Suncor's (TSX:SU) Profits Nearly Tripled in Q2: Why Didn't the Stock Rally?

Description

Suncor Energy Inc (TSX:SU)(NYSE:SU) released its quarterly results last week. The company had a remarkable net income of $2.7 billion, which was far and away better than the $972 million profit it posted a year ago.

Its profit margin also soared from 9.3% a year ago to a whopping 27%. Despite the impressive improvement in the company's bottom line, however, the stock not only didn't rally, but continued to fall.

Why weren't the markets bullish on the results?

Although Suncor posted a significant profit during the quarter, sales were actually down more than 3% from the prior year. In terms of production, however, it was a record for Q2 despite the Alberta curtailment program being in effect.

Suncor credits its flexibility and broad asset base in being able to shift production among its different assets. Unfortunately, its oil sands operations were the only segment that saw sales rise from the prior year.

Both exploration and production as well as refining and marketing segments were down year over year.

Ultimately, the main reason for the big improvement during the quarter wasn't sales growth, instead, it was due to income tax recoveries of over $1.1 billion as a result of the corporate tax rate in Alberta being reduced from 12% to 8%.

To a lesser extent, a gain on an asset disposal reduced the company's operating expenses by $158 million. Financing expenses were also down significantly from the prior year, mainly to do with foreign exchange gains that were nearly a near mirror image of the losses that were incurred in the prior year.

If we look at pretax earnings of $2.1 billion and add back the $158 million gain as well as the foreign exchange impact on financing expenses totalling $455 million, that would reduce it down to $1.5 billion, a very modest 2.4% improvement from the prior year.

As you can quickly see, there were some significant non-recurring items that had a drastic impact on Suncor's overall results. That makes for a weak quality of earnings, which is why despite what looked to be a solid performance by the company, the stock didn't soar on the results.

The reality is that Suncor won't see these items on future quarters and that means investors won't rely on them either.

Bottom line

If it looks too good to be true, or inflated as a result of a one-time benefit, it usually is. There was a lot of noise on Suncor's financials this past year.

It underlines exactly why investors should always do their own research and due diligence when evaluating a company's performance. Simply looking at sales and profits won't tell the whole story.

However, these results do not by any means make Suncor a bad buy. It was still a good quarter for the company, and getting a tax break shouldn't be looked at as a negative, as it could help give the company some added funds to help grow the business.

That's definitely a big positive, and with the stock down 12% over the past three months, investors that buy Suncor today could be getting a great bargain, if for no other reason than its great dividend.

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