Suncor Energy Second Quarter 2021 Financial Results Call

Thursday, 29 July 2021

Operator: Good day and thank you for standing by. Welcome to the Suncor Energy Second Quarter Earnings Call. At this time all participants are in a listen-only mode. After the speakers' presentation, there will be a question and answer session. (Operator Instructions). I would now like to hand the conference over to your speaker today, Mr. Trevor Bell, Vice President of Investor Relations. Please go ahead.

Introduction

Trevor Bell

Vice President of Investor Relations, Suncor Energy Inc.

Thank you, operator, and good morning. Welcome to Suncor's second 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. The actual results may differ materially from the expected results due to various risk factors and assumptions that are described in our second quarter earnings release as well as our current Annual Information Form. 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 second quarter earnings release. Following formal remarks, we'll open up the call to questions.

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

Opening Remarks

Mark Little

President & Chief Executive Officer, Suncor Energy Inc.

Great, well thanks Trevor and good morning and thank you everybody for joining us.

In late May, we held our Investor Day. And at that event, we detailed our five-year plan which focuses on value capture of our integrated business model. Building on the growth phase from 2015 to 2019, this optimization phase is governed by extracting increasing value from our business through enhancing margins, lowering our cost structure, providing increased shareholder returns, and fortifying the balance sheet with significant deleveraging. In comparison to the growth phase, we will lower our economic capital by 40% and add new revenue streams at mid-teens returns.

The optimization phase is expected to deliver significantly higher shareholder returns, including a 25% dividend CAGR through 2025 and continued stock buybacks. At the same time, we'll maintain a $35 US WTI breakeven and retire debt, strengthening the long-term financial health of the company.

Foundational to this performance is our steadfast focus on operational excellence. By increasing the productivity and efficiency of our operations, optimizing the value of each barrel, and thereby increasing free funds flow, we will grow cash returns to shareholders and fortify our financial position.

The second quarter results delivered our focused objectives namely - operational excellence, lower costs and increased shareholder returns.

I'm going to go into each area in a bit more detail.

Our focus on operational excellence continues to result in strong operating performance. Our operating performance from November to June of 2021 marks the best months of production from our Oil Sands Operations asset in our company's history – that's the best eight months of production in 50 plus years! Base Plant utilization was 98% over this period. And we had yet another quarterly record at In Situ with 253,000 barrels per day.

We also completed significant turnarounds at all of our refineries, as well as at Syncrude and Buzzard – and at the same time, generated funds flow from operations of $2.4 billion. Approximately 40% or $1 billion of these funds was returned to shareholders in the forms of dividends and buybacks. Since we began the buyback program in early February through to the end of July, we have bought back over 42 million shares for $1.2 billion – representing approximately 3% of the outstanding shares.

Turning now to operating performance.

Oil Sands Operations production of 460,000 barrels per day was approximately 10,000 barrels per day higher than the first quarter, reflecting strong and reliable operations. From a utilization perspective, Base Plant operated at an average utilization of 96% in Q2, continuing a strong trend.

Meanwhile, the operating performance at In Situ from November 2020 to June 2021 averaged 250,000 barrels per day, making it the highest daily production period in nearly 20-year history for Firebag and MacKay. Executing the nameplate capacity increase at Firebag last October contributed to this record production.

In terms of costs, second quarter cash operating costs at Oil Sands Operations were $23.85 per barrel. Looking at the last eight months, Oil Sands Operations averaged $23.50 in cash operating costs per barrel. We've achieved these type of unit costs before, but what makes our 2021 performance stand out is that we've fully absorbed over a 100% increase in natural gas price versus the previous periods with similar unit cost results. That's approximately $1 a barrel increase being absorbed by reducing costs elsewhere.

Syncrude production of 110,000 barrels per day includes the impact of significant turnaround at their largest coker. All planned scope, including some planned for this fall was completed within budget. All three cokers are online, and operations are fully lined out for a solid second half of the year. While we went through this in detail at Investor Day, it's important to recall that this asset's operating performance has steadily improved and we have a clear line of sight into synergies and reliability to achieve sustainable $30 per barrel cash operating cost.

At Fort Hills, production of approximately 45,000 barrels per day reflects the updated mine plan that we discussed on the first quarter call – specifically, building ore inventory for ramp up towards a two-train operation. By the end of the quarter, the ore inventory build was slightly behind schedule, with access to additional contractor equipment and labor taking more time to ramp up than expected. We now have most of the additional contract resources in the mine and we expect that we'll be fully ramped up by the end of August.

Subsequent to the quarter, we realized that we would need to change the slope of the south mind face, to maintain slope integrity. As this part of the mine will form a critical permanent pillar between Fort Hills and the Syncrude Aurora mines. This will delay our ramp up at Fort Hills to two-trains until the end of 2021. As the south mine face contained approximately 60% of our ore inventory that we thought was available. So, to access this ore we'll need to mine more overburden, which is just going to take some additional time. Obviously given the mine is very early in its life our flexibility to ramp up earlier is limited.

As a result, Fort Hills plans to continue on one-train at the current production level for the remainder of the year, with a transition to both primary extraction trains beginning late 2021 to enable full production in early 2022. 2021 annual guidance for Fort Hills production and cash operating costs have been updated to reflect these changes. There's no change to our long-term view on costs as discussed at our May 26 Investor Day – namely, we expect costs to continue to improve every year towards a cash cost target of $20/bbl by 2024.

In our E&P operations, generally volumes were consistent with the first quarter other than Buzzard, which fully executed its turnaround in the second quarter.

With our Downstream segment, throughput of 325,000 barrels per day included planned turnaround activities across all our refineries. This was an opportune time for this activity as "stay in place" orders continued in Canada throughout the quarter and broader North American refinery complex faced a continued challenged macro environment. As we discussed previously, we built refined product inventories to support the planned turnarounds. With turnarounds complete and demand increasing across Canada as COVID restrictions are lifted, we are confident about our Downstream's strength and positioning for the second half of the year.

We expect the U2 turnaround at Base Plant to begin in early August having a production impact of approximately 125,000 barrels per day in the third quarter. We anticipate partially offsetting the impact of the turnaround via increased bitumen sales to market. Our decision to swiftly respond and stagger maintenance activities when COVID cases surged in the region, specifically pushing the U2 turnaround from Q2 to Q3, enabled us to complete the planned scope at the Syncrude turnaround and ensure safe and reliable operations across the assets. This was the right approach, considering the strong operational performance at Base Plant and no material change to the scope or cost of the planned turnaround. We have completed one of the most significant maintenance schedules in our history during this quarter. While this has had an impact on production and costs at Syncrude and refineries in the quarter, we're now running at full rates and sets the stage for strong results in the second half of 2021 and into 2022.

In closing, I wanted to emphasize that our business model and philosophy, regardless of short-term volatility, will remain laser-focused on operational excellence, capital discipline, long-term shareholder value creation, and returning that value to shareholders, while fortifying our balance sheet by continuing debt reduction.

Alister, I'll now hand it over to you for the financial highlights.

Financial Highlights

Alister Cowan

Chief Financial Officer, Suncor Energy Inc.

Thanks, Mark, and good morning, everyone.

For the second quarter, we returned approximately $1 billion to shareholders in the form of $315 million in dividends and $650 million in share repurchases. During the quarter, our buyback amounts to approximately 23 million shares at an average price of $28 per share. In addition, we have received approval from the Toronto stock exchange to increase our share buyback program from 44 million shares, or approximately 3% of Suncor's issued and outstanding common shares to 76 million shares, or approximately 5%.

In the second quarter, as Mark highlighted, Suncor generated $2.4 billion of funds from operations.

The business environment continued to strengthen in the quarter with WTI increasing $8 per barrel or 14%. This flowed through to realizations, with the average price of Oil Sands crude basket increasing by $10 per barrel or approximately 16% versus Q1, despite a strengthening Canadian dollar averaging 81 cents during the quarter. This translated into approximately $300 million of additional upstream Oil Sands funds flow when compared to the first quarter results – even though production was 75,000 barrels per day lower due to the planned maintenance. Our Q2 financial results reflects our solid cost and reliability performance and demonstrates our leverage to increasing oil prices.

The E&P segment generated $410 million of funds from operations with price realizations of nearly $82 Canadian per barrel, delivering approximately $350 million of free funds flow net of capital expenditures.

And finally, Downstream recorded approximately $600 million of funds from operations with 70% utilization which reflected the significant turnaround activity across the refineries and the continued lower consumer demand. The profitability in the second quarter reflects the lower demand due to COVID restrictions which were maintained throughout the quarter in Canada, and also the reduced volumes due to the planned turnaround activities. However, as Mark noted, we were able to partially offset some of the maintenance impacts by executing on our inventory build strategy we outlined on our previous quarterly call.

Gasoline demand has steadily been improving in Canada with Q1 at 20%, Q2 at 15% and gasoline demand in July at 5% below 2019 levels. Diesel demand has recovered, while current jet demand still remains 50% below 2019 levels, however it is important to remember that less than 5% of our refined product volume is jet fuel. This improving demand trend paired with our strong utilization expected in the second half of the year, gives us confidence in the operational and financial performance of our Downstream business going forward.

As we expected, our debt reduction in the quarter was smaller than Q1. We are managing our debt reduction and share buyback strategy on an annual basis and remain on track to our two-third debt reduction and one-third buyback strategy, that we outlined in Investor Day.

Apart from Fort Hills which Mark discussed, the only guidance changes relate to updating the business environment. Strip commodity prices have increased since Q1 resulting in higher forecast profitability and cash flow – and as a result we've updated the cash tax range for 2021.

Lastly, I'd like to note a couple of items for the second half of the year:

We expect to close the Golden Eagle sale in September. The production will continue to be reflected as part of Suncor's volumes until the sale closing, at which point it will be purchase price adjusted. There's no change in our full year volumes guidance either, specifically for E&P or overall, for Suncor.

Secondly, we expect the tax refund for the 2020 tax year in the fourth quarter which will reduce our working capital.

Total cash proceeds of approximately $1 billion from these two items will be used for debt reduction, in the second half of the year.

Before I close, I'd like to note that we have updated disclosure related to our Rackforward business in our Operating Summaries supporting the financial statements and also in our Supplementary IR deck. We hope you'll find this additional disclosure useful, as it does add some more transparency on a significant part of our integrated model.

And with that, I'll pass it back to Trevor.

Trevor Bell: Thank you, Mark and Alister. I'll now turn the call back to our operator to take some questions.

Q&A

Operator: (Operator instructions). Your first question comes from the line of Greg Pardy from RBC Capital Markets, you may ask your question.

Greg Pardy (RBC Capital Markets): Thanks, good morning. Mark, I was wondering if we could come back to Fort Hills. Does the timeline in terms of ramp up just in the first quarter present any issues, and maybe could you talk as well just around when it became evident around the instability, just in the slope you mentioned earlier.

Mark Little: Yeah, Greg, thanks for your question. So, let me just step back for a minute on this, because the focus is on getting Fort Hills fully ramped up to two-trains. And yes, that's been delayed until the end of 2021. So, we're not expecting any impact in 2022 production. And so, we found out about this in July as we got later in the month, associated with it. And this is really around focusing to ensure that the slope has stability. And because as I mentioned, this is a critical pillar between the south end of the Fort Hills lease and the north end of the Syncrude Aurora lease. And because that mine face has about 60% of what we thought was the available ore and it's not going to be available until we clear more of the overburden associated with it. So, this is just a time issue. We don't think it has any fundamental impacts beyond just delaying the ramp up of Fort Hills to add that incremental production to what you're seeing in our results now. So that's kind of where we're at. And this south mine face, after we've mined it, it's just so critical that we don't want it moving and becoming unstable. In a lot of places, it's not nearly as relevant but this is a very critical piece of infrastructure going forward.

Greg Pardy: Ok, terrific. And I'm going to switch gears entirely here just to come back, I mean, you're a part of the quintet on the oil sands pathways net zero back in early June, you guys announced that. What are the milestones we should be looking for in terms of progression and so forth?

Mark Little: Well, it's interesting, Greg, if you just step back. Essentially, this is about taking the whole oil sand industry to net zero by 2050. I view this as an unprecedented collaboration between the oil sands producers. It represents 90% of the operators today. So, I fully expect that we will have the remaining operators join this journey as we go forward. There's one very significant foundational set of infrastructures that we see is critical for this. And it's around building the carbon capture and sequestration capability for the industry. We think this is about 50% of the industry solution as we go forward as we think to the future, and so it's really important. By working together, we realize we can drop the cost of this significantly, because we can all use a lot of common infrastructure and we can go faster, and we can do it cheaper. All of which I think is super important in this journey going forward.

So, if you look on the -- there's a web site now the oil sands pathways to net zero by 2050. And if you look on that web site, you'll see the map of the carbon sequestration system and such. So, you're going to see that that's going to be a common piece associated with it. Other parts are independent. So, if you look at it, there's a whole strategy there. Some of its around carbon sequestration, some of its around fuel switching like our Cogen up north, some of it’s switching to things like clean hydrogen, like our announcement that we made in Edmonton. So, some of this you'll see through the company window, but the big foundational project is what's being worked on. But we also have things like sharing solvent infrastructure, clean hydrogen infrastructure, those sorts of things.

So, if you watch that web site, you'll start to see more and more details come out. And we've just come out with some of the details around the carbon sequestration system. We’re in the 90-day consultation period with the feds and we're working to sort out the details around the investment tax credits associated with it. So, we're making good progress and we've been very happy with the cooperation between the province and the federal government.

Greg Pardy: Thanks a lot Mark.

Mark Little: Thanks Greg.

Operator: Your next question comes from the line of Neil Mehta from Goldman Sachs. You may ask your question.

Neil Mehta (Goldman Sachs): Good morning Mark, Alister – good morning team. The first question is around how Fort Hills facts into the production guide. You did maintain the 740,000 to 780,000 consolidated upstream number. Is it fair to say that you guys are targeting based on what you know right now, the low end of the guidance range?

Mark Little: Yeah, I think that's probably fair, Neil. The assets have performed very well as I went through in my prepared remarks. You're seeing the oil sands year-to-date, it's in the high 90s utilization. Syncrude has a proven strong record post turnaround that we've just gone through that coming into their turnaround in the second quarter. So, with the completion of that work, we're expecting that the assets will perform very well. So, we're maintaining the corporate guidance associated with it, but we're not at the top end of guidance, but we're comfortable with the total guidance range.

Neil Mehta: Ok, that’s great. And then the follow-up is just around the buyback strategy. Obviously, the stock has lagged peers here over the last two -- the better part of the last two years. Free cash flow yield is very robust. So, it seems like you guys are going to lean into the buyback and should average to the top end of that 5% limit. Just talk about your buyback strategy and how you take advantage of the valuation?

Alister Cowan: Yeah Neil, I’ll take that one. I mean, if you look at where we're headed, we obviously got 3% already executed. We’ve got approval to go to 5%. We will be executing on that provided obviously, commodity prices remain at current level. So, you'd expect to see that the top end of that range through to February of next year and the buyback period. Really the strategy is, one of a ratable buybacks through the period, which is why you saw $600 million in the quarter. We continue to execute it that way, obviously, within the remainder of the buyback.

Neil Mehta: Thanks guys.

Operator: Your next question comes from the line of Phil Gresh from JPMorgan. Your line is open, you may ask your question.

Phil Gresh (JPMorgan): Hi, yes, good morning. I wanted to follow-up on Fort Hills. One of your partners on the project was referencing some issues with groundwater. And so, I just want to understand the technicals of this a little bit better. You're talking about slope stability. So, I just want to make sure I fully understand why this would be a one-time issue as opposed to a recurring issue?

Mark Little: It's interesting, Phil. On the south mine face, it's just the south mine face, right? Like this is the one that we're building the corridor between the two mines. So, the integrity of that mine face is important. Anytime you're building a dam structure it’s super important that it have integrity and can be managed accordingly. Water management in oil sands is a very common issue and whether it's from rain events. But anytime you have soft rock mining, we are getting some egress of water from ground sources and such into the mine. So, we have procedures to be able to manage it.

Some events are more challenging than others associated with it. But this is common across, I would say, almost all of the mines, if not all the mines in oil sands, associated with it. So, this is following protocol. We don't expect this to be a fundamental issue any more than what we've seen. And in fact, as we go north and head into center pit and stuff, we expect the vast majority of this to diminish associated with it. So yes, I mean, it needs to be managed and that's what we've done, and we have the procedures in place and we're executing according to those procedures. So yes, is water an issue. Yes, it always is. And we manage it accordingly.

Phil Gresh: Ok, thank you for that**.** My follow-up question is just on OpEx. Obviously, acknowledging the strong performance for oil sands overall. The total company OpEx run rate is tracking a little bit over 10.8 billion. You mentioned, the natural gas headwinds, which I think everybody's dealing with obviously. But are you still confident in the 10.6 billion guidance you laid out for the year that you gave at the Analyst Day, given where the run rate looks and seasonality and other considerations?

Alister Cowan: Yeah, I'll take that one Phil. I mean if you look at our year-to-date numbers, there's about $250 million in there of one time – what we consider one-time items related to restructuring, remember the big severance restructuring provision we took in Q1 to do with our workforce reduction. There's been some additional costs in the first half of the year related to some of the COVID restrictions, they're obviously easing, and we expect those to be significantly less in the second half of the year. So, we are confident about that trend for the second half of the year to be able to achieve that run rate or the numbers that we disclosed in the Investor Day. And then obviously, as you move forward into '22, '23, '24, a continuing trend downwards as we execute on our $2 billion of additional cash flow improvement plan. The other thing I would say on the gas side, which you correctly said, everybody will face, is that we get a benefit on the other side of that through our power revenue, which is obviously tied to gas prices in Alberta. So, we are -- is not captured in our OS&G, it's included in our revenue line.

Phil Gresh: And just to confirm, the 10.6 billion guide just out of the one-time factors that you're talking about?

Alister Cowan: Yes, Phil, we excluded those. We focus more on the run rate rather than including one-time restructuring items in there.

Phil Gresh: Ok, thank you very much.

Operator: And your next question comes from the line of Manav Gupta from Credit Suisse. You may ask your question.

Manav Gupta (Credit Suisse): Hey guys. My question is a little bit of a follow-up on Neil Mehta's question. But, looking at the quarter, I think you guys have given a guidance that 66% of the discretionary cash that's post dividend cash goes to debt reduction and 33% goes to buyback. And when we look at this quarter, there's about 750 million of discretionary cash and 640 million went to buybacks and 100 million to debt reduction. So I'm just wondering if there's a change a little bit in strategy there or you basically expect a billion in kickbacks and Golden Eagle sale to come next quarter, so this was just a one off quarter and there is no change to strategy?

Alister Cowan: Yeah, thanks Manav. Allow me to clarify. There's no change to that annual allocation and it's an annual allocation 2/3 debt repayments and 1/3 buybacks. So, quarter to quarter it will move around and obviously Q2, we always knew we'd be impacted by the maintenance, higher capital and lower cash flow increase, so that's why we're looking at annual. But you're absolutely right, we have $1 billion of cash proceeds coming in, in the second half of the year from tax refunds and the Golden Eagle sale and we're going to use those for the debt reduction.

Manav Gupta: Ok, So, a quick follow-up in the last one year or so, while most of the US refiners have lost money, Suncor has been unbelievably resilient in its downstream, and I think it's functionally for integration and how well you run. And you've consistently generated like 400-500 million. Now this quarter was lower. I'm hoping is this just a function of the downtime, because I think your utilization was dropping to 70 and once you go back to 90, again, we'll get back into that run rate of 500-600 million free cash? Or was this anything else, especially happening in Canada with the lockdowns or something else?

Mark Little: Well, I think Manav, it's really twofold. And you've touched on it here is obviously, we had all of our refineries doing turnaround work through this period of time. And you saw at Investor Day we talked about when you look at refinery utilization, we said that we were 2x as profitable as the next peer, when we benchmark that from a cash perspective, that didn't count our rackforward business associated with it. So, the environment has improved significantly, as Alister talked about in his comments, as we go into the third quarter here. The turnarounds are complete. The cracking margins are robust, and demand has recovered significantly even in July versus the second quarter. So, we think we're set up really well for the back half of the year. And it's just the fact that between COVID and the turnarounds, you've seen a much weaker market in the second quarter. So, we think we're in very good shape to be able to perform well in the back half of the year.

Manav Gupta: And you guys are not even that run exposed. Great set-up for you. Thank you so much for taking my questions.

Mark Little: Thanks, Manav.

Operator: And there are no further questions. At this time, I will turn the call back to Trevor Bell.

Trevor Bell: Great. Thank you, Operator. Thanks everyone for attending today. I know it's a busy day for earnings and we appreciate you listening in. We're around all day if you have any follow-up questions. Thank you.

Operator: And this concludes today's conference call. Thank you for participating. You may now disconnect.