Is Suncor Energy Inc. a Safe Investment for 2016?

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) has weathered the 2105 energy storm much better than its peers, but investors are wondering if the name will hold up just as well next year.

Let's look at the current situation to see if the company deserves to be in your portfolio.

Smart acquisitions?

Suncor is taking advantage of the oil rout to add new assets at low prices.

The company sealed a deal to purchase an additional 10% stake in the Fort Hills oil sands project and is trying to buy **Canadian Oil Sands Ltd.** to increase its share of Syncrude to 49%.

The market has mixed feelings about the moves.

Construction of Fort Hills began when oil prices were still at nosebleed levels, and the partners on the project have decided to see it through, despite the poor economics at the current oil price. If energy prices recover by 2018, when Fort Hills is expected to begin production, Suncor's deal to boost its stake to nearly 51% will look like a savvy one.

The wisdom of buying Canadian Oil Sands is also hotly debated. Syncrude has been plagued by operational problems for years and continues to struggle. With WTI oil now trading around US$35 per barrel, the deal doesn't look like a great one for Suncor's shareholders.

Canadian Oil Sands says Suncor's offer is too low and the board is urging investors to reject the proposal. With no competing offer on the table and a bleak outlook for the oil market, it is quite possible that Suncor will succeed.

Suncor has the balance sheet strength to ride out a prolonged slump and both Fort Hills and Syncrude are expected to produce for decades. If oil is headed back to $70 or higher over the long term, as some analysts predict, these acquisitions will be beneficial for investors.

Integrated business model

Suncor is primarily known as an oil sands producer, but the company also owns four refineries and a large retail operation.

Suncor's oil sands operations are very efficient. The company expects 2016 cash operating costs to be $27-30 per barrel at the core facilities. Since 2011, Suncor has reduced the oil sands cash costs by 25%.

Production is expected to drop slightly in 2016 as a result of scheduled shutdowns to complete some major maintenance work. The lower production will hit cash flow, but the opportunity cost of getting the work done now is less than it would be if oil were at higher levels.

The company's refining and marketing divisions should be able to pick up the slack, as they did in Q3 2015. During the third quarter, Suncor's oil sands facilities delivered an operating loss of $50 million, but the downstream segments performed well, and the company's overall Q3 operating profit came in at $410 million.

Dividend safety

Suncor is one of the few energy companies that actually raised its dividend in 2015. The current payout of $0.29 per share yields about 3.3%.

Suncor had to tap its savings to cover part of the dividend in Q3, and that is likely to be the case again in the fourth quarter. Investors shouldn't be too concerned in the short term as the company is still sitting on more than $5 billion in cash and cash equivalents.

Should you buy Suncor?

As a long-term bet on the oil sector, Suncor is a strong pick, and the company will likely emerge from the oil rout with significant additional assets purchased at fire-sale prices. However, the stock is not cheap and the short-term outlook for the industry isn't very good.

If you believe oil prices are bottoming and want a safe bet to play an eventual rebound, Suncor is a solid choice, but there probably isn't a rush to buy right now.

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