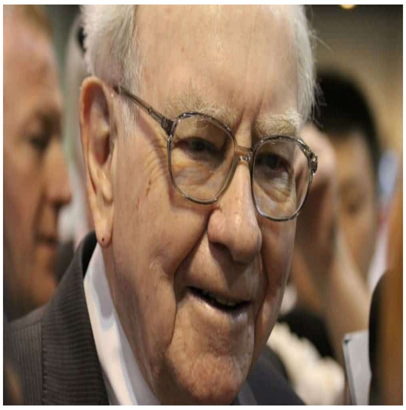

Why Is Warren Buffett Buying Suncor Energy Inc. (TSX:SU)?

Description

On February 14, shares of **Suncor Energy** (TSX:SU)(NYSE:SU) popped after **Berkshire Hathaway's** Warren Buffett disclosed a 10.8 million share stake, representing 0.7% the entire company.

This move followed a 22% reduction in Buffett's **Phillips 66** stake, so the bet likely represents far more than a simple industry-wide wager. Still, *Reuters* reported that Buffett's involvement "highlights the benefits of being an integrated oil company and could revive investor interest in the languishing Canadian energy sector."

It's as if suddenly, other fund managers came out of the woodwork to support the company and its shares.

"Suncor [has] a strong downstream operation, which financially benefits from oil bottlenecks and that is unique to Suncor, which you can't get with many other companies in the energy space," noted a portfolio manager at **Manulife**. A VP at Acumen Capital Finance commented that Buffett's purchase was at an "attractive entry point for an out-of-favour sector."

What exactly does Buffett see in Suncor? Why has market sentiment shifted so quickly since his stake was disclosed?

Perusing the bargain bin

It should come as no surprise to learn that the Canadian energy sector has been wildly out of favour. Since August, shares of **Canadian Natural Resources**, **Husky Energy**, **Imperial Oil**, and **Encana** have all experienced drops of 20% or more.

Suncor hasn't been immune to this industry-wide pressure. In the summer of 2018, the stock was consistently around $55 per share. By Christmas, shares had fallen to just $35 apiece. Buffett's purchase price is estimated to be in the low-$30s.

This actually isn't the first time Buffett has purchased Suncor shares through his investment company

Berkshire. In 2013, Berkshire took a position in Suncor, only to exit its stake in 2016 for roughly the same price. Buffett's familiarity with the company likely influenced his ability to snap up shares quickly after they dipped suddenly.

Why did shares drop?

Suncor's rapid dip stemmed from news outside its control. In December, I wrote that "Suncor is facing pressures regarding forced production cuts, limited pipeline capacity, and surprisingly weak Canadian crude prices."

At the time, Alberta was awash with excess oil supply without enough pipeline or rail capacity to export production. Local crude prices fell by more than 50%. The government opted to enforce mandatory production cuts to correct the imbalance.

"On the contrary," I continued, "certain tailwinds like cost-effective production gains and earnings stabilization from its refining arm could position the company for a rebound year." These are likely the factors that Buffett purchased shares for.

While other oil producers need to compete aggressively to refine their output, Suncor owns three facilities that process more than 75% of its output. That's a huge advantage considering investors don't have to worry if WCS prices continue to trade at a discount. With multiple ways to cushion downside risk, it's easy to understand why Buffett chose Suncor as his pick in a beaten-down industry.

Should you follow Buffett?

Suncor remains a viable investment option only for oil bulls. Like I said in January, most of the company's growth projects target US$50-per-barrel breakeven prices. Unless crude prices remain above that level, shareholders will find growth difficult.

Due to its integrated nature, however, Suncor is a more diversified bet for taking advantage of rising energy prices. If the Canadian energy sector rebounds, Suncor should follow suit. If pressures remain, Suncor should have limited downside risk compared to its less-integrated peers.

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