Why Do Suncor Energy Inc. Shares Imply $70 Oil?

Description

According to research analysts at Bernstein, oil prices are due for a strong rebound. In fact, the Bernstein Energy price deck calls for an average WTI oil price of US$48 per barrel this year. The analysts then expect WTI to average US$68 in 2017 and US$78 in 2018.

So does that mean you should buy energy stocks? Well, not exactly. The companies that benefit most from a rebound tend to be the ones that have the weakest balance sheets. So if the recovery doesn't come as quickly as expected, these companies could go bankrupt.

But the alternatives aren't that great either; **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) offers a perfect illustration. Suncor is much more stable than most of its peers, but there's a catch: its share price implies WTI of more than US$70. We take a look at why below.

Optimism about oil

Bernstein isn't alone; energy analysts are generally expecting a robust recovery. In a December survey by *The Business News Network*, only 8.5% of respondents expect WTI to remain below US$40 by the end of 2016. In fact, there were just as many people thinking WTI would shoot back to US$60.

And there are good reasons to believe oil will rebound. As pointed out by Bernstein senior analyst Bob Brackett during a presentation in Toronto, shale oil companies simply cannot generate sufficient returns at today's oil prices. For that reason, these firms have cut back dramatically on drilling. And while there's a six- to nine-month lag between drilling activity and production, we've already seen production numbers start to decline.

Mr. Brackett also claims that efficiency gains in shale oil have been maxed out; in other words, we won't see costs continue to fall. Meanwhile, the demand picture isn't all that bad, especially since the Chinese are buying more and more SUVs.

An extra premium on safety

Generally speaking, fund managers like to be cautious, and that should surprise no one. After all, clients generally don't get mad if a fund underperforms during a bull market, because they are still making money. But if a fund suffers steep losses, then clients may leave, which could do damage to a fund manager's career.

Furthermore, fund managers usually don't exclude any sectors in their funds because if a sector (such as energy) outperforms by a wide margin, then anyone who avoided that sector would have some explaining to do.

So you could imagine that safe energy companies must come at a premium. And they don't come any safer than Suncor.

But individual investors aren't bound by the constraints that fund managers face, which all of a sudden makes Suncor a lot less attractive. Put another way, there are better options for your portfolio.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

Category

1. Energy Stocks
2. Investing

Date
2025/07/20
Date Created
2016/03/07
Author
bensinclair