Suncor Energy Third Quarter 2019 Financial Results Call

Thursday, 31st October 2019

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Suncor Energy Third Quarter 2019 Financial Results Call (Operator Instructions). I would now like to hand the conference over to your speaker today, Trevor Bell, Vice President of Investor Relations. Please go ahead, sir.

Introduction

Trevor Bell

Vice President of Investor Relations, Suncor Energy Inc.

Thank you, operator, and good morning. Welcome to Suncor's third quarter earnings call. With me this morning are Mark Little, President and Chief Executive Officer; and Alister Cowan, Chief Financial Officer. Please note that today's comments contain forward-looking information. Actual results may differ materially from the expected results because of various risk factors and assumptions that are described in our third quarter earnings release as well as in our current annual information form. And both of these are available on SEDAR, EDGAR and our website, suncor.com.

Certain financial measures referred to in these comments are not prescribed by Canadian GAAP. For a description of these financial measures, please see our third quarter's earnings release. Following formal remarks, we'll open the call to questions.

Now, I'll hand it over to Mark Little for his comments.

Opening Remarks

Mark Little

President & Chief Executive Officer, Suncor Energy Inc.

Good morning, everybody, and thank you for joining us. In a volatile quarter for commodity and refined product prices, Suncor continued to deliver strong and consistent results. In the third quarter we generated $2.7 billion of funds from operations and $1.1 billion in operating earnings which marks the ninth consecutive quarter where we've generated over $2 billion of funds from operations. The reliable nature of our cash flow, combined with disciplined capital management, resulted in $1.4 billion being returned to shareholders through dividends and share buybacks in Q3. We continue to see significant value in our company and given the market conditions accelerated our buyback program in the quarter to repurchase 1.2% of our outstanding shares for approximately $760 million.

At the same time, we continue to strengthen our balance sheet reducing our debt by $570 million, all of which, yet again, demonstrates the value of our integrated model and our ability to create substantial cash flow and value for shareholders in various market conditions. Reliable production from our upstream oil sands assets contributed to our strong results despite the impacts of the planned maintenance in the quarter and

continued mandatory production curtailment, which has been much higher than we anticipated at the start of the year.

Given our planned maintenance there was limited availability and opportunity to purchase production quotas from other operators in the quarter. As a result, total oil sands production of 670,000 barrels a day was approximately 20,000 barrels per day lower compared to Q2.

Consistent with prior quarters, we were able to transfer production quotas among our oil sands assets, generating $1.6 billion of funds from operations and $500 million of operating earnings in our oil sand segment. Throughout 2019, Suncor's unique footprint and asset flexibility has allowed us to make the strategic choice to optimize the mix of our allocated production during mandatory curtailment. We've focused on value over volumes, producing the highest margin barrels given market conditions. We've increased the production of higher sales price but higher cost SCO barrels at the expense of lower price, and lower cost, bitumen barrels. While this has put pressure on our 2019 volumes and cost per barrel, our results have benefited by a net margin increase of $2 per barrel or more than $200 million of operating cash flow at Base Plant year-to-date.

Moving to our offshore assets, production in the third quarter was approximately 90,000 barrels per day, down almost 20,000 barrels per day from the second quarter, primarily due to an unplanned outage at Hibernia and higher maintenance at Buzzard. Both of these assets are now back on line. While our Hebron and Oda growth projects continue to ramp up and partially offset these unplanned outages, crude prices weakened in the quarter resulting in $380 million of funds from operations and $170 million of operating earnings from our E&P segment.

In the Downstream, we achieved refinery utilization of 100% during the quarter, generating $885 million of funds from operations and $670 million of operating earnings. This is an outstanding operational performance, and it also drove our refinery operating expenditures below $5 per barrel in the quarter.

Following the Alberta government's clarification on the electricity market regulations, we announced the sanctioning of a cogen investment at our oil sands Base Plant in September, making significant progress towards achieving two ambitious goals, increasing structural cash flow by $2 billion by 2023, which is a 20% increase over last year's funds from operations; and secondly, reducing our greenhouse gas emissions intensity by 30% by 2030. The cogen facility will reduce greenhouse gas emissions intensity associated with steam production at oil sands Base Plant and is expected to be a significant contributor to reaching our greenhouse gas goal, getting us one quarter of the way there. At the same time, the cogen facility will reduce Alberta's provincial greenhouse gas emissions by displacing more greenhouse gas intensive electrical sources. The combined benefit is a reduction of Alberta's greenhouse gas emissions by approximately 2.5 million tons per year which is the equivalent of taking 550,000 vehicles off of the road. In addition to the many tangible environmental benefits, the cogen facility is expected to be a significant contributor towards Suncor's goal of increasing structural cash flow by contributing more than 10% of the $2 billion target we have for 2023.

Along with the deployment of autonomous haul trucks and our tailings technology advancements; the construction of the Suncor and Syncrude interconnecting pipeline; and optimization of our supply and trading processes, we're now executing on projects that are expected to deliver approximately 60% of the $2 billion cash flow growth target. Just to emphasize that again, the projects that are in execution represent 60% of the $2 billion.

So, in addition to those projects, we have a number that are in development that are nearing sanction or deployment representing an additional 25% of our goal. With many focused on building standard digital platforms and leveraging data to extract value from our existing businesses. Finally, we have numerous initiatives in the identification stage, which we expect will contribute to the final 15% of the goal.

Investing in projects across our integrated business that are largely independent of oil price and pipeline egress demonstrates our ability to grow cash flow and shareholder value with high return projects in a variety of market conditions. Our progress to-date should provide confidence that we can achieve our cash flow growth target over the next four years, which in turn will enable increasing returns to shareholders and continued investment in our business. At the same time, we remain focused on our operational performance by delivering safe and reliable operations through a volatile business environment, planned maintenance and ongoing mandatory production curtailment.

One last comment, I was very pleased this morning to see that the Alberta Government has agreed to provide curtailment relief for oil ship by added rail. This is aligned with the industry proposal that we've been working with the Alberta Government now for some time. This is a very significant development for the industry and the province and that sets the stage for the government to remove itself from the Alberta crude markets. So I'd certainly like to pass on a special thanks to the Premier and the Energy Minister for providing this support to the industry.

So with that I'll pass it along to Alister to provide some financial context to our third quarter results.

Financial Highlights

Alister Cowan

Chief Financial Officer, Suncor Energy Inc.

Thanks, Mark. And as you've previously highlighted Suncor was able to generate $2.7 billion of funds from operations and $1.1 billion of operating earnings in the third quarter. Now it's despite the impact of a weakening business environment that continued higher levels of mandatory production curtailment and the planned maintenance we have. Once again, we demonstrated the strands of our innervated model in various market conditions.

In addition to returning more than 50% of our funds from operations to shareholders during the quarter in the form of dividends and share buybacks, we also fully funded $1.5 billion of capital expenditures and strengthened the balance sheet by repaying $570 million of debt. So year-to-date we have returned approximately 3.8 billion to our shareholders in dividends or share buybacks, or roughly 46% of our funds from operations, while at the same time repaying nearly $1 billion of debt.

Now as Mark mentioned, we continue to see significant upside value in our company's shares and as a result, we accelerated our share buyback program in the quarter, spending approximately $760 million to repurchase 1.2% of our outstanding shares at less than $40 dollars per share. Year-to-date we have spent $1.8 billion on share buybacks and have repurchased almost 3% of our outstanding shares. We remain on track to complete the authorized $2 billion program that started in May and expires next spring, but have the ability as in prior years to approach our board for an increase, but that will be dependent on future commodity prices.

Looking to the balance of 2019, we've maintained our capital guidance range, but we did narrow our total production range by reducing the top end to 790,000 barrels per day from 820,000 barrels per day. Now we increased our Oil Sands operation's cash operating cost per barrel range by approximately $2 dollars. These changes really reflect the ongoing impact of higher mandatory production curtailment than we expected and the product mix strategy that Mark discussed earlier. Now we've also adjusted the guidance range for our East Coast Canada royalties to 13% to 17%, knocked down 4% and that really reflects the impact of third-party outages on the East Coast.

Consistent with prior years, we expect to release the 2020 corporate guidance in the coming weeks. We will obviously be looking at that with additional clarity this morning on rail from the Alberta government and further information on where the mandatory production curtailment program will be for 2020.

From our perspective, the results in the third quarter add to our track record and demonstrate our ongoing commitment to sustainably increasing cash flow and shareholder returns in the short, medium and the long-term.

Trevor Bell: Thank you, Alister and Mark. I'll turn the call back to the operators to take questions first from the analyst community, then if time permits, from the media. Operator?

Q&A

Operator: (Operator Instructions) Our first question comes from Neil Mehta with Goldman Sachs. Your line is open.

Emily Chieng (Goldman Sachs): Hi guys this is Emily Chieng on behalf of Neil here. Just my first question on CapEx, what do you think is an early rate on 2020 spend, and how do you – how should we be thinking about the cogen annual spend profile of $1.4 billion dollars over the next couple of years?

Mark Little: Thanks Emily. In the second quarter, I think, we were asked that question and somebody asked about whether the range from 5.5% to 6% was good and I would say, given the fact that we haven't published our guidance, and Alister just spoke to that, you know I'd say right now, notionally, that's a good range. One of the reasons our range is going up is because of decisions like cogen, and so, it's incorporated in that capital spend credit.

Emily Chieng: Great. Thank you. And just one follow-up, please, on the crude by rail announcement this morning. Does this change the way you guys think about using rail as a means of crude export to increase production or is it still really an economic decision here?

Mark Little: Well, the economic decision we're faced with is really around should we leave crude shut in or should we produce that and ship it to market by rail. So when you compare those two options, it's economic which is the whole point of this is that although, the – this natural spread in the market place might not say that rail's economic, you're considering that against whether you should – it assumes that you're already producing the barrel. And so, the opportunity here and the whole design of the program is, to allow us to produce above our quotas, if we can move the volume up.

So we're comparing, we either leave it shut in the ground or remove it by rail. I think this is a very positive development because the whole purpose of curtailment was to reduce production to align with the takeaway capacity. But I think we all know that ever since that was implemented the takeaway capacity in Western Canada has declined, which is the exact opposite of what you want to have happen when you have excess production. But the design of this system is to incent operators like ourselves and the 16 others or the 16 in total that are curtailed to go get rail, increase the takeaway capacity from the entire basin, so that we can access markets.

And then once the industry is demonstrated that all the productions on and we can move at all and we have all of the takeaway capacity. The government then has the ability to leave the markets. And when everybody has all their production flowing then they're incented to invest to grow their production, right now nobody and none of those 16 companies are incented because if they grow production they're just going to leave it shut in. So the whole design of the program is to try and help get the markets going. Allow us to get full value, increase royalties and taxes for the provinces, allow the companies to demonstrate that with market forces we can clear the market.

And when everybody has all their production flowing, then they're incented to invest to grow their production. Right now nobody, none of those 16 companies are incented because if they grow production, they're just going to leave it shut in. So the whole design of the program is to try and help get the markets going; allow us to get full value; increase royalties and taxes for the provinces; allow that companies to demonstrate that with market forces we can clear the market. And on top of this development, there's about 200,000 barrels a day of increased pipeline capacity that's coming to market early next year through the work that's happening on Line 3, on the Canadian portion of Line 3, Keystone and Express.

So when you look at the incremental rail capacity, which we think is somewhere in the neighborhood of 200,000 to 300,000 barrels a day of additional rail that could be brought to market and another 200,000 barrels a day of pipe, this is super positive for the industry to move forward. And hopefully we'll get some investment going. So that's why we're very thankful for the leadership that the premier and the energy minister have put to this.

Emily Chieng: Great. Thank you.

Operator: Thank you. Our next question comes from Dennis Fong of Canaccord Genuity. Your line is open.

Dennis Fong (Canaccord): Hi. Good morning and thanks for taking my question. Just maybe is a bit of a follow on to Emily's question. The thought process for me is that you guys don't necessarily trend toward very much crude oil by rail, but do have a fairly robust rail operation more geared frankly to the refined products side. With respect to your current obviously or fairly little exposure to the crude oil transportation side, how should I be thinking about your maybe strategy or approach to potentially gaining incremental capacity via maybe some of your peers if they have available capacity to ramp up production by their railroad curtailments quota?

Mark Little: Yeah. Dennis, thanks for the question. And that was certainly a message in my response to Emily. So I think as we've stated many many times prior to this we were moving all of our production by pipe, but clearly with the government intervention we're not able to do that. So we will be taking advantage of this development and curtailment relief that's been put out by the Alberta government this morning. And in anticipation of

that and our long-standing relationship in the rail markets and working with the railways, we actually have direct contracted capacity of 30,000 barrels a day with the rails to move crude by rail and we will plan to be getting that operational in the next month or two. I haven't talked to the folks this morning about how long it will take but I think it will take a couple of months plus or minus. And so we plan on taking advantage of this for sure to get our production moving.

Dennis Fong: Okay. Perfect. And I suppose the other -- I guess the other side of it would be it's given that there are other producers that may be producing and have maybe access rail capacity that could probably also mean that they have incremental credits that they could potentially sell for you as well?

Mark Little: Yeah. The design of the system is to allow the market to actually solve this, so clearly people that are sitting with rail without the production are incented to find people with production to move it by rail. And it also incents producers to go get rail contracts and such. And I think you'll see that this is significant in the Alberta government getting rid of its rail contracts because if people sign up for them they want to be able to use the rail and so all of these pieces are tied together.

Dennis Fong: Okay. If you'll indulge me, I have just 2 quick more. Just quickly on kind of free cash flow and so forth, I understand that, Alister, you didn't make kind of comments around decisions around the NCIB and I know you guys have during the context of this year paid back some significant pieces of term debt, given them that you don't really have any near-term term debt expiries or anything coming due until I believe 2021, should the focus -- or should I kind of read between the lines that the larger focus will be towards returning cash to shareholders via the share buyback program, which if you're on pace as you are today could frankly be exhausted by the end of this year?

Alister Cowan: Thanks for that, Dennis. No, I would say that we're very measured in where we allocate our capital and we will be very clear on what is going to the stock buyback. We did accelerate it in the quarter, but we're very opportunistic. We saw lots of value in there at these price levels. I wouldn't say that you should assume that the Q3 purchases now we're a new run rate and when we said $2 billion a year, I did say we could go back to the Board if commodity prices would allow that. On the debt side, we have -- well, we don't have any term debt due till '21, we do have $1.5 billion of commercial paper which we used to flex up and down on. So there'll still be a measured allocation to stock buybacks, dividends, capital and debt repayment.

Dennis Fong: Okay. Thanks. And then just the last little bit here is, just on the guidance, it looks like the base mine specifically at U2 upgrader had a bit of an extended turnaround going into Q4. Is there any incremental pieces of prep work or anything like that that you guys are focusing on an operational basis, just given that it's maybe a little bit more, we'll call it downtime with respect to the upgrader component of things? And I'll turn it back. Thanks.

Mark Little: No, it's interesting, because we're working on a coker set that was down and then actually got put back on line during the fire. And so this is kind of an unusual circumstance that has taken us a little bit of additional time. We don't think that this is characteristic of what we'll see going forward. So this just ended up needing a little bit more work than we anticipated going in. Every time you do a turnaround and you open up these vessels, there's a certain amount of work that you find through the process, because we don't have perfect knowledge so we get into it. And so it's caused a little bit of a delay.

Dennis Fong: Okay. Perfect. Thank you.

Operator: Thank you. Thank you. And our next question comes from Phil Gresh with JPMorgan. Your line is open.

John Royall (JP Morgan): Hey, good morning, guys. This is John Royall on for Phil. So, can you hear me?

Alister Cowan: Yes. Thanks, John.

John Royall: So you guys have seen higher cash costs per barrel this year for a variety of reasons and I think some includes reliability. So as we look ahead at the $2 billion FFO improvement target and the guided per barrel cost targets for each asset, is there any risk of offsetting headwinds like labor inflation or other factors that might lead to fewer net benefits versus the $2 billion target?

Mark Little: No. It's interesting because your characterization of the operating cost is part of the issue with it is we're low in the production range, curtailments been much higher than we anticipated. And I think we've been kind of foreshadowing that all along. Originally it was announced that curtailment would be 325,000 barrels a day for the first quarter and 90,000 barrels a day on average for the remainder of the year.

Originally, it was announced that curtailment would be 325,000 barrels a day for the first quarter; and 90,000 barrels a day on average for the remainder of the year. We won't get to that number essentially until the end of the year. So it's been substantially higher. I think just if you do the math, it's 30% to 40% higher curtailment through the year than what was originally stated. Because it's a high fixed cost business, production is lower, operating costs are higher. And then back to we've intentionally -- as I mentioned in my prepared comments around mixes, we've intentionally shut in low-cost, low-value barrels and maximized or shifted the allocation so we could produce higher cost, but much higher margin.

And so our average margin, the net effect of the increased cost and increased margin is we've been able to generate $200 million of incremental cash flow for the shareholder. So the issue with it is, our focus has been on driving value for the shareholder and generating cash flow, not on how do we make the number lower. If we wanted to make the operating cost number lower, we would have done the exact opposite of what we did do. The only issue is we would have lost a whole bunch of cash generation. So we think we've made the right decisions here. Curtailment has created a bunch of interesting dynamics. Going forward, we fully expect curtailment to disappear and next year with this deal that I've talked about, it will help us to move a lot of volumes that we wouldn't have been able to without it.

John Royall: Understood. Thank you. And then just the second one, we've seen reports on the spill at Keystone. Do you guys have any commitments on Keystone in either way, what do you think the net effect would be on Suncor and how long do you think it would take to resolve the spill?

Mark Little: I would literally be speculating on all of that. We do move some product on Keystone and so we'll wait to hear from the operator what it is and I have no idea.

John Royall: Okay. Thank you.

Operator: Thank you. And I'm currently showing no questions at this time. I'd like to turn the call back to Mr. Trevor Bell for closing comments.

Trevor Bell: Great. Thank you, operator. Thanks everyone for attending the call. I know it's a busy earnings day and season, but in particular today. Happy Halloween everyone and IR will be around all day should you have any more detail questions, please give myself or my team a call. Thank you.

Operator: Ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.