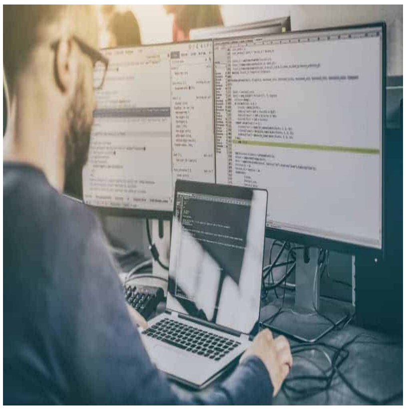

Is Suncor Energy Inc. (TSX:SU) a Risky Investment?

Description

The outlook for crude continues to improve, driving the price of West Texas Intermediate (WTI) higher in recent days to see the North American benchmark trading at over US$52 per barrel. This, along with narrower price differentials for Canadian crude blends because of Alberta's mandatory production cuts, will be a boon for oil sands operators. That has sparked considerable conjecture that now is the time to acquire quality Canadian energy stocks such as integrated energy major **Suncor Energy Inc.** (TSX:SU)(NYSE:SU).

Weak heavy oil prices benefit the company

Suncor, Canada's second largest oil sands producer opposed the mandatory cuts to production announced by Alberta's provincial government in late 2018. This was because unlike other large oil sands producers, it possesses considerable refining capacity and the profitability of its downstream business soars when the prices of its key feedstock bitumen is significantly lower than WTI.

For the third quarter 2018, Suncor reported record quarterly operating earnings of $939 million, which were 57% greater than the $597 announced for the equivalent period in 2017. Along with its highest quarterly oil production ever, that was a powerful tailwind for the energy major's record quarterly funds from operations of $3.1 billion.

The primary driver of this impressive performance aside from higher oil was the wide differential between Canadian heavy crude known as Western Canadian Select (WCS) and the WTI. Over the course of the quarter, the discount applied to WCS rose to almost US$30 a barrel, which meant that the cost of feedstock for Suncor's refineries, which can process around 460,000 barrels daily or over half of its bitumen output, fell significantly**.**

Yet, the energy major was still able to sell the finished fuels and other products at a premium price, thereby substantially boosting its refining margin, which for the third quarter rose by an impressive 42% year over year to $34.45 per barrel processed. The differential between WCS and WTI widened substantially during the fourth quarter 2018 as the localized bitumen glut in Western Canada grew to record levels, boding well for further strong quarterly results from Suncor's refining business.

Now that the price of WCS has more than doubled from its record November 2018 lows, because of Alberta's production cuts, Suncor won't benefit from cheaper feedstock for its refineries, which will impact the financial performance of that business.

Nonetheless, its upstream business will profit from higher prices for Canadian light and heavy crude, particularly with that operation reporting record fourth-quarter production of 831,000 barrels, 12% greater than the previous quarter.

Another notable aspect of Suncor's operations compared to other oil sands producers are its low cash costs, which for its oil sands operations for the third quarter came to $22 per barrel. That underscores just how profitable that business even amid an environment in which WCS is trading at $56 per barrel. For these reasons, it isn't difficult to foresee Suncor reporting further strong financial results for the fourth quarter despite WTI falling sharply toward the end of the year.

Is it time to buy Suncor?

Suncor's quality integrated operations, ability to refine a large portion of its bitumen production, low operating costs and growing production make it one of the least risky operators in the energy patch. And that, along with the improving outlook for crude and that it has lost 14% over the last year make it an attractive play on higher oil.

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