Why Suncor Energy Inc. Will Surprise Investors Once Oil Recovers

Description

Suncor Energy Inc. (TSX:SU)(NYSE:SU) has been widely seen as a "safe haven" name for investors during the oil-price rout. Since oil prices began falling in mid-2014, Suncor is down about 23% compared to oil itself, which has fallen 70%.

Suncor's success is due partially to its integrated business model. Suncor's refining segment saw cash flows rise by 31% over 2015, growing to 46% of total cash flow by the year's end and insulating the company from weakness in its oil sands and exploration and production segment.

Suncor has proven to be best in class in terms of operational excellence, making massive improvements since the oil crisis began by driving down operating costs, being highly disciplined and efficient with capital, and making a series of acquisitions at attractive prices.

All of these decisions will allow Suncor to emerge from the oil-price crisis with higher production as well as lower costs, which means Suncor is set to benefit significantly as prices recover into the $40 (or higher) range. Here's how Suncor is setting itself up to profit from an oil recovery.

Suncor has been extremely successful at driving down costs

For 2015, Suncor set the goal of having all-in oil sands cash operating costs (including natural gas input costs) of between $30 and $33 per barrel. At year-end, Suncor significantly outperformed its guidance, posting cash operating costs of $27.85 per barrel, down 17% from the $33.80 per barrel realized in 2014.

It is important to note that Suncor has not realized operating costs this low since 2007. Suncor attributes the reduction in cost to a few separate things, such as reliability initiatives that improved production (reducing per barrel costs), cost-reduction initiatives, and a reduction in natural gas prices.

While improved reliability and driving down costs is always welcomed by investors, investors also want to see costs actually being removed from the business—not simply the same costs being spread across more barrels of production.

Suncor was very successful in this regard, and at the start of 2015 it set the goal of reducing operating expenses over a two-year period by $600-800 million. In 2015 alone, Suncor reduced operating expenses by nearly $1 billion. Suncor believes the majority of these savings are sustainable.

While falling natural gas prices did play a role in these cost reductions, Suncor also streamlined business processes and eliminated non-essential work. Suncor reduced its workforce by about 1,700 people, a reduction it sees as being sustainable. Suncor plans to further reduce operating costs by about $500 million in 2016 by improving productivity and business processes.

For 2016, Suncor could have total operating costs of $8 billion, down from $9.5 billion in 2014. This is despite the fact the Suncor's production will have grown from 535,000 boe/d in 2014 to an estimated 640,000 boe/d in 2016.

The end result is Suncor is set to have more production with less operating costs, which means improved netbacks and a greater benefit from rising prices.

Suncor is also funding its long-term growth

Even though Suncor has seen its cash flow fall significantly, a strong balance sheet and capital discipline has made it possible for Suncor to continue investing in its long-term production growth during the oil-price rout.

For Suncor, this long-term growth comes in the form of its Fort Hills oil sands mining project as well as it Hebron project. Both of these projects are set to come online in late 2017. Combined, these projects should add around 130,000 barrels per day of new production by 2018.

These projects will drive production growth at Suncor over the next several years and should allow Suncor to sell more volume into a market with improving pricing.

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Date
2025/08/25
Date Created
2016/03/02
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