A Top Canadian Oil Stock for Buy-and-Hold Investors

Description

It seems the strength in oil prices isn't enough for investors to get excited about the top Canadian oil stocks.

The bottlenecks in the Canadian pipeline system is the biggest reason for this apathy. These pipeline constraints are stopping these oil-sand producers to ship their products to market. As a result of this glut, the price of Western Canadian Select (WCS) continues to trade at a discount when compared with WTI prices.

Amid these constraints and rising taxes, this situation is unlikely to change in the near term. According to a new forecast by **Barclays PLC**, the WCS-WTI differential for this year will rise to US$24.60 per barrel. It reached US$21.70 on March 19, down from peaks of nearly US$30 in February.

WCS discounts would cost the Canadian economy about $15.6-billion a year, or 0.75% of GDP, if maintained at current levels, according to Scotiabank Chief Economist Jean-Francois Perrault.

Against this dismal backdrop, should oil bulls stay on the sidelines? I think this is probably a good approach until we see some political settlement on this issue. But long-term investors who want some exposure to oil sector should also look for good entry points if the stock prices of large producers decline further.

For such buy-and-hold investors, I recommend **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), Canada's largest oil-sand producer. Here's why:

Diversification

Suncor has a good business-mix, which is a type of hedge against falling oil prices. With its extensive oil-sand operations, Suncor also owns refineries and more than 1,500 Petro-Canada service stations. This diversification keeps cash flows strong even during a prolonged downturn in oil prices.

Cost-cutting

Since the 2014 oil downturn, Suncor management has undertaken an aggressive cost-cutting program that has prepared this diversified and integrated oil giant to take advantage of higher oil prices.

During the past five years, Suncor's cost to dig a barrel of crude oil has fallen to $23.80 in 2017 from $37 in 2013, thereby representing the lowest level achieved in more than a decade. With crude prices trading at more than $60 a barrel, Suncor expects to generate over $10 billion in funds from operations in 2018, giving it a cash flow yield of ~15%.

The bottom line

With a 3.34% annual dividend yield, Suncor has a great track record of rewarding its investors. Last month, Suncor hiked its quarterly dividend by 12.5% to $0.36 per share, marking the 16th year of consecutive annualized dividend increases.

I don't see Canada's pipeline constraints easing anytime soon, and so I can't make a bullish case for the local oil producers. But if you're a buy-and-hold type investors, buying Suncor stock isn't a bad idea when its price is down about 9% this year and the company is forecasting to generate decent cash flows.

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Date
2025/09/16
Date Created
2018/03/21
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