Suncor Energy Inc. (TSX:SU) Looks Overvalued and Ripe for a Pullback: Buy This Oil Sands Stock Instead!

Description

What a rally it's been for oil prices!

With WTI surging past US$70, the commodity has since started to experience a reversal in its momentum with oil at US$67 and change at the time of writing.

President Trump isn't a fan of high oil prices, so I think it's safe to say that he'll do everything within his power to drive oil prices down, whether it's through urging OPEC to boost production or by some other means.

While oil's rally has made some investors rich, most notably investors in the pure-play Canadian oil sands producer **MEG Energy Corp.**, which doubled up in conjunction with oil's rally, many larger (and safer) integrated plays in the space, like **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), haven't rallied by nearly as much.

And while such a dampened rally may suggest the stock has some "catching up" to do, given the potential for oil prices to fall back to a new equilibrium level (likely in the mid-US$50s, according to some pundits). I think Suncor may be overvalued and ripe for a mild correction of 10-15% in the coming months — especially when you consider the stock only retreated by 2%, which is substantially lower than the average producer in Alberta's oil patch.

Something doesn't quite add up here.

Suncor's integrated assets make way for stable operating cash flows, so it's not a mystery as to why the stock isn't as sensitive to the price of oil as other plays. However, Suncor still needs oil prices to remain above a certain threshold to enjoy meaningful long-term growth. If oil continues to pull back, the company won't be able to turn on the taps in its promising oil sands projects, and that's going to stunt growth, even with its industry-leading integrated operations, which serve as a foundation of stability.

Simply put, lower oil prices will make such projects uneconomical and unworthy of bringing online. Moreover, given Suncor isn't at the cutting edge of advanced oil extraction techniques like the solventaided process (SAP), I think a peer like **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) could enjoy lower breakeven costs and a higher degree of growth over the next five years and beyond if oil prices were to stabilize in the US$50 range.

Of course, Suncor's integrated operations will allow it to perform better should oil prices implode as it did in 2014, but given Cenovus's recent moves, I don't think it will be left with its pants down like last time, especially when you consider the stock is still substantially lower than before the 2014 oil crash.

With a long-term perspective, Suncor, while a safer bet, looks richly valued, especially when you consider the company isn't exactly at the forefront of extraction techniques, which will likely mean Suncor's peers may be able to enjoy greater efficiencies and lower breakeven costs down the road.

Foolish takeaway

With Suncor, you're paying up for safety and stability — not necessarily on long-term growth.

While the company has the capacity to grow production at an astounding rate given its promising asset base, this growth is conditional on the higher price of oil. If oil prices stabilize at a lower level, the stable dividend may be all you'll end up with, at least until management can make significant strides in SAP technology to improve efficiencies and enable economical production growth at modest oil prices.

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Author
joefrenette