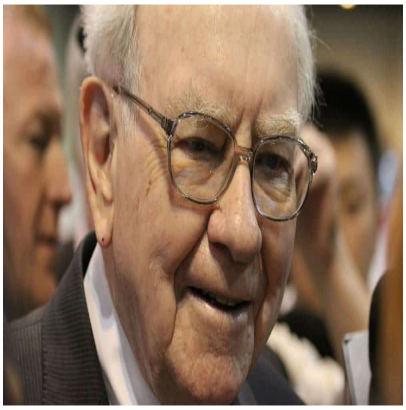

Invest Like Warren Buffett Buy Suncor Energy Inc. (TSX:SU)(USA)

Description

Canadian integrated energy giant **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) continues to garner considerable attention given the controversial mandatory oil production cuts introduced by Alberta's provincial government. Boosting that interest is news that the world's greatest investor Warren Buffett has taken a fresh 0.7% stake in the energy company worth around $491 million after exiting his last holding in Suncor in 2016. It's easy to understand the attraction that Suncor holds for Buffett despite Canada's oil sands becoming an increasingly unappealing investment because of environmental concerns and significant volatility associated with Canadian crude prices.

Diversified operations enhance profitability

Edmonton's cuts, which attracted the ire of Suncor, **Imperial Oil Ltd.** and **Husky Energy Inc.**, have breathed life back into Canadian bitumen prices, giving many oil sands producers hope that Western Canadian Select (WCS) would stabilize at a profitable level. The rational for Suncor's opposition to the cuts was simple: the wide price differential between WCS and the North American benchmark West Texas Intermediate (WTI), which peaked at around US$47 a barrel, made its refining operations extremely profitable.

For the third quarter 2018, Suncor's net income from its refining business soared by 57% year over year to $939 million supported by a notable 42% increase in the company's refining margin of $34.45 per barrel processed. Fourth-quarter net income declined to $723 million because of weaker WTI and higher feedstock prices, particularly for WCS, but Suncor still reported an impressive margin of $41.50 per barrel refined, which was 30% greater than a year earlier.

That refining business effectively allows Suncor to offset the impact of weaker WCS on its upstream oil sands operations. This becomes evident when reviewing the energy giant's 2018 results. The sharp decrease in the refining margins didn't materially impact Suncor's bottom-line. Full-year operating earnings surged by 35% compared to 2017, and Suncor reported record funds from operations of $10.2 billion, 11% higher year over year.

That strong earnings growth can be attributed to a combination of higher upstream production, notably from its oil sands business, firmer oil and increased refining margins. The 26% year over year decline in net earnings to $3.3 billion can be attributed to a significant $989 loss on Suncor's U.S. dollar denominated debt as well as a $90 million non-cash loss recorded against natural gas assets.

This not only indicates that the significant decrease in net income wasn't caused by operational failings, but it also clears the books for Suncor to report a stellar 2019. The integrated energy major expects 2019 production to rise by between 7% and 12% when compared to 2017 to as high as 820,000 barrels daily**,** with most of that growth coming from its Syncrude operation.

Suncor's share of Syncrude's synthetic oil output is expected to increase by as much as 25% during 2019. This is important to note because the synthetic oil produced by Syncrude typically realizes a sale price equal to the WTI benchmark or higher. That more than offsets the high operating costs associated with its oil production and will give Suncor's profitability a boost if WTI moves higher over coming months.

Notably, this notable increase in output isn't because of an untested expansion of the facility, but is in line with its existing nameplate capacity.

You see, Syncrude experienced a prolonged outage during 2018, which forced operations to go offline for roughly a month and causing third-quarter 2018 production to fall to 180,000 barrels daily, or around half of its capacity.

Suncor is also a low-cost operator, and its upstream production isn't afflicted by the high production costs affecting many of its peers. For 2018 it reported oil sands cash operating costs of $25.25 per barrel produced, and these are expected to fall by up to 5% to $24 per barrel, which along with firmer oil and higher production, will give earnings from Suncor's upstream business a solid lift.

Why buy Suncor?

It is easy to understand Buffett's interest in Suncor. The outlook for crude has improved markedly**,** in part because of OPEC production cuts, but also because of signs that global economic growth will not decline as sharply as initially believed now that a trade war between the U.S. and China appears to have been averted. Because of its integrated operations and ability to refine a large portion of its own oil production, Suncor is uniquely positioned to benefit from higher oil as well as wider price differentials between Canadian crude and WTI.

For these reasons, Suncor's earnings should keep growing at a solid clip. While investors wait for that to give its stock a solid boost, they will be rewarded by a regular sustainable dividend yielding almost 4%.

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