Should Income Investors Buy Suncor Energy Inc.?

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) bucked the trend and raised its dividend this year. Investors love the name, and the share price continues to defy gravity, even as oil plunges towards new lows.

Is the strength warranted or is this a case of the emperor's new clothes?

Let's take a look at the current situation to see if Suncor deserves to go into your portfolio right now.

Integrated business model

Suncor is different from many of its competitors in that the company derives revenue all along the hydrocarbon value chain.

Investors primarily identify Suncor as an oil sands producer and the upstream operations are the core assets of the business, but Suncor also owns four large refineries and a huge network of retail locations.

This diversification has allowed the company to generate strong operating profits in a very difficult environment. For Q3 2015, Suncor brought in cash flow from operations of $1.88 billion, spent $1.74 billion on capital expenditures, and delivered an operating profit of $410 million.

The oil sands operations actually had an operating loss of $50 million in the quarter, but the refining and marketing group picked up the slack with an operating profit of $613 million. The corporate, energy trading and eliminations segment had an operating loss of $153 million.

Oil sands woes

Low oil prices are impacting margins in the upstream operations, and Suncor recently announced a surprise cut to 2016 production estimates. This rattled the market a bit and has resulted in a small pullback in the shares, but a close look suggests there shouldn't be too much concern.

Oil production is a maintenance-heavy business. Suncor said it expects production to average 525,000-

565,000 barrels per day in 2016, slightly lower than the 2015 numbers.

The company is planning major maintenance activities at its facilities and the downtime will result in lower output. In the big picture, this isn't a bad thing. The company has the cash and balance sheet strength to absorb the lower output, and it makes sense to do the work when oil prices are low.

Suncor remains a very efficient producer. The company expects 2016 cash operating costs per barrel to be $27-30 at its core oil sands facilities. Operational improvements have reduced the oil sands cash costs by 25% since 2011.

Dividend safety

Suncor raised its quarterly dividend earlier this year to $0.29 per share. The distribution yields about 3.1%.

The company had to dip into its savings to pay some of the dividends in the third quarter, which isn't a positive sign, but the amount was relatively small and Suncor has a lot of cash. In fact, the company finished Q3 2015 with $5.4 billion in cash and cash equivalents.

For the moment, Suncor's dividend looks very safe.

Should you buy?

Suncor is positioning itself for a rebound in the oil market. It recently acquired an additional 10% stake in the Fort Hills oil sands development and is trying to buy out **Canadian Oil Sands Ltd.**, which would boost its stake in the Syncrude oil sands project to 49%.

If you want to own one of the stocks that will survive the rout, Suncor is a safe pick.

However, at 25 times forward earnings Suncor's stock isn't cheap, and the midstream operations are carrying the company right now. Fans of the stock say you have to pay up for quality names, but WTI oil is back down to $40 per barrel and threatening to fall further. I would stay on the sidelines for the moment and hope for a better entry point in the coming months.

Suncor is a solid long-term play, but it just looks too expensive.

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