The Silver Lining for Suncor Energy Inc. Shareholders

Description

If you were fortunate enough to have your entire oil and gas exposure through **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), you would have made through the oil-price decline in relatively good shape. While oil prices fell nearly 70% from their July 2014 high, Suncor shares saw a 27% decline, some of which was offset by its steady dividend (which actually rose in July 2015).

Despite this, oil prices are currently sitting around US$33/bbl, which is much lower than the US$39/bbl average that Suncor is expecting for the year and less than the roughly US$50/bbl Suncor would need to fund its full capital program and dividend for the year.

In fact, at prices of about US$36-37/bbl (the current futures prices for 2016), Suncor is estimated to see a cash flow shortfall of about $4 billion. In such a situation, Suncor's net debt could expand by as much as $6.5-6.8 billion (according to **RBC**). While this may sound bad, there are some definite silver linings for Suncor shareholders.

1. Suncor has the balance sheet to withstand a year in the US$30/bbl range

Suncor enters 2016 with an excellent balance sheet and plenty of liquidity. Assuming oil prices average US$37/bbl for the year (the current futures price), Suncor is anticipated to end the year with a net-debt-to-cash flow ratio of 3.5 (net debt that is 3.5 times the company's cash flow). This compares with Suncor's peer group of integrated oil companies, which will have a net-debt-to-cash flow ratio of 3.7.

Large intermediate producers are averaging 4.8 times cash flow in a US$37/bbl environment. This means Suncor has less debt than its peers. Even more important than Suncor's debt levels, however, is the degree of liquidity Suncor has.

A company could have low debt levels, but if it does not have access to cash and/or capital markets to fund its expenses, it will be in the position of having to reduce production or dividends. Currently, Suncor has about CAD$4 billion of cash on its balance sheet and CAD$7 billion of unused credit lines.

Suncor expanded its available credit lines in 2015 by adding a new US$2 billion credit facility in 2015, and it currently has an investment-grade credit rating.

Suncor's cash and credit facilities combined gives it CAD$11 billion of liquidity in 2016, which would easily fund the $4 billion cash shortfall that would be expected in a $37/bbl scenario (and even in a much weaker scenario).

2. Suncor is still preserving its production growth.

Despite the weak pricing environment, Suncor is still investing heavily in its future growth. For 2016, Suncor is expecting to spend between $6 and $6.5 billion on capital expenditures in total. Of this amount, about 55% is longer-term growth capital (the rest is sustaining capital to maintain its current production).

A large amount of this growth capital is going towards the development of its Fort Hills and Hebron projects. Combined, these projects will add 123,000 barrels per day of production by 2018. Suncor's recent acquisition of Canadian Oil Sands will also add to this production growth.

It is important to note that much of the reason Suncor has an expected cash flow shortfall in 2016 is because the company is funding its future growth (which is the company's choice). If Suncor's growth capital was taken out, it would only be spending about $3.1 billion in capital, which would leave a much smaller shortfall (and no shortfall if prices rose to about US$40/bbl).

Fortunately, Suncor planned ahead for this growth spending by building up the cash on its balance sheet to pre-fund the projects. This means that even though prices are weak, Suncor is setting itself up to grow once prices improve and new production comes on.

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Author
amancini