Will Suncor Energy Inc. (TSX:SU) Rise 30% in 2019?

Description

Like many Canadian energy producers, shares of **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) have taken a hit over the past six months, down roughly 25%. Today, there are several external factors influencing the company's performance, making it difficult to determine which variables matter most.

As we look ahead to 2019, Suncor is facing pressures regarding forced production cuts, limited pipeline capacity, and surprisingly weak Canadian crude prices. On the contrary, certain tailwinds like cost-effective production gains and earnings stabilization from its refining arm could position the company for a rebound year.

Is Suncor headed for a difficult 2019, as its recent share price suggests? Or can it return to its earlier trading levels, suggesting more than 30% upside?

Recent weakness comes from temporary problems

Over the last six months, Suncor shares have dipped from multi-year highs of more than $40 to under $30, the same level shares were trading at in December of 2015. Extraneous shocks are to blame.

In December, Alberta announced a surprise, mandatory production cut, thereby reducing output in the entire province by 325,000 barrels per day. Limited pipeline capacity was causing producers to compete on price in order to get their output to refineries or outside markets.

Limited capacity caused crude oil prices in the area to drop below $30 per barrel, sometimes falling as far as $15 per barrel. These selling prices were wildly different than the better known West Texas Intermediate price index, which floated around $50.

While these production cuts won't come into effect until January, crude oil prices in the region have already doubled. The discount versus WTI prices narrowed from roughly $30 per barrel to just $20 a barrel nearly overnight. The discount still exists—and rightfully so considering the quality and locationof the production—but margins for producers like Suncor have improved immensely, even if shareshave yet to rebound.

It's important to note that these productions cuts are temporary, and will cease when the region's oil stockpiles are liquidated. This may last only a few months. Afterwards, production cuts will fall to just 95,000 barrels per day for the remainder of the year, perhaps even less.

Suncor is still well positioned for the future

Even after considering the mandatory production cuts, Suncor is still on track to increase its production in 2019, all without increasing capital expenditures.

On December 14, the company announced that its capital spending program for 2019 will range from $4.9 billion to $5.6 billion, which is similar to 2018 levels. Meanwhile, production is set to rise by 10%. Becoming more capital efficient is an important step forward in a difficult pricing market.

Margins are also looking healthy for the upcoming year. At its oil sands and Fort Hills' facilities, cash costs should be under $20 per barrel. Cash operating costs at the more expensive Syncrude facility should come in around $30 per barrel. So even with Western Canadian Select oil prices trading at a $20 discount to WTI, Suncor should still be able to turn a profit.

Most important, the company's refinery facilities provide a huge cushion against any ongoing WTI and WCS pricing differentials. The company owns three refineries that process more than 75% of its oil sands production.

After oil is refined, it is typically priced much closer to WTI prices, so even if WCS prices remain weak, the company can convert this lower priced crude into more valuable material. Companies without these refinery facilities have no such advantage, which is why their shares have dropped much further than Suncor's in recent months.

In total, Suncor remains a good bet for oil bulls. Rising production gives you growing upside, while flat capital expenditures and healthy margins should result in good operating leverage. And with company-owned refinery capabilities, investors don't have to worry if WCS prices continue to trade at a discount.

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Date
2025/08/18
Date Created
2018/12/24
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