Suncor Energy Inc. (SU)

Updated August 28th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	$33	**5 Year CAGR Estimate:**	6.7%	**Market Cap:**	$42.8 B
Fair Value Price:	$51	**5 Year Growth Estimate:**	-6.0%	**Ex-Dividend Date:**	8/31/2023
% Fair Value:	65%	**5 Year Valuation Multiple Estimate:**	9.0%	**Dividend Payment Date:**	9/25/2023
Dividend Yield:	4.7%	**5 Year Price Target**	$37	**Years Of Dividend Growth:**	2
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Suncor Energy is one of the largest integrated energy producers in Canada. The company is involved in all the aspects of the energy value chain, operating 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$42.8 billion. Suncor reports financial results in Canadian dollars. However, the figures listed in this research report are in USD.

In mid-August, Suncor reported (8/15/23) financial results for the second quarter of fiscal 2023. Its upstream production remained flat sequentially but the company was hurt by lower refining margins and a significant correction of the price of oil, as the oil market has partly absorbed the impact of the Ukrainian crisis. As a result, adjusted earnings-per-share declined -29%. Given the correction in the price of oil and refining margins, we have lowered our forecast for annual earnings-per-share from $4.30 to $3.90. Due to the severe downturn in the energy market in 2020, Suncor cut its quarterly dividend by -55% in 2020 and thus it broke its 18-year dividend growth streak (in CAD). We also reiterate that the results of Suncor are very sensitive to commodity prices. On the bright side, thanks to favorable oil prices and refining margins, Suncor doubled its quarterly dividend in late 2020 and raised it again, by another 12% last year.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$2.52	$1.60	-$1.04	$0.20	$2.06	$1.56	$2.18	-$1.15	$2.03	$6.24	***$3.90***	***$2.86***
DPS	$0.71	$0.89	$0.86	$0.84	$0.99	$1.11	$1.27	$0.83	$0.83	$1.45	***$1.56***	***$1.76***
Shares[1]	1,478	1,444	1,446	1,668	1,641	1,585	1,536	1,525	1,453	1,350	***1,320***	***1,250***

Suncor was greatly affected by the pandemic in 2020, but the company has recovered strongly thanks to favorable oil prices and wide refining margins. Suncor expects to achieve growth thanks to the ramp-up of production at Fort Hills and Hebron and other growth projects, which enhance value within its integrated asset portfolio. The company also makes sustained efforts to reduce its operating expenses. Despite the strong results in 2017-2019, the losses posted in the last quarter of 2018 are a harsh reminder of the company's sensitivity to oil prices, particularly the discount of Canadian crude to WTI. We expect exceptionally high earnings-per-share this year thanks to above average oil prices and refining margins, but we expect oil producers to boost their output eventually and thus send oil prices to more normal levels, around $50-$60. Given the high comparison base formed this year, we expect a -6% average annual decline of earnings-per-share over the next five years.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	13.0	21.8	---	---	15.6	23.7	14.4	---	10.7	5.3	***8.5***	***13.0***
Avg. Yld.	2.2%	2.5%	3.1%	3.2%	3.1%	3.0%	4.0%	4.6%	3.8%	4.4%	***4.7%***	***4.7%***

[1] In millions.

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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. As we have assumed relatively strong earnings in 2028 compared to the 10-year average earnings of the company, we believe that a fair price-to-earnings ratio for this energy company in 2028 is 13. Suncor is currently trading at a price-to-earnings ratio of 8.5, which is much lower than our assumed fair ratio. If the stock trades at our fair valuation level in five years, it will enjoy a 9.0% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	28.1%	55.4%	---	43.0%	47.8%	71.3%	58.0%	---	40.9%	23.2%	***40.0%***	***61.7%***

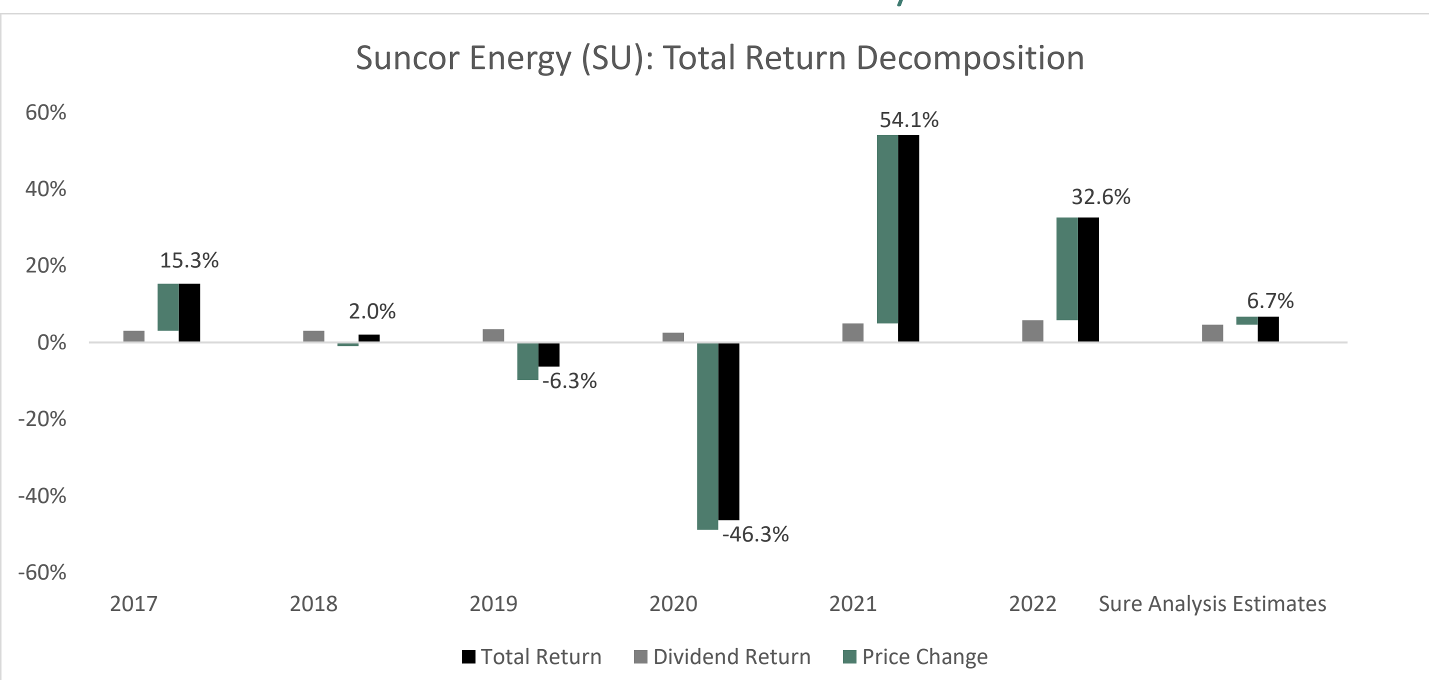
The integrated structure of Suncor Energy somewhat mitigates its exposure to the fluctuations of commodity prices. However, the company is still very sensitive to the underlying crude oil prices. In addition, as a commodity producer, Suncor lacks a meaningful competitive advantage. On the bright side, the company has a decent balance sheet, with only 52% of its assets financed through liabilities and a healthy interest coverage ratio of 15.8.

Until recently, Suncor was 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 extended well beyond this arbitrary five-year cutoff, but its high sensitivity to oil prices and its vulnerability to downturns forced the company to end its 18-year dividend growth streak (in CAD) in 2020 due to the pandemic. The high cyclicality of the stock and its volatile performance may render its dividend unsuitable for income-oriented investors.

Final Thoughts & Recommendation

Suncor has rallied 16% off its bottom in July thanks to a bounce in oil prices. The stock could offer a 6.7% average annual return over the next five years thanks to a 4.7% dividend and a 9.0% valuation tailwind, partly offset by a -6.0% decline of earnings-per-share. The stock receives a hold rating, but investors should be aware of its high cyclicality.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	38,450	36,107	22,884	20,243	24,656	29,741	28,890	18,407	32,808	48,352
Gross Profit	16,905	14,668	7,927	8,165	11,753	14,408	11,460	4,496	15,546	22,117
Gross Margin	44.0%	40.6%	34.6%	40.3%	47.7%	48.4%	39.7%	24.4%	47.4%	45.7%
SG&A Exp.	3,111	3,196	2,781	3,087	2,940	3,211	3,666	7,409	5,910	6,177
Operating Profit	6,512	4,774	(42)	76	3,551	4,959	1,483	(4,205)	5132	10,785
Op. Margin	16.9%	13.2%	-0.2%	0.4%	14.4%	16.7%	5.1%	-22.8%	15.6%	22.3%
Net Profit	3,798	2,445	(1,563)	328	3,440	2,541	2,184	(3,224)	3,285	6,977
Net Margin	9.9%	6.8%	-6.8%	1.6%	14.0%	8.5%	7.6%	-17.5%	10.0%	14.4%
Free Cash Flow	3,227	1,789	170	(681)	1,863	3,993	3,664	(934)	5,750	8,117
Income Tax	2,394	1,713	(25)	(271)	1,125	1,304	(276)	(1,327)	1,157	2,490

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	73,551	68,631	55,868	65,790	71,168	65,769	68,466	66,357	65,676	62,347
Cash & Equivalents	4,886	4,734	2,918	2,237	2,125	1,631	1,500	1,478	1,729	1,459
Acc. Receivable	4,934	3,683	1,982	2,360	2,609	2,354	3,102	2,476	3,556	4,471
Inventories	3,704	2,986	2,227	2,403	2,758	2,319	2,879	2,837	3,223	3,727
Goodwill & Int.	2,904	2,656	2,219	2,281	2,434	2,247	2,341	2,610	2,763	2,642
Total Liabilities	34,876	32,793	27,735	32,688	35,078	33,460	36,281	38,316	36,960	33,341
Accounts Payable	6,659	4,914	3,824	4,145	4,933	4,146	5,018	3,673	5,100	6,018
Long-Term Debt	9,771	10,592	10,114	12,928	11,396	12,738	11,513	14,736	12,160	9,289
Total Equity	38,675	35,838	28,132	33,102	36,090	32,308	32,185	28,041	28,716	29,006
LTD/E Ratio	0.25	0.30	0.36	0.39	0.32	0.39	0.36	0.53	0.42	0.32

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	5.1%	3.4%	-2.5%	0.5%	5.0%	3.7%	3.3%	-4.8%	5.0%	10.9%
Return on Equity	9.7%	6.6%	-4.9%	1.1%	9.9%	7.4%	6.8%	-10.7%	11.6%	24.2%
ROIC	7.7%	5.2%	-3.7%	0.8%	7.4%	5.5%	4.9%	-7.5%	7.9%	17.6%
Shares Out.	1,478	1,444	1,446	1,668	1,641	1,585	1,536	1,525	1489	1390
Revenue/Share	25.60	24.65	15.82	12.56	14.81	18.26	18.51	12.06	22.03	34.79
FCF/Share	2.15	1.22	0.12	(0.42)	1.12	2.45	2.35	(0.61)	3.86	5.84

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.