Is It Time to Buy Suncor Energy Inc. (TSX:SU)?

Description

Oil's latest price collapse, which sees West Texas Intermediate (WTI) trading at around US$51 a barrel has led to increasing speculation that crude has entered a new bear market. There are fears that WTI could fall to US$40 a barrel or lower in coming months because of a confluence of events, indicating that the outlook for oil is not as positive as energy markets believed two months ago.

That, coupled with a widening spread between the price of Canadian heavy crude known as Western Canadian Select (WCS) and WTI is placing considerable pressure on Canadian energy companies, particularly those focused on the oil sands.

One company that has demonstrated that it is relatively immune to oil's latest gyrations is integrated energy major **Suncor Energy Inc.** (TSX:SU)(NYSE:SU). While WTI has lost around 10% since the start of 2018, Suncor has only lost 8%, and there are indications that the deep discount applied to WCS is having a significantly lower impact on the company than it is having on many of its peers.

Now what?

The strength of Suncor's operations is evident from its solid third quarter 2018 results. The energy major reported a new quarterly record funds flow from operations of $3.1 billion, which was 27% greater than a year earlier. Impressively, Suncor's net earnings shot up by 41% year over year to $1.8 billion, with its oil sands and refining business serving as the primary drivers of that spectacular growth.

There were a range of reasons for this strong financial performance key being higher crude, significantly improved refining margins and record oil sands production because of the Fort Hills bitumen operation coming on-line. For the quarter Suncor's total production expanded by just under 1% compared to the equivalent period in 2017 to almost 744,000 barrels daily.

A notable aspect of the company's oil sands operations are their low cash costs of $22 per barrel produced. These are lower than many of Suncor's peers and means that it can remain profitable at prices where other oil sands operators are incurring a loss.

Nonetheless, when WCS dipped below $20 a barrel earlier this month Suncor was making a large loss on every barrel of bitumen produced.

While sharply weaker WCS is wreaking havoc on many of Suncor's peers including Canada's third largest oil sands producer, **Cenovus Energy Inc.,** it is beneficial for the energy major, as Suncor has invested considerable capital in developing its refinery operations to have processing capacity of over 450,000 barrels daily.

The bitumen produced by Suncor's oil sands operations acts as an important feedstock for that business. When the price differential between WCS and WTI widens it boosts the margin that business generates, offsetting the financial impact that it has on Suncor's oil sands production.

For the third quarter, the company's refining business reported record quarterly net earnings of $939 million, which were 57% greater compared to a year earlier. This was driven largely by its refining margin, which more than doubled to $386 million during the quarter.

Suncor has therefore rejected calls from other industry players such as Cenovus and **Canadian Natural Resources Ltd.** for the government of Alberta to introduce mandatory production cuts. The push for production cuts has arisen because of the sustained weakness of WCS caused by a lack of pipeline capacity to transport growing bitumen production to key U.S. refining markets. That has created a localized supply glut with oil stocks in Western Canada at record levels that's weighing heavily on prices.

So what?

The reasons discussed demonstrate why investors should still consider Suncor even in a difficult operating environment where oil remains weak and the spread between WCS and WTI remains wide. The latest sharp decline in oil means that Suncor's fourth quarter 2018 results won't be as strong as the third quarter, but it is well-positioned to benefit when oil rebounds in coming months. According to industry analysts, crude's latest sell-off is overdone and WTI is expected to recover to around the US$60 a barrel mark before the end of the year.

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