suncor's solid balance sheet will be a major advantage. If drilling costs decrease and the company wants to grow production, it can do so. Or if Suncor wants to acquire a weak competitor, it can do that as well. In the meantime, the company has chosen to raise its dividend.

3. A lower payout ratio

There's a very simple reason why Suncor was able to raise its dividend: the company's dividend was very low to start with. To illustrate, Suncor earned $1.84 per share last year, but paid out only $1.02 per share. Compare that with many of the energy patch's higher-yielding names, whose dividends exceeded their earnings.

Of course, this also means investors get a lower yield. Even after the recent dividend hike, Suncor's dividend yields just over 3.2%.

This should make a lot of sense. After all, if you're looking for a safe dividend in the energy patch, you'll probably have to accept a pretty low yield.

Fortunately, there are reliable dividends in other industries with much bigger yields than Suncor's. Check out the free report below.

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