The 3 Secrets to Suncor Energy Inc.'s Q3 Success

Description

Last week **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) reported pretty decent third-quarter results, all things considered. The Canadian oil giant not only earned $0.28 per share, which beat the consensus estimate by $0.04 per share, but its cash flow from operations of $1.9 billion wasn't all that far off from the $2.3 billion it produced in the year-ago quarter, despite a significant reduction in the oil prices.

Here are the three secrets to its better-than-expected success.

1. Strong refining operations

In commenting on the quarter, Suncor's CEO Steve Williams first pointed to "the strength of [the] downstream business" as one of the reasons why the company delivered another strong quarter. This specifically related to the favourable pricing environment benefiting its refineries, whereby the company was processing cheap crude oil and selling higher valued, refined petroleum products into a market that is seeing increased demand, especially for gasoline.

This dynamic led to robust refining margins driving "near record earnings and cash flow," according to comments made by Williams on the company's conference call. Further, Suncor's refineries were running at stronger utilization rates after improving utilization from 94% in last year's third quarter to 96% this past quarter. Because of these factors, the company's refining segment alone contributed 42% of its cash flow during the quarter.

2. Driving down costs

Another major key to the company's solid cash flow generation during the quarter was its ability to drive down costs at its oil sands operations. During the quarter, its operating costs were $27 per barrel, which was well below the $31 per barrel in the year-ago quarter and the lowest level since 2007.

Driving down its costs was a combination of lower natural gas prices, which drove down the cost of producing steam at its in situ facilities, as well as the company's cost-reduction initiatives. Those initiatives really paid off during the quarter and should enable the company to keep its operating costs low, even if natural gas prices rebound.

3. Low-cost growth

The third secret to Suncor Energy's success was the way it increased its production from lower-cost sources of oil. Over the past year Suncor Energy's production has increased from 519,300 barrels of oil equivalent per day (BOE/d) to 566,100 BOE/d this past quarter. Among the drivers of this increase was production from in situ facilities, which again benefited from cheap natural gas prices, delivering strong growth in low-cost oil.

Investor takeaway

The oil-market downturn has really proven the value of Suncor's integrated business model, with its refining operations cashing in on low oil prices. In a sense, these assets are a hedge against weak oil prices for the company, enabling it to deliver strong cash flow.

However, in addition to the huge benefit from refining, Suncor Energy is also benefiting from lower costs as well as from growing its production from low-cost sources. This is propping up its cash flow thanks to the one-two punch of improved margins and higher volumes.

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