Why Suncor Energy Inc.'s Production Will Surge by 42% Over the Next Few Years

Description

There is almost unanimous consensus among energy analysts that **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) is a "best in breed" name. Its strong balance sheet, integrated business model, and focus on operational excellence have made it a major safe haven for energy investors during the oil-price rout—and its price performance during the rout has reflected this.

Unlike much of its competition, Suncor was not simply in "survival mode" during 2015. In fact, thanks to strong contribution from Suncor's downstream refining operations, Suncor actually generated $139 million in free cash flow. This is even more impressive when considering that Suncor funded an extensive capital program in 2015 ($6.2 billion), of which a huge 58% was growth capital to fund long-term growth.

While many energy names could barely afford capital to sustain production, Suncor not only sustained production levels, but actually grew production by 8%, while still investing in long-term production growth. Here are several major investments Suncor made to secure long-term growth.

Suncor continued to invest in Fort Hills

Fort Hills is a massive oil sands mining project and one of the last of its kind in Canada. The project is currently 50.8% owned by Suncor, along with partners **Teck Resources** and **Total**, and first oil is expected to occur in the fourth quarter of 2017.

Overall, Fort Hills is expected to have gross production of 180,000 barrels per day, and because it is an oil sands mining project, Fort Hills is estimated to have a mine life of over 50 years. With Suncor's 50.8% stake, Fort Hills is expected to add 91,000 barrels per day to Suncor's overall production in 2018.

The main issue with Fort Hills is because it is a greenfield oil sands mining operation, it required massive upfront capital spending to get it started and, in Suncor's case, this cost is about $6.5 billion dollars. Suncor will spend about $2.3 billion towards this project in 2016. Fortunately, Suncor has about

$4 billion in cash on its balance sheet, which it generated during better economic times. This cash basically pays for the remaining investment in Fort Hills.

In September Suncor further added to its position in Fort Hills by purchasing an additional 10% interest in the company from **Total,** which increased its working interest from 40.8% to 50.8%. Because of the weak pricing environment, this investment allowed Suncor to add production at a very low cost.

Suncor spent about $310 million on the increase stake, and acquired 330 million barrels of reserves, which works out to a cost of only $0.94 per barrel—this is very cheap compared to what other producers have paid to acquire interest in Fort Hills.

Suncor will also see production growth from Syncrude

Suncor recently purchased **Canadian Oil Sands Ltd.** for $6.6 billion (of which $4.2 billion is equity and $2.4 billion is debt). This purchase increases Suncor's interest in the Syncrude oil sands mine from 12% to 48.7% after the purchase is completed.

This purchase will add production of about 108,000 barrels per day over the next year or two, bringing Suncor's total Syncrude production up to almost 139,000 barrels per day (from about 30,000 barrels per day in 2015). While this is a fairly large increase (about 24% of Suncor's 2015 production), there is potential for it to increase much more.

Syncrude has had major problems with reliability over the past several years, suffering from shut downs and other issues. Suncor has said it will use its expertise improve the reliability of the mine, which in turn should allow the mine to produce at a much higher percentage of its total capacity. Currently, Syncrude has a good year if it produces at 80% of its capacity, which is fairly low.

While Syncrude and Fort Hills will be sources of production growth for Suncor, Suncor also has other projects in the works, like its offshore Hebron development. This will add 31,500 barrels per day by 2018 as well.

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Date
2025/08/26
Date Created
2016/03/04
Author

amancini