Should Dividend Investors Buy Suncor Energy Inc.?

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) surprised the market recently with solid earnings and dividend increase. Let's take a look at Canada's largest integrated energy company to see if it deserves to be in your portfolio.

Integrated business model

Suncor is a bit unique in the energy space because it has significant operations all along the hydrocarbon value chain.

The company's upstream operations include massive oil sands facilities. These make up nearly seven billion of Suncor's 7.7 billion barrels of reserves as well as another 18.8 billion of the company's 23.2 billion in contingent resources.

That's a lot of oil that can be mined and sold for decades to come.

Long-term oil bulls look at the potential cash flow and say the stock doesn't reflect that opportunity. At the same time, oil bears say the reserves are worth nothing if they can't be mined profitably, or even worse, are destined to be abandoned as a result of tighter carbon regulations. Investors should consider both angles when deciding whether to buy the stock.

In the midstream segment, Suncor operates four large refineries that produce gasoline, lubricants, asphalt, and diesel fuel.

These operations help provide a hedge against lower oil prices because they can benefit from movements in the "crack spread," which is the price differential between the WTI-based input costs and the Brent-based pricing of the final products. Profits are tough to predict from the refining operations and the facilities require frequent maintenance, but the refineries definitely help diversify the revenue stream.

Suncor also operates a network of 1,500 Petro-Canada retail outlets. This part of the business tends to do better when oil prices drop because drivers can fill up their cars with much cheaper fuel and feel better about taking more road trips. People are also more comfortable buying vehicles with larger engines when gasoline is less expensive.

Earnings strength

Suncor reported operating earnings of $906 million, or $0.63 per share, for the second quarter of 2015, driven by strength in the refining and marketing business units, which accounted for $631 million of that amount.

The company's oil sands operations are feeling the pinch of lower market prices, but the division is making good progress on improving operational results. Production in Q2 increased by 45,000 barrels per day compared with the same period last year, and operating costs dropped to $28 per barrel. That's pretty good compared with some of the other oil sands operators.

The company is also doing an excellent job of reducing expenditures while boosting output. Guidance for the year dropped another $400 million, and Suncor now expects to spend $5.8-6.4 billion in 2015.

Dividends and share buybacks

Management feels confident about the earnings outlook, despite the difficult environment. As a result, the company increased the quarterly dividend to $0.29 per share and renewed its share repurchase program.

Should you buy?

The company is riding the strength of its downstream business units, and this should continue as the oil market works its way through the rout. At this point, the dividend looks very safe.

Suncor's shares are not cheap, but investors get stability through a diversified revenue stream and a very strong balance sheet.

If you are an oil bull but don't want to gamble on a pure producer, Suncor is as good a pick as you will find. Having said that, the company isn't immune to weak prices and refining profits can be volatile, so there might be more downside risk in the coming months.

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