



Does Suncor Energy Inc. Have Any Upside Remaining?

Description

Investors comparing the charts of **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)) and WTI crude oil prices recently may have noticed some interesting differences. Most interestingly, Suncor is currently trading at about the same price it was back in early June when WTI crude oil prices were above US\$50 per barrel.

Of course, Suncor is an integrated name with a large downstream refining segment (refining generated 96% of Q2's cash flow, although this was heavily influenced by the Albertan wildfires), so it won't see the same correlation to oil prices as a smaller pure-play operation.

Despite this, Suncor is actually looking reasonably valued when looking at one-year-out cash flow. Analysts at **Toronto-Dominion Bank** expect Suncor to earn debt-adjusted cash flow per share (DACF—a common cash flow measure in the oil industry) of about \$5.46 over the next 12 months. This is assuming oil prices of US\$52.65 for the year. This would give Suncor an enterprise-value-to-DACF ratio (a common oil-valuation metric) of eight.

How does this compare to Suncor's history? Typically, Suncor would expect to trade at about 9.1, which is the long-term historical average. This means Suncor is actually doing fairly well, and this reasonable valuation is based largely on two factors: a favourable outlook for oil prices and rapid production growth from Suncor.

Suncor is expecting huge production growth

While Suncor may have a reputation for being boring with low growth, it has expected production growth for 2017 (and even more production growth beyond that) that would make even quickly growing junior names envious.

Suncor is expecting about 600,000 barrels per day of production in 2016 (based on the mid-point of its guidance). Looking out to 2017, analysts see Suncor having about 700,000 barrels per day of production, which would represent an impressive 16% production growth over the year.

Beyond 2017, Suncor has stated that it is expecting its production growth to exceed 800,000 barrels

per day by 2019. This would be 40% production growth over a four-year period and a 6% production per shares CAGR over the period.

This growth is coming from a variety of sources, both organic and inorganic. Suncor's Fort Hills project, for example, is set to see first production at the end of 2017, and by the time the project is fully ramped up by the end of 2018, Suncor should see 90,000 barrels per day based on its 51% working interest.

Suncor will also see production growth from its Hebron project on the east coast, which should have 30,000 bpd of production ramping up in 2017. Suncor has also spent over \$9 billion on acquisitions in 2016, which included expanding its stake in Syncrude from 12% to 54% by purchasing Canadian Oil Sands Ltd. earlier in the year and a 5% stake from **Murphy Oil Corp.**

These acquisitions were made at the bottom of the oil cycle for attractive prices and were funded largely through equity (60%) with the remainder being cash and debt. Suncor has been using excess free cash flow over the past several years to build cash on its balance sheet (\$3 billion currently) and buy back stock. Suncor has bought back 10% of its stock over the past three years and has effectively pre-purchased its acquisitions by doing so.

The end result of this production growth is that Suncor has increased its leverage to rising oil prices. Currently, Suncor expects that a US\$1 move in crude prices would result in \$220 million cash flow compared to \$165 million in 2015.

Suncor still has some upside

As a result, it seems that Suncor still has some upside. Analysts at TD Bank see 2017 DCF per share of \$6.22 (based on US\$60 oil prices for the year), which would give Suncor a 2017 EV/DCF of only 7.05. A move up to eight or 8.5 would take Suncor to more average levels.

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