If You Don't Buy Suncor Energy Inc. (TSX:SU) Today, You'll Be Kicking Yourself Later

Description

Canada's energy sector has been making headlines lately, but for all the wrong reasons.

First, investors have to understand not all oil is the same. Light crude is ideal because it's much easier to refine into gasoline and other related products. Heavier crude can also be refined, but the process is more expensive. Thus, it's only natural heavier crude — like the stuff produced in the oil sands — would be priced lower. A spread between the two prices always exists.

These days that spread is higher than ever. West Texas Intermediate (WTI) trades at approximately $68 per barrel after a bit of a sell-off. Western Canadian Select (WCS) trades at just $18 per barrel. The $50 per barrel gap is a huge spread. Just five months ago, the spread was as low as $10/barrel.

The huge gap can be attributed to a couple of factors. There are two big refineries offline that normally process a lot of the production coming from Northern Alberta. These facilities should be back to full capacity in a few months. Second, investors are punishing the Canadian government for delays in expanding its recently-acquired TransMountain pipeline system. Even if everything goes well, it might take a decade for the planned expansion to be built.

Naturally, the largest heavy oil producerf, **Suncor Energy Inc.** (TSX:SU), has taken this news squarely on the chin. Shares are down 14% over the last three months after hitting a 52-week high. It's obvious that the market is expecting short-term results to be weak.

Investors should take advantage of this weakness and add shares to their portfolio. I'm confident that a long-term investment in Suncor should work out handsomely. Here's why.

WCS recovery

Suncor is in a great position to benefit when WCS prices recover.

The same pattern happens all the time, especially in commodity companies. Nobody is developing much of anything in the region. And who can blame them? It's going to take a big improvement in WCS prices before anyone even thinks of adding production capability. But remember, it takes years for oil sands projects to get off the ground, which means that companies like Suncor will get to enjoy the benefits once prices recover.

A solid balance sheet

Suncor has gone on a bit of a buying spree over the last few years, further consolidating its dominant position in the oilsands.

It has done so while keeping its balance sheet rock solid. The company has just over $16 billion worth of net debt versus more than $45 billion worth of shareholder's equity. That's a debt-to-equity ratio of just 28%. It also easily earns enough to cover the interest payments as well as the dividend.

Other assets

One of the things I really like about Suncor is the company's diverse operations. Sure, it's still tied to the oil sands. But it owns plenty of other assets that churn out predictable profits.

Through the first six months of 2018, Suncor generated approximately $5 billion in funds from operations. $1.8 billion — or nearly 40% — of that was earned by the refining and marketing division, which includes Suncor's four refineries and its 1,500 Petro Canada locations.

Giving back to shareholders

Suncor has consistently raised its dividend over the years, including an increase every year since 2010. Yes, Suncor even managed to increase its dividend during the 2015 oil rout, a vicious bear market that saw most of its competitors cut or eliminate their payouts. Shares currently yield 3%.

The company is also rewarding shareholders by repurchasing its stock. Suncor bought back some 20.86 million shares through the first six months of 2018, spending nearly $1 billion on buybacks. Once you add in the dividends, Suncor is on pace to give back $4 billion to shareholders in 2018.

The bottom line

You don't become one of the largest oil producers in the world by accident. Suncor's management are disciplined capital allocators in charge of a company that's well positioned to weather this current storm. The spread between WCS and WTI will indeed return to normal. When it does, investors who don't buy now will be lamenting the missed opportunity.

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Date
2025/08/26
Date Created
2018/10/24
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