Suncor Energy Inc.: Can the Rally Continue?

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) has been on a roll lately, and the stock is getting close to its 12-month high.

At the current level the shares definitely look pricey, and investors who missed the surge are wondering if this is the start of a much bigger move or simply another head fake before the next pullback.

Here's how things look right now.

Earnings

Suncor reported a Q3 net loss of $376 million. The number looks bad, but it was caused by a non-cash foreign exchange hit due to the revaluation of the company's U.S. dollar denominated debt.

When you look at Suncor's operations, the earnings story is pretty good. Operating cash flow for Q3 2015 came in at $1.9 billion, or $1.30 per share, driven by strength in the company's downstream business units. Overall operating earnings for Q3 were $410 million.

In the upstream segment, Q3 oil sands production was 430,300 bbls/d compared to 412,000 bbls/d in the same period last year. Cash operating costs in the segment decreased to $27/bbl in Q3 compared to $31.10/bbl in Q3 2014.

Despite lower production costs and higher output, the oil sands group recorded a net loss of $50 million in the third quarter. Investors don't want to see losses, but considering the drastic drop in prices through the summer, the result is actually quite impressive.

Suncor's refining and marketing operations saved the day. Third quarter net earnings from refining came in at $506 million, and the marketing group, which includes Suncor's Petro-Canada franchise, earned $107 million.

The company had an operating loss of $152 million in its corporate, energy trading and eliminations group.

Acquisitions

Suncor is taking advantage of the weak market conditions to beef up its resource base.

The company just picked up additional 10% share of the Fort Hills oil sands project for $310 million and recently launched an all-share bid to buy **Canadian Oil Sands Limited** (COS) for about $6.6 billion.

Suncor and COS are partners on the Syncrude oil sands project. A successful takeover would give Suncor a 49% interest in Syncrude, but COS is doing its best to stay independent, or at least to find a white knight willing to pay more.

Regardless of how the COS bid turns out, Suncor's investors should see more activity in the coming year because the company is sitting on a massive $5.4 billion in cash and cash equivalents.

Management could use the funds to pay down the $15 billion in debt, but the debt load is very reasonable given the company's size. Suncor's covenants require it to keep total debt lower than 65% of total debt plus shareholders' equity. As of September 30, the ratio was just 27%.

Suncor also has access to $6.9 billion in undrawn credit facilities. When this is combined with the cash position, the company is sitting on a war chest of more than $12 billion. That's a powerful position to be in.

The energy market is currently full of companies with great assets and destroyed balance sheets, so Suncor is likely to emerge as a larger company when the oil rout ends, and most of the new assets are going to be acquired at rock-bottom prices.

Dividends

Suncor increased its dividend when it reported the Q2 numbers. The quarterly payout is $0.29 per share and yields about 3%. Suncor has raised the distribution by 45% since the end of 2013.

Should you buy Suncor?

The stock is certainly not cheap at 29 times forward earnings, but you get a safe dividend and a chance to own a company that will actually benefit from the oil crisis.

If you believe oil has bottomed, Suncor is a reasonable pick, and the stock will move higher on stronger crude prices. Having said that, the easy money has already been made and I think Mr. Market might serve up a better entry point in the coming months.

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Date
2025/09/18
Date Created
2015/11/02
Author
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