Suncor Energy Third Quarter 2022 Financial Results Call

Thursday, 3 November 2022

Operator: Good day, ladies, and gentlemen, and thank you for standing by. Welcome to the Suncor Energy third quarter 2022 results conference call. [Operator instructions]. At this time, I would now like to hand the conference over to your host today, Mr. Troy Little, Vice President of Investor Relations. Please go ahead.

Introduction

Troy Little

Vice President of Investor Relations, Suncor Energy Inc.

Thank you operator, and good morning.

Welcome to Suncor Energy's third quarter earnings call.

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, both of which are available on SEDAR, EDGAR and our website, suncor.com.

Certain financial measures referred to in these comments are not prescribed by Canadian Generally Accepted Accounting Principles. For a description of these financial measures, please see our third quarter earnings release.

We will start with comments from Kris Smith, Interim President and Chief Executive Officer, followed by Alister Cowan, Suncor's Chief Financial Officer. Also, on the call are three of our senior operating leaders - Peter Zebedee, Executive Vice President Mining and Upgrading; Shelley Powell, Senior Vice President In-Situ and E&P; and Arnel Santos, Senior Vice President Refining & Logistics.

Following the formal remarks, we'll open up the call to questions.

Now, I'll hand it over to Kris to share his perspective on the quarter.

Opening Remarks

Kris Smith

Interim President & Chief Executive Officer, Suncor Energy Inc.

Great, thanks Troy. Good morning to everyone and thank you for joining us.

On our last call, I discussed that achieving best in class safety and operational performance is Suncor's core focus and that my goal every day is to execute on our plans to drive that performance. A key element in delivering this is the focus of our senior operations leaders on driving changes through the organization to the front line. We're doing something a bit different than past calls – our three senior operating leaders – Peter, Shelley and Arnel – are with Alister and me today to demonstrate our increased focus on this and to answer any questions you may have on operations.

Now, taking a brief look at the quarter, we generated $4.5 billion in adjusted funds flow from operations which included a FIFO loss in the downstream of $585 million. And, as it's designed to do, our physical integration between Upstream and Downstream mitigated the impact of wider heavy crude differentials, delivering strong margins. Upstream volumes came in as expected at 724,000 barrels per day during the quarter and I expect these volumes to increase in the fourth quarter as our maintenance activities at Syncrude and Base Plant Upgrader 1 were completed in October.

In the Downstream, we had strong Q3 margins on the back of a 100% utilization rate and the third best crude refining throughput in our history. Downstream margin capture was 85%, reflecting higher than normal levels of processing of sweet crude in our refineries primarily due to a planned outage in the Edmonton sulfur recovery unit in the quarter. As well, we continued to see solid volumes and margins in our sales & marketing segment, with distillate demand in particular continuing to be strong.

During the quarter we distributed $1.7 billion to shareholders in the form of dividends and share buybacks. Also, we successfully completed an upsized bond repurchase tender that resulted in buying back our debt below face value and lowering our structural break-even by nearly $1 per barrel on a WTI basis. These actions keep us on track with our capital allocation framework and move us toward our goal of reducing our net debt and, depending on commodity pricing, increasing capital allocation to share buybacks to 75% by the end of Q1 2023.

Now, my comments on the quarter today are intentionally brief because we've delivered a strong quarter in-line with our expectations. Instead, the focus in my opening remarks will be on recent actions that we've taken on improving safety and optimizing our asset portfolio.

Work continues across the company to improve safety and operational excellence, with a particular focus on our mining and tailings operations. My priority has been to remove distractions from the organization and to focus our employees on safe, reliable operations and our biggest opportunities. With fresh external mining perspectives and a number of leadership changes in place, we are in position to execute and deliver on our plans at an accelerated pace.

In particular, there are three actions I'd like to highlight today:

- First, I've initiated a thorough review of the makeup of our front-line workforce with a view to reduce our exposure hours, enable robust workforce planning which will allow safe work execution, and improve efficiency and competitiveness. As part of this, we are following through on an objective to reduce our contractor workforce in our Mining & Upgrading business by 20%. As of today, more than half of this objective has already been completed and we are on track to safely achieve and sustain the full reduction by the first half of 2023. In addition to streamlining our contractor workforce, I'm also taking action to enhance our contractor management processes to ensure consistency and simplification in how we assure safe work practices in the field, and we will continue to work together with our contractors to embed industry best practices and strengthen safety culture.
- Second, as previously mentioned, we are installing industry leading technologies for collision awareness on over 1,000 pieces of mobile mine equipment across our operating assets to mitigate a key risk in our mining operations. I'm pleased to say this initiative is progressing well, and two-thirds of Syncrude's Aurora mine equipment will be outfitted by year end, and installations on the remaining equipment at Aurora are expected to be completed by January 2023, nearly two months ahead of schedule. Deployment schedules for the remaining mines are on plan, with Syncrude's Mildred Lake Mine and Fort Hills going live in mid-2023 and Suncor's Base Mine being complete by the end of next year. As well, our fatigue management system installation, as discussed in previous calls, will be completed across all mines by early 2023 and is already fully installed and functioning at Syncrude's Mildred Lake and Aurora mines. This technology has so far demonstrated the potential to reduce fatigue related events by up to 80%.
- Third, and crucial to our long-term success, we are partnering with industry leading subject matter experts to better equip our leaders across all our operations with practical skills to lead and sustain safe behaviors on the front line of our organization. I'm enhancing our leadership coaching and competency programs to ensure sustainment of visible, felt leadership. Our approach leverages Human Organizational Performance principles – consistent with other industry leaders – to strengthen our safety culture while ensuring we have a strong focus on our material risks and assurance of our critical controls.

These are a few key examples of how we're driving focus in improving safe, reliable operations going forward.

I would now like to move to our progress on our efforts to optimize our asset portfolio towards our core integrated business. As you know, we've initiated a robust process to divest from non-core assets to increase "fit and focus" in our portfolio. Recently, I announced the sale of our wind assets for $730 million dollars and also, during the quarter we closed the sale of our Norway E&P assets. Meanwhile the process to sell our UK E&P assets continues and I expect that process to conclude in the coming months.

A portion of the proceeds of these non-core assets sales is being used to increase our operated ownership interest in the Fort Hills asset by approximately 21%. This additional interest in Fort Hills demonstrates our confidence in the long-term value of the asset which is backed up by a detailed assessment by our new and highly experienced mining leadership. Last week in our Fort Hills announcement, I discussed our multiyear performance improvement plan for Fort Hills which will have short term impacts to both production and cost over the next three years and set up the asset for long term success.

Although there is no change to our 2022 Fort Hills guidance, as we begin to execute this plan, we do expect volumes to be reduced in the 4th quarter as well as into Q1 2023. When combined with other factors such as extended turnarounds in our Oil Sands business and at non-operated E&P assets, we expect our overall company production to come in towards the lower end of our 2022 guidance. We continue to manage through the Fort Hills plan, and I look very forward to providing a more fulsome update at our Investor Presentation on November 29th.

This targeted portfolio optimization focuses Suncor on our core integrated business and along with our capital allocation framework, accelerates the execution of our plans to grow shareholder value.

As well, a core part of our long-term success will also be on continuing to advance our plans to decarbonize our assets, a big piece of which is collaborating with our Oil Sands industry peers in the Pathways Alliance to reach net zero by 2050. I'm pleased to see the Government of Alberta select the Pathways Alliance for pore space in the Cold Lake area and this is an important milestone in Pathways' plans to develop a world scale carbon capture system for the Oil Sands industry. I am encouraged by this progress and continued industry, government and stakeholder co-investment and collaboration will be key to the success of this world scale endeavor.

And with that I'll now pass it over to Alister for his comments.

Financial Highlights

Alister Cowan

Chief Financial Officer, Suncor Energy Inc.

Thanks Kris. I'll briefly focus on a couple of items.

First, capital allocation. We continue to buy back shares and reduce our net debt. Year to date Q3 we have returned $6.3 billion in total to shareholders, comprising $1.9 billion in dividends plus $4.4 billion in share buybacks – and that's roughly 7% of our outstanding shares. We've also reduced net debt by $2.5 billion dollars, excluding approximately $1 billion dollars of foreign exchange translation loss due to the significantly stronger US dollar this year. Depending on commodity prices, we expect to increase our allocation to share buybacks to 75% by the end of Q1 2023. And this will complement our 4% dividend yield.

Next, during the quarter we recorded a $2.6 billion after-tax impairment related to Fort Hills. Note that the impairment is guided by the transaction value of the recently purchased additional stake in the project.

With that, over to you Troy.

Troy Little: Thank you Kris and Alister. I'll turn the call back to the operator to take some questions.

Q&A

Operator: Thank you. [Operator Instructions] We have our first question from the line of Greg Pardy of RBC Capital Markets. Please go ahead and ask your question.

Greg Pardy (RBC Capital Markets): Definitely like what you and your team are doing in terms of steps taken. I want to ask about Fort Hills, but maybe just before I do that, when I look at your downstream business going into the fourth quarter, two big advantages, obviously, cracks and the other one is just high utilization. Are you continuing to see a high utilization rate in the -- in your refineries and just any other color you can give us on the downstream as we go through Q4.

Kris Smith: Sure. Hey thanks. Hi Greg, and thanks for the question. And yes, to your point, we're certainly seeing a really strong cracking margin environment. We're expecting that to continue into the fourth quarter. You know, I do have Arnel here, our Senior Vice President of Refining. And why don't I pass it to Arnel and just ask him to just talk a little bit about refinery utilization and our expectations in Q4.

Arnel Santos: Thank you, Kris. Let me first start by saying, we continuously look at all the profitability drivers for our downstream business. That includes feedstock mix, products slate, product channels and of course, focus on cost and capital delivery. As I look back in the third quarter, when the overall utilization was 100%, we did have to account for the planned outage of the Edmonton sulfur recovery unit. And this impacted our ability to fully capture the margins in that period, as we reoptimize our crude slate. For the fourth quarter, I am anticipating similar utilizations, was slightly weaker cracks, but well still within above historic levels.

Kris Smith: Thanks, Arnel. And so, we've got a strong -- I think we're setting up for a strong end to the year, Greg, is the way I would say it on the downstream side. And you know what, I'd expect as we go into 2023, the macro environment for refining is going to continue to be quite strong for us. Now, you said you had another question on Fort Hills.

Greg Pardy: Yes. So, let's come back maybe to Fort Hills exactly. So, with the remediation plan, stuff I wanted to dig into and recognize you're going to talk more about this at the Investor Open House. But can you talk maybe just a bit about ore variability, water and then maybe what some of the differences are between the south, central and north pits. And then, I guess, overall, how you'd sort of characterize that resource distribution. Where is most of the ore? And how does the plan now set you up for long-term success at Fort Hills?

Kris Smith: Yes. No, thanks, Greg. And yes, we will definitely talk about this in detail at the Investor Day, and as we talk also about our 2023 guidance. As we said, we have this improvement plan related to the asset, to deal with a lot of the issues that you're just raising in your question. I have Peter here beside me, Peter Zebedee, who's our Executive Vice President of Mining and Upgrading, has obviously been working extremely closely with his team. And maybe I'll just pass this one over to Peter to provide a color to your question.

Peter Zebedee: Thanks very much, Kris. Let me first start off by saying that we -- myself along with the team have done a really in-depth review over the last few months on the Fort Hills asset. And firstly, I think it's important to note that our fixed plant facility really is world class. And our focus around -- and the challenges that we've seen have really been around the ore body and the mine as you stated.

Some of the issues that we're seeing are related to 2021 events and really around physical constraints in the pits, and this will require changes on how we mine and sequence the ore in the years to come. You're correct, Fort Hills asset has three mine pits, the south pit, which we're currently completing mining in, transitioning to the central pit in the early part of 2023. And then ultimately, the north pit and it is indeed the north pit that has the largest amount of reserves and is largest in surface area.

The new plan really accelerates the transition that we have to both the center and the north pit. This will ultimately give us more operational flexibility and it gives us more ability to increase our operating efficiency in the year to come. So, we are actively monitoring the risks around devonian water, pit wall stability. We have controls in place. And while the new plan is not without risks, we believe we have a good handle on what's to come, that we've got appropriate mitigations in place.

Kris Smith: Great. Thanks, Peter. And thanks Greg for the question.

Greg Pardy: Thanks very much.

Operator: Thank you so much, Greg. And your next question comes from the line of Doug Leggate from Bank of America. Please go ahead.

Kalei Akamine (Bank of America): Hey, good morning, this is actually Kalei on for Doug. Thanks for taking my questions, here. I've got a couple. The first one is just on the reliability. It seems like you guys are making some improvements there. We can see it in the numbers. Can you just talk about what's changing in your operations to drive that better performance?

Kris Smith: Yeah. No. Thanks very much for the question. That's exactly one of our key focus areas in all aspects of the business, upstream through downstream. And the teams have been working on that specifically and with a lot of focus. It isn't one thing. It's really the combination of driving the focus across the organization on the performance of the assets and reliability, and just the work that all the teams are doing across all the assets, fixed plant, as well as our mining assets. As you heard a bit in Peter's comments, so you know, I am really pleased to see the progress we're making on it, and we're going to continue to move quickly in that direction to continue to improve on reliability.

Kalei Akamine: Okay. I appreciate that. Second question is just a follow-up on Fort Hills. So, after this acquisition where you acquired your non-op partners stake, can you talk about any other incremental M&A opportunities that might be on your radar, maybe other assets that you own a piece of, that you would like to own more of?

Kris Smith: Yes. No, thanks for the question. First of all, just to be clear, we're not looking to do M&A. What we do, do, is there's an opportunity that's going to provide compelling value to our shareholders, that's on strategy, then we'll take a look at it. And the example of the transaction we just did at Tech is a clear example of that where we had an opportunity to do – to take a partner interest in an asset that we operate, we know well. It's a long-life asset, has low-intensity GHG barrels, and we were able to transact at a very compelling value for our shareholders. And so, when we can do that sort of thing, we'll be very disciplined, and we'll be very opportunistic.

Kalei Akamine: Appreciate it. Thank you.

Kris Smith: Thank you.

Operator: Thank you. Your next question comes from the line of Neil Mehta of Goldman Sachs. Please go ahead and ask your question.

Goldman Sachs: …on the recently announced acquired interest, is that sort of a natural stopping point at that particular asset, or are there any kind of longer-term plans to increase ownership, obviously, acknowledging the recent announcement how the strong element of price associated with it?

Kris Smith: All right. Thanks for that. I think the question is.. I'll give you the answer, I just gave to the last question because it's the exact same. It – we did this transaction based on all the dimensions I just said, extreme compelling value for shareholders, strategic fit and it was an opportunity that presented ourselves to do that and add significant value for our shareholders.

We're not in the mode of looking to do M&A, and we really just -- those types of opportunities present themselves, then we'll obviously take a close look at it. If it's going to create compelling value for our shareholders.

Goldman Sachs: Okay. Thanks. And then just as a follow-up on Capex so, and acknowledging you'll be talking about this a little bit more later this month. But how are you thinking about next year spend with West White Rose and the elevated cost environment, as well as continuing to monitor Fort Hills?

Kris Smith: Yes. Thanks for the question. And we're going to be talking about that in detail at our upcoming Investor Day on 2023. We're going through the portfolio very carefully on our capital plan, and we'll be in a position to share that with you then.

Goldman Sachs: Thanks.

Kris Smith: Thank you.

Operator: Thank you. Your next question will come from the line of Menno Hulshof of TD Securities. Your line is now open.

Menno Hulshof (TD Securities): Now, I'll start with your incremental free funds flow targets. I believe the plan is still to get to $2-$2.15 billion by 2025, and it looks like you're targeting $875 for this year and $1.3 billion for next year. So, can you just give us a sense of how much of your ...$875 million target for 2022 has already been achieved, and how you're tracking on your $1.3 billion target for next year?

Kris Smith: Yes. No, thanks very much, and yes, we continue to push forward on that program. And just a reminder, that program is made up of initiatives and investments that drive increased revenue and margin enhancement, as well as cost reduction. We're on track relative to those plans, and we're seeing those come through. And examples we've talked about them in the past, examples is the interconnected pipeline that we invested in and that we really started in 2022, really leveraging that asset, and we're seeing the benefit of that asset through the performance of the business.

We're also driving cost reduction. Now cost reduction, we're expecting more of that program to be playing out in 2023/2024. Obviously, we have inflation headwinds that we're going to need to work through. And so, we're actually working and pushing the team to find other cost reduction offset knowing that we've got these inflation headwinds in front of us. So, feel we're on track relative to the program, still much to do in the back half of it and a lot of focus by the teams to deliver.

Menno Hulshof: Thanks, Kris. And then my second question relates to turnarounds and utilization for 2023 and maybe this also falls into the wait till the end of the month bucket, but I'll throw it out there. Can you just remind us, or maybe just walk us through where we should expect to see the largest turnarounds and impact to utilization across upstream and downstream in 2023?

Kris Smith: Sure, sure. Thanks, Menno. You know, on downstream, it's going to be a, what I'll call a regular turnaround kind of program through 2023. Probably the largest event is going to be at the Commerce City refinery with the turnaround for plant 2. Why don't I ask Peter actually, we do have U2 as planned maintenance next year, and so why don't I just ask Peter to provide a bit more color to your question.

Peter Zebedee: Yes. I would say for 2023, the biggest events are indeed U2, as you mentioned, Kris, and then a Syncrude turnaround also next year. I do want to highlight, though, maybe just building on what you said, Kris, what is different for us compared to historical performance really is this interconnect pipeline between Syncrude and the base plant. It really helps us to give much more operational flexibility.

In the past, when we needed bitumen production, the coke and hydrogen treating units, we really needed those to start up together in sequence. With the use of the interconnect pipeline, we've decoupled that, and we can really prioritize bitumen-producing assets to start exporting bitumen as the cokers aren't ready, or on the other side, export sour crude as the cokers are online and the hydrotreaters is still down. So, it just gives us a bunch more operating flexibility, and that's really changed the game for us.

Kris Smith: Great. Thanks Peter. Any other questions Menno?

Operator: Yes. We have your next question from the line of John Royall of JPMorgan. Please go ahead and ask your question.

John Royall (JPMorgan): So, just one on capital allocation. A couple of your peers have been using buybacks and in addition, going to special or variable dividends more recently. I think your framework really just allows for the buyback. So, maybe you can just talk about how you think about a variable dividend as a tool relative to the buyback and the preference there to buybacks?

Kris Smith: Yes. No, thanks for the question, John, and we're very focused on being disciplined against our capital allocation framework. And actually, I'm going to ask Alister to take that question.

Alister Cowan: Thanks, Kris. John, I mean, essentially, we set out a capital allocation we're 50/50 between buybacks and the debt reduction, we expect to move to 75/25 pretty quickly in the next few months as I laid out.

Variable dividends at this point given the enhanced value in our stock are not part of the equation, but I've never ruled them out longer term as being part of the capital allocation as we go forward. So, when I look at the value of our stock, it's significantly undervalued, and our focus is definitely on buying stock back.

John Royall: Okay. Thank you, Alister. And then if I could just follow-up on the 75% level and certainly not looking to split hairs here about a month or two here or there. But just if you can clarify what you mean by a dependency on the commodity environment? Is that -- if price declines precipitously, you might not move to the 75%? Just trying to understand exactly what that comment means.

Alister Cowan: Yes. I think if you -- we have commodity price is in line with where we're at today, I think no problem in meeting the end of Q1 next year, if you saw a very significant reduction in commodity prices and cracks, obviously, that would get extended out.

John Royall: Yes. Thank you.

Operator: Thank you so much. And your last question comes from the line of Doug Leggate of Bank of America. Your line is now open.

Doug Leggate (Bank of America): …doubling up here, and I was caught on another call earlier, but I did want to -- Kris, first of all, I did want to say -- I don't know if it's been called out yet, but the strong operating performance again this quarter ahead of the Analyst Day, I'm sure everybody is happy to see that.

But my question is on the slide deck. I might be getting ahead of the Analyst Day here, but the $2.15 billion target is now us thinking characterized as offsetting headwinds, obviously, inflation amongst other things. Should we think of that of signaling that the $2.15 billion is no longer in absolute, but -- or sorry, is no longer a net and maybe an absolute with some offsets. And any early look to how you're thinking about that ahead of the end of the month would be helpful. Thanks.

Alister Cowan: Yeah, I'll take that one. Doug, yeah, thanks for that. Yeah, I mean, obviously, we still and as Kris mentioned earlier moving through and achieving the specific items we had in that 2.15 revenue margin and some cost reductions, with a big focus on cost reductions coming in 2023 and then obviously, in 2024, 2025, we have the addition of the margin and revenue from the co-gen. If I look at what was in that assumption was that we would absorb, you know, sort of regular inflation run 2% - 3%, we're obviously not in that environment. So, while we are targeting and asking our operations to find additional offsets, it's certainly going to be difficult to offset inflation across our business to the extent that we're seeing it today. So, some of it will be used to offset inflation, there’s no doubt about that.

Doug Leggate: Great. We'll wait on the Analyst Day. Thanks a lot fellas.

Kris Smith: Yeah. Thank you.

Operator: Thank you so much. And we don't have any questions on queue. I would now like to turn the conference back to Kris Smith for closing remarks.

End of Q&A

Kris Smith: Great. Thanks, everyone, for joining us and for the questions. I hope everyone can join us for our upcoming investor presentation on November 29th. In preparation for that, the leadership team and I are completing a deep review of the portfolio towards providing a robust company guidance for 2023, and I'm looking forward to the conversation with everyone on that day.

And in closing, I just want to emphasize that, I am taking action to drive shareholder value and achieve operational excellence. And make no mistake, this is the focus of our leadership team every day and my top priority. And so, thanks, everyone. And I will end the call there. Thank you, Operator.

[Operator concludes call]