Suncor (TSX:SU) Is a Top Energy Stock to Buy in October

Description

Oil keeps whipsawing wildly, as energy markets react sharply to any good or bad news. After some brief optimism regarding the outlook for crude earlier this year, oil has spiraled lower to see the international benchmark Brent down by 29% over the last year to be trading at US$60 per barrel. The North American benchmark West Texas Intermediate (WTI) has lost 27% over the same period to be selling for US$54.55 a barrel. The poor outlook for crude, which is being exacerbated by softer global manufacturing activity, the U.S.-China trade war, and fears of a recession, is weighing heavily on Canadian energy stocks.

Nonetheless, this shouldn't prevent investors from bolstering their exposure to quality oil, because there are signs that it will eventually rebound, and that higher prices are on the way. Alberta's introduction of mandatory production cuts at that start of 2019 has caused the wide price differential between the Canadian heavy oil benchmark Western Canadian Select (WCS) and WTI to close significantly, boosting the profitability of oil sands producers.

One of the best plays on higher oil is integrated energy major **Suncor** (TSX:SU)(NYSE:SU), which has lost 14% over the last year, creating an opportunity for investors to acquire a quality integrated energy company at an attractive price. Suncor's appealing valuation is underscored by it trading at 13 times projected earnings and 1.4 times book value.

Low-cost operations

What many investors fail to realize is that Suncor can remain profitable at prices that many upstream oil explorers and producers can't. This is because of the integrated nature of its operations, where it has upstream oil-producing operations and downstream refining as well as marketing businesses. When oil prices fall, that reduces the cost of materials for Suncor's refining operations, which have the capacity, according to its second-quarter 2019 results, to process around half of the oil it produces.

This has allowed Suncor to report solid profits, even when the discount applied to WCS during the second half of 2018 saw many other oil sands operators like **Cenovus** pumping bitumen at a loss. In fact, during the second half of 2018 Suncor announced solid financial results for its refining business despite the deep discount applied to WCS, which saw Canadian heavy oil selling for as little as US$6 per barrel, despite WTI trading at close to US$50 a barrel.

That was because feedstock for Suncor's refineries was significantly cheaper than the market price for crude, but it was able to sell the refined products at rates reflecting the price of WTI, allowing it to make a substantial profit. That highlights one of Suncor's key strengths and how its considerable refining capacity gives it a financial advantage over Cenovus and **Canadian Natural Resources**.

Another positive characteristic is Suncor's ability to significantly expand its oil production. For the second quarter 2019, its oil output soared by 21% year over year to an average of 804,000 barrels daily, positioning it to take full advantage of firmer oil and make up for any revenue shortfall triggered by weaker prices. This growth came from Suncor's oil sands assets with it focused on ramping up operations at its Fort Hills oil sands facility.

What many investors fail to recognize is that once the substantial upfront costs to develop an oil sands asset have been expended, they require low amounts of sustaining capital and have long production lives. That makes oil sands assets very cost effective to operate. This combined with Suncor's focus on cost reductions and more efficiently deploying capital will be a key driver of greater profitability, despite weaker oil. For the second quarter, it reported oil sands cash operating costs, of $27.80 per barrel, which was 3% lower than a year earlier. Suncor also reported that its return on capital employed had risen by 2.1% compared to a year earlier to 10.4%.

Foolish takeaway

Suncor is one of the best lower-risk plays on higher crude. While patient investors wait for oil to rebound and Suncor's earnings to grow, they will be rewarded by its sustainable dividend, which it has hiked for 16 years straight to yield a juicy 4%.

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