Suncor Energy Inc. (SU)

Updated August 23rd, 2018 by Nick McCullum

Key Metrics

Current Price:	$54	**5 Year CAGR Estimate:**	2.9%	**Volatility Percentile:**	58.4%
Fair Value Price:	$38	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	84.5%
% Fair Value:	142%	**5 Year Valuation Multiple Estimate:**	-6.8%	**Valuation Percentile:**	8.2%
Dividend Yield:	2.7%	**5 Year Price Target**	$53	**Total Return Percentile:**	13.8%

Overview & Current Events

Suncor Energy is one of the largest integrated energy producers in Canada. The company is involved in all aspects of the energy value chain, including exploration & production, marketing, and refining. The company operates in three segments: Exploration & Production, Refining & Marketing, and Other. Suncor is headquartered in Calgary, Alberta, Canada and is cross-listed on both the Toronto Stock Exchange and the New York Stock Exchange, where it trades under the ticker 'SU' with a market capitalization of US$67 billion. Suncor reports financial results in Canadian dollars. Accordingly, the figures listed in this research report are in CAD and the company's TSE-listed shares have been used for the purpose of valuation analysis.

In late July, Suncor reported (7/25/18) financial results for the second quarter of fiscal 2018. Results were very strong. Suncor generated operating earnings of $1.190 billion (or $0.73 per diluted share), which was a tremendous increase over 2017's $199 million (or $0.12 per diluted share). Robust growth in operating earnings was driven by improved crude oil prices, which drove the company's refining margins higher. Using an alternative profitability metric, Suncor's funds from operations of $2.862 billion (or $1.75 per common share) also increased noticeably over last year's $1.627 billion (or $0.98 per common share), although this growth was not as strong as the company's rise in operating earnings. Suncor's second quarter earnings release was positively received by the markets and shares rose by as much as 4% on the first day following the announcement.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.26	$0.95	$1.71	$2.67	$1.79	$2.60	$1.84	-$1.38	$0.27	$2.68	***$2.70***	***$3.79***
DPS	$0.20	$0.30	$0.40	$0.43	$0.50	$0.73	$1.02	$1.14	$1.16	$1.28	***$1.35***	***$2.08***
Shares	931.52	1559.8	1565.5	1558.6	1523.1	1478.3	1444.1	1446.0	1667.9	1641.0	***1620.0***	***1500.0***

Although the company had a very difficult year in 2015, Suncor's recovery is well underway. Indeed, the company's 2017 earnings-per-share were its highest *in the last decade*. 2018's earnings-per-share are widely expected to be roughly flat over last year's figure. Beyond that, we believe that Suncor is capable of generating 7% earnings-per-share growth over full economic cycles.

Share repurchases will also boost Suncor's per-share growth. In the most recent quarter, the company repurchased $849 million of stock (about 1% of its current market capitalization). Moreover, Suncor's Board of Directors approved an increase to its existing share repurchase program from $2.15 billion to $3 billion. Because of this, we believe the company's rapid pace of share repurchases is likely to continue moving forward.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	21.0	35.0	19.7	13.6	17.8	13.0	21.8	---	---	15.6	***19.9***	***14.0***
Avg. Yld.	0.4%	0.9%	1.2%	1.2%	1.6%	2.2%	2.5%	3.1%	3.2%	3.1%	***2.7%***	**-**

Like many large energy companies, Suncor's valuation history has been very volatile as the company has battled tremendous fluctuations in its earnings-per-share. Using peak earnings (which Suncor is currently achieving), we believe that a fair price-to-earnings ratio for this energy company is 14. The company is trading at a price-to-earnings ratio of 19.9 today. Valuation contraction will likely introduce a meaningful headwind to this stock's total returns over the medium term. More specifically, if Suncor's price-to-earnings ratio reverts to 14 over the next 5 years, this will reduce its total returns by 6.8% per year during this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	29.1%	13.9%	24.9%	27.6%	27.6%	28.5%	28.0%	22.7%	19.1%	23.4%	***25.0%***	***25.0%***
Debt/A	55.4%	51.1%	48.7%	48.4%	48.7%	47.4%	47.8%	49.6%	49.7%	49.3%	***50.0%***	***50.0%***
Int. Cov.	3.5	4.2	9.7	70.3	38.9	18.0	13.6	-3.3	1.2	22.2	***25.0***	***25.0***
Std. Dev.	59.8%	39.9%	24.8%	34.1%	24.8%	20.0%	23.4%	23.4%	25.1%	19.7%	***22.0%***	***22.0%***
Payout	8.8%	31.6%	23.4%	16.1%	27.9%	28.1%	55.4%	N/A	430%	47.8%	***50.0%***	***54.9%***

Suncor Energy generates a higher level of gross profits relative to its total assets than many of its peers in the Canadian energy space. The company's balance sheet is sound, with less than 50% of its assets financed through debt. Suncor's payout ratio also gives it room to continue increasing its dividend in the event that earnings growth stalls temporarily. The only negative observation that investors can take from Suncor's quality metrics is that the company has a stock price volatility that is well above-average among our investment universe.

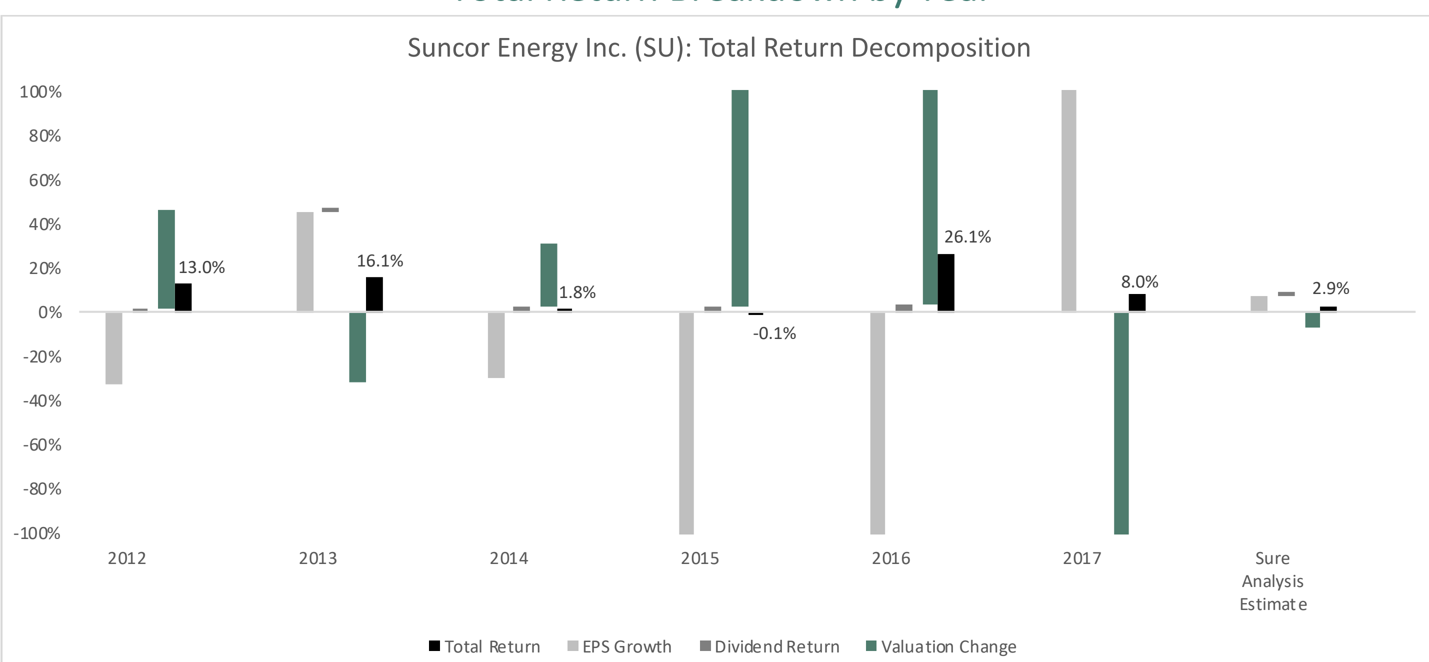
Separately, Suncor is a committed dividend grower. The company is a member of the S&P/TSX Canadian Dividend Aristocrats Index, which is comprised of companies included in the S&P Canada BMI that have increased their dividends for at least five consecutive years. Suncor's dividend growth streak extends well beyond this arbitrary five-year cutoff, but what really stands out is the pace of these dividend increases. Suncor's 10-year dividend growth rate is *45%.*

Final Thoughts & Recommendation

Suncor Energy has an undisputed leadership position within the Canadian energy markets. The company rebounded quickly from the decline in oil prices that began in 2014 and has a strong growth runway ahead of it.

With that said, Suncor's total return prospects are quite poor, largely due to an expensive valuation. The company appears likely to deliver low single-digit total returns from its current price. Accordingly, Suncor earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.