Why Suncor (TSX:SU) Stock Is a Buy

Description

Over the past decade, oil and gas stocks have seen their fair share of ups and downs. Prone to significant bear and bull markets, the price of oil is typically the catalyst that drives stocks prices in the industry. Given the volatility, I prefer to focus on the industry's best-in-class companies such as **Suncor Energy** (TSX:SU)(NYSE:SU).

Leaving aside the recent upswing (more on that later), the oil and gas industry has been battered over the past year. Down 21.97%, the TSX Capped Energy Index has significantly underperformed the broader market. Whereas as the typical retail investor gets spooked in such times, as seasoned investors we know better. Instead of letting fear take hold and selling in a downtrend, it's time to take advantage of the breadth of opportunities.

Terrorism attacks

This past weekend's terrorist attack on Saudi Arabia's largest production facility is a wake-up call for the industry. The attack took out half of the Saudi's production capacity and approximately 5% of the global supply. On the first day of trading following the attack, the TSX Capped Energy Index jumped 10% on the back of a 15% jump in oil prices — the largest single-day trading bump in over a decade.

It was an overreaction. Saudi Arabia announced that full production would resume by the end of September. As a result, the price of oil retreated, and oil and gas stocks gave up a good portion of their gains from the previous day.

The important takeaway from the events of the last few days is that production facilities are vulnerable. The successful drone attack may encourage similar strikes and the industry is ill equipped to handle them. We live in uncertain times, and this alone will keep the markets skittish and should sustain oil prices. At prices above $50 a barrel, Suncor is highly profitable and generates a ton of cash flow.

Valuation

Even before the events of the past few days, Suncor was an attractive investment, as it was trading at cheap valuations. The company currently sports a price-to-earnings of 11.86, which is well below the company's historical average of 19.7 times earnings. It is worth noting that the company hasn't been this cheap since the start of the 2015-17 oil bear market. This is notable as the price of oil was trading at much lower prices during that bear market.

Today, the price of oil is trading at approximately $60 per barrel, while it traded below $40 a barrel for a period of nearly two years. At today's prices, Suncor is more profitable and generating greater cash flows. Yet it is trading at similar valuations.

Cash flows are a key metric for oil companies. As such, it is also best practice to look at a company's valuation against cash flows. There is a similar trend. Suncor is trading at 6.32 times operational cash flow, much lower than its 9.07 historical average. Once again, it hasn't been this low since the early days of the most recent oil bear market.

Analyst are also in agreement that Suncor is cheap. There are 25 analysts covering the company with an average "buy" rating and a one-year price target of $53.04. This implies 25% upside from today's price of $42.57 per share. For a company the size of Suncor, such a price disconnect is a rarity.

Foolish takeaway

Over the past year, Suncor has lost 17% of its value. We've seen how vulnerable the industry is to sudden terrorism attacks and the price of oil is unlikely to enter a bear market anytime soon. At today's oil prices, and as one of the lowest-cost producers in the oil sands, Suncor is on solid financial footing.

Thanks to recent sector weakness, now is the perfect time to add best-in-class industry leaders such as Suncor on the cheap. Don't wait too long; these prices won't last forever.

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