Imperial Oil Ltd. & Suncor Energy Inc.: 2 Names That Should Outperform With Lower Oil Prices

Description

Imperial Oil Ltd. (TSX:IMO)(NYSE:IMO) and **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) are two of the largest integrated oil producers operating in the oil sands today.

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While many exploration and production (E&P) companies, like **Baytex Energy Corp.** and **Bonterra Energy Corp.**, have seen their earnings decimated due to persistently lower oil prices that have endured since the start of 2015, "integrateds" like Imperial Oil and Suncor haven't suffered nearly the same fate.

This is because unlike the E&Ps, which extract crude from the ground and sell it to refiners to turn the oil into petroleum products like diesel, gasoline, and plastic compounds, the integrated producers own the refining assets themselves.

So, while the E&Ps have to deal with a lower realized sale price for their crude oil while prices are depressed, for the integrated producers, the lower oil price actually reduces the input costs before converting the crude to gasoline and other petroleum outputs.

The bigger factor affecting the performance of these integrated producers is not the level of oil prices, but rather the differential between crude prices and refining outputs, or what is commonly referred to as the "crack spread."

While oil prices have fallen from $95 a barrel to under $50 per barrel, have you seen the cost to fill your vehicle with gas fall by 50%?

I didn't think so.

Let's take a closer look at Imperial Oil and Suncor to see how they've fared during the oil downturn and review the forecasts for these companies going forward.

Imperial Oil

IMO shares trade at forward P/E of 15 times, and investors who own the shares are getting paid a 1.57% yield while they wait for the value of the shares to appreciate.

While the dividend yield for Imperial Oil is actually on the low side, in 2016 the company generated a return on equity of 10.6% and paid out only 19.6% of its earnings in the form of dividends.

This means the company has room to grow the dividend from current levels with a sustainable dividend growth rate of 8.5%.

Revenue was up 37% for the most recent quarter, and the company is expected to generate 13% sales growth for the full year.

However, analysts are forecasting a 9% drop in sales next year, which is likely the reason there are three “hold” and one “underperform” ratings on the stock as it stands today.

Suncor

Suncor trades at a forward P/E of 18.6 times, which is more expensive than Imperial Oil, but the company offers a better yield of 3.17%, which may be of interest to income investors and retirees.

But while Imperial Oil appears to have potential to grow its dividend for years ahead, we don’t quite see the same potential with Suncor’s shares.

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The company’s payout ratio sat at over 125% for the past year, which must be making investors nervous.

That said, Suncor shares appear to offer better prospects for growth as compared to Imperial Oil. Analysts are forecasting 27% and 6% top-line growth over the next two years.

For the sake of current shareholders, hopefully that growth will translate into earnings and a healthier payout ratio.

Which should you buy?

Both companies are not without their moles, so to speak, but they offer more earnings stability than many E&P companies while oil prices remain subdued.

While there are better opportunities elsewhere in the market, if you need to have part of your portfolio allocated to the energy sector, these are two companies are probably a safe place you can park your money in the meantime, until the outlook improves.

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