Why This Depressed Energy Stock Could Light Your TFSA on Fire

Description

Suncor Energy (TSX:SU)(NYSE:SU) has taken a beating in the markets over the past six months. Trading as high as $55 in August of 2018, it fell to $35 on December 24 — a 29% slide. It has recovered significantly since then but is still down about 22% from its 12-month high.

Recently, Warren Buffett made waves by investing in Suncor — a move that was taken by some as a vote of confidence in the Canadian Energy sector. Buffett's endorsement caused Suncor shares to rally 4% immediately after the news was announced. And after beating earnings estimates for three consecutive quarters, there are indeed strong signs that this stock is set for a comeback.

To understand why that is, we need to take a look at the company's operations.

About Suncor

Suncor Energy specializes in the production of synthetic crude from oil sands. The company also invests in offshore oil and has a large exploration division. In 2018, Suncor hit a new production record of 740,800 barrels a day, about 90,000 barrels ahead of the previous record. That's an impressive production ramp up. In the past, low margins were cited as a major concern for tar sands extraction — which is much more expensive than other types of crude production. However, there are reasons to think that that concern might be overplayed.

Why Buffett bought

Warren Buffett famously doesn't comment on recent share purchases. However, we can speculate as to why he took an interest in Suncor Energy.

In addition to the fact that the company has beaten expectations for three consecutive quarters, there's the fact that tar sands production is getting cheaper — at least for Suncor. In a recent infographic, the company showed that its operating cost per barrel (CPB) of oil has fallen from $37 to $25. That's a 32% reduction. At the past CPB of $37, Suncor's margins were dangerously thin at certain crude oil price points. But now, at $25, the company’s operating costs are well below the selling price of Canadian Crude, which has hovered around $42.

Earnings

Suncor’s financials can be characterized as generally strong but with misses here and there. In its most recent quarter, the company posted a $280 million GAAP net loss, down from a $1.3 billion profit in the same quarter a year before. That’s a mighty steep slide, but the loss includes a one-time foreign exchange loss on U.S. dollar debt and a non-cash investment loss. The company’s operating income was healthy at around $500 million. Relative to analyst expectations, Suncor’s earnings have outperformed in all but one of the past four quarters.

Bottom line

Suncor Energy is the kind of beaten-down stock that can make for a great contrarian TFSA investment. The company is financially sound and, for the most part, growing. The company’s earnings have taken a slide here or there, but the long-term trend is positive. The fact that the company’s operating costs are on a downtrend is encouraging. And, over the past five years, when TSX energy stocks have tanked as a class, Suncor has risen 22%. This stock might be one to keep an eye on in 2019.

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