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Cardinal Update

Sunny Days for Suncor

After a dismal 2020, Suncor Energy is on the move.

The Calgary-based company was hit hard early in the pandemic – even being dethroned by Canadian Natural Resources as Canada's most valuable energy company – but it has rebounded significantly since then along with rising oil prices.

Suncor shares returned 54 per cent, including dividends, in 2021 and it increased its dividend by 100 per cent, returning it to pre-Covid levels. We believe a combination of upcoming operational improvements and free cash flow generation still leave Suncor undervalued.

The company posted a profit of $1.6 billion in its just-completed fourth quarter, a reversal from a net loss of $168 million for the same quarter in 2020. It has also strengthened its balance sheet considerably over the past 12 months, reducing debt at the fastest pace in its history from $19.8 billion to $16.1 billion, a decline of $3.7 billion or nearly 19 per cent.

Suncor's share price has rebounded from less than $22 at the beginning of 2021 to more than $37 by mid-February, a gain of more than 77 per cent.

The company had several operational missteps in 2021, including a delay to its ramp-up in Fort Hills, Alberta, and unplanned downtime in its oil sands operations. While that was disappointing, there is a long history of operational excellence. Reliability should improve and with the Fort Hills project returning to capacity this year, Suncor's production is expected to be close to 800,000 barrels per day.

Another reason we like Suncor is its strategy, which does not target production growth from new oil sands projects that are expensive and take years to become profitable. Instead, the company is focused on projects that improve reliability, efficiency and its environmental footprint. For example, its Permanent Aquatic Storage Structure project improves its tailings pond reclamation time by 10 years and eliminates 30 square km of land disturbance. This cost the company $400 million but will result in $325 million of annualized free cash flow savings by 2025.

Suncor is working on several of these projects, which are expected to generate $2.15 billion of increased free cash flow by 2025. In fact, with soaring oil prices, we expect Suncor to generate more than $8 billion of free cash flow in 2022, a figure that should grow to $9 billion as the remaining efficiency projects come online.

Mark Little, Suncor's president and CEO, says the company will continue to drive down its costs by increasing its workforce productivity – the target is 10 per cent – through the implementation of enterprise-wide systems and processes, increased digitization of its operations and uncovering further synergies.

Source: The Globe & Mail

"As many are looking at the strong macro environment, Suncor is well positioned in 2022 to deliver higher production and substantial free funds flow increase with a clearly defined capital allocation framework that accelerates shareholder returns," Little said in a recent analyst call on the company's fourth quarter 2021 results.

Suncor became the majority owner of Imperial Oil's long-struggling Syncrude mine last year, a steady process that saw it boost its ownership stake from just 12 per cent in 2015. Over those seven years, utilization at Syncrude grew from 71 per cent to 91 per cent. The company is on track to realize about $100 million in cost savings at Syncrude by the middle of 2022.

Suncor is reportedly considering selling a portion of the U.K. North Sea Rosebank oilfield and is also considering divesting marketing exploration and production assets in Norway.

At just six times free cash flow, we believe Suncor is undervalued. It could pay out a dividend that yields 16.7 per cent or it could buy back the entire company in just six years.

COMPANY FOCUS: NOVARTIS

Novartis is one of the world's largest pharmaceutical companies and its product portfolio is diversified across growing treatment areas such as oncology, cardiovascular, immunology and neuroscience. The Switzerland-based company has a long history of consistent growth and has done a good job of navigating patent losses for key products. This consistency has allowed Novartis to boost its dividend every year for a quarter century, including the most recent increase of 3.3 per cent, which was announced in early February.

The dividend yield is currently 3.9 per cent and the company trades at a price-to-earnings multiple of 13.6 times, which is toward the low end of its historical range.

The company's key focus areas are increasing access to medicines and improving health equity. The company has also placed a heavy emphasis on ESG (Environment, Sustainability and Governance).

Novartis was ranked No. 2 in the 2021 Access to Medicines Index and was the only company recognized for equitable access strategies in low-income countries across its portfolio. Sustainalytics, an ESG ratings company, ranks Novartis in the top two per cent of the pharmaceuticals industry.

DIVIDEND INCREASES

Allied Properties REIT	2.9%
CN Railway	19.1%
Comcast	8.0%
Wells Fargo	25.0%

(During the period January 1-31, 2022)

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