After a 15% Drop, Is Now the Time to Buy Suncor Energy Inc.?

Description

Just when investors were convinced the price of crude was about to recover, the market threw another curveball.

The latest issue has come from Iran. In exchange for the country placing some limitations on its nuclear program, leaders of six of the world's largest economies agreed to lift sanctions placed on it. This opens up the world to Iran's oil, which is estimated to hit the market sometime during 2016.

Crude slipped lower once the deal appeared to be closed. After spending much of the spring at or above $60 per barrel, the spot price for the commodity is now $52, and that's even after a slight rally over the last couple of days.

With analysts saying Iran's oil could spark a new price war that could last for years, it's not surprising that Canada's oil producers have sold off on the news. That, combined with the recent NDP victory in Alberta's provincial election, has led to some producers retesting previous lows.

One of those producers is **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), which saw its shares dip from more than $40 each in April to just over $34 now. Is this an opportunity to buy a good company on the dip, or should investors stay away?

The bear case

At this point, an investment in an oil producer is basically just a bet on crude recovering.

There's nothing wrong with making that bet because it's very likely crude will recover over time. The issue is predicting when exactly this will happen. There are plenty of factors keeping the commodity down now, but they're just temporary. Over the long term, I'm convinced it will head higher.

Many other investors have figured this out, and are using Suncor as a way to invest in crude's recovery. On the surface, this makes sense. Suncor has a fine balance sheet, steady income from downstream operations, and the management expertise to make it through this troubling time.

But is it the best way to bet on crude’s recovery? I’m not sure it is. It might represent one of the safest ways to invest in the theme, but investors are sacrificing safety for potential return. Because of its downstream operations, Suncor isn’t very leveraged to the price of crude. A pure-play energy producer is going to be much more leveraged to oil’s recovery.

The bull case

Of course, the safety issue I just outlined is the very thing that attracts many investors to Suncor in the first place, especially after being disappointed by lower-quality producers.

Thanks to its refineries, its other liquids business, and its nationwide network of Petro-Canada gas stations, Suncor’s earnings aren’t expected to be so bad in 2015. Analysts expect the company to earn $0.80 per share, mostly on the back of those downstream operations. Earnings are expected to jump to $1.50 next year.

There’s also Suncor’s generous dividend, which yields 3.2%. While the company won’t earn enough to cover that payout in 2015, there’s still no reason for investors to think it might get cut. Suncor has one of the best balance sheets in the sector, with nearly $5 billion in cash on hand, and the ability to borrow in the slight chance that it burns through all that cash.

Suncor is also spending big money to further invest in Alberta’s oil sands. Both the upcoming Fort Hills and Hebron oil sands projects are on pace to be completed in 2017, which will add significant production. Additionally, the weak market in the area should help it extract some cost savings on these projects, perhaps helping Suncor come in under budget.

There’s certainly logic in buying the biggest and best producers during this market sell-off. You won’t get the huge upside, but many investors are happy to make that trade-off in exchange for a safer investment. In the energy sector, it doesn’t get much safer than Suncor, which is why it’s a pretty solid choice for retirees and other risk-adverse folks.

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