Suncor Energy Inc.: Is the Stock Too Expensive Today?

Description

Investing in the Canadian energy sector isn't for the faint of heart. Many oil firms are still struggling to jump out of their funk, despite the recent rally in oil prices to the high $50 levels. Many pundits are calling for $60 oil next year, but should you opt for a beaten-up oil sands operator? Or would is it a smarter move to pay a premium multiple for a robust high-quality business with the ability to outperform its peers regardless of the condition of Alberta's oil patch?

Suncor Energy Inc. (TSX:SU)(NYSE:SU) is arguably the safest way to invest in the oil sands. With a top-notch management team and the ability to outperform in a low oil price environment, it's definitely a blue-chip stock that many cautious investors should feel safe holding.

Why Suncor?

The company has one of the best integrated operations out there, resulting in a stable cash flow stream, which allows the company to be less susceptible to fluctuations in oil prices, as we've seen during the plunge in oil prices earlier last year. With an extremely healthy balance sheet, Suncor has the ability to take advantage of opportunities should another oil plunge present itself.

The company recently announced plans to spend between $4.5 and $5 billion in 2018 to ramp up upstream production to achieve a 760,000 boe/d. Steve Williams, Suncor's CEO, said that Suncor would be positioned to return cash to shareholders through dividends and share buybacks in 2018 while production surges thanks to new projects. Mr. Williams's statements should come as no surprise to investors since the company has been a dividend-growth king in the years following the Great Recession.

There's a tonne of room for growth with many oil sands projects that could fuel more dividend hikes for many years to come. With production ramping up and oil prices recovering, investors can expect the magnitude of annual dividend hikes to increase going forward.

Why not Suncor?

Other operators in Alberta's oil patch are starting to use solvent aided process (SAP) to lower the cost of oil extraction. **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) has a steam-assisted gravity drainage process, which is even more efficient than your typical SAP, resulting in a significant reduction in costs and greenhouse gas emissions.

If oil prices head south again, Suncor may find it difficult to thrive without such an efficient solvent-aided extraction process. Although management has shown a commitment to the SAP, it doesn't have a front-row seat yet, but that may change in time.

In addition, shares of Suncor are trading at a hefty premium to many of its peers with a 20.6 price-to-earnings multiple, a 1.6 price-to-book multiple, and a 2.4 price-to-sales multiple, all of which are higher than industry average multiples.

Bottom line

Suncor is a more stable stock than many other oil sands operators, but you'll be paying a premium for this lower volatility. I think Suncor is one of the best long-term holdings for those with a long-term time horizon; however, I'd much prefer waiting on the sidelines until a better entry point presents itself.

If you look at the last five years, you'll see sharp dips in share price; it's these dips that are terrific opportunities to accumulate shares.

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