2 Reasons Why Warren Buffett Is Wrong About Suncor Energy (TSX:SU) Stock

Description

It's usually not a good idea to bet against Warren Buffett. From 1965 to 2018, **Berkshire Hathaway Inc.** (NYSE:BRK-A)(NYSE:BRK-B) returned more than 20% annually.

Over the same period, the **S&P 500 Index** compounded at roughly 10%. That gap is huge. Investors that trusted Buffett frequently ended up with *millions* in extra capital.

But as with any stock-picker, Buffett isn't always right. In 2008, he wrote about one of his biggest mistakes of his career. "Without urging from Charlie or anyone else, I bought a large amount of **ConocoPhillips** stock when oil and gas prices were near their peak," Buffett wrote.

"I in no way anticipated the dramatic fall in energy prices that occurred in the last half of the year." In the end, his $7 billion bet was reduced to just $4.4 billion in a matter of months.

Suncor Energy Inc. (TSX:SU)(NYSE:SU) is another energy giant that Buffett has dabbled in, with limited success. In 2013, he bought a sizable stake, only to liquidate the position three years later at breakeven prices.

Markets were surging during this period, so although Buffett didn't lose much on the bet, the opportunity cost was high.

This February, Buffett stepped up to the plate again, buying more than $500 million in Suncor stock, nearly 1% of the entire company. Already, it appears as if Buffett has taken a small loss on the bet. Long-term, this could wind up as another failed energy wager by the Oracle of Omaha.

Fighting time

There are two types of companies: those benefiting from secular growth and those facing secular decline. Print newspapers are a classic example of an industry in secular decline. For more than a decade, traditional newspaper companies have struggled with cost competitiveness and a loss of advertisers.

Digital media carves into their dwindling profits on a daily basis. Mobile telecom networks are a recent example of an industry experiencing secular growth. For the last two decades, the number of mobile subscribers in nearly every country has risen consistently.

When investing, it’s critical to know whether a specific stock is facing secular growth or decline. In one instance, a rising tide may lift all boats. In the other, the company will constantly be at odds with the rising tide.

There are several reasons to believe Suncor is facing secular decline. That means that over time, your odds of success will diminish, which is not a good place to be. The biggest factor working against the company is simply cost.

Oil sands production, which heavily dominates Suncor’s revenue mix, is one of the costliest ways to produce oil. That’s because oil sands output typically needs more refinement before it can be processed into useable end-products. More refinement results in more costs, putting oil sands at a structural cost disadvantage.

Today, most oil sands producers have a breakeven price of $35 per barrel or more. While that provides some breathing room at prevailing prices, it’s at the higher end of the industry cost curve.

For example, oil giants like **Exxon Mobil Corporation** and **Chevron Corporation** are exploring North American shale plays with breakevens as low as $15 per barrel.

In the age of ever-falling production costs, it’s not clear how oil sands companies can survive the next decade.

That’s why, several years ago, famed investor Jeremy Gratham revealed his belief that “tar sands will end up as a stranded asset in the next decade or two.”

Fighting politics

In addition to structurally higher costs, oil sands are also some of the most environmentally destructive energy projects on the planet. Regardless of your personal beliefs, it’s clear that political pressure has been hurting oil sands stocks for years. Pushback has stalled large projects and critical pipeline approvals.

Rising populism could put an end to oil sands projects before their poor economics can run their course. Nearly everything is moving against Suncor, and while there may be money to be made over the short term, the risk factors simply outweigh the potential upside.

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