Will Suncor (TSX:SU) Stock Survive the Market Crash?

Description

Suncor Energy (TSX:SU)(NYSE:SU) appears financially strong, with investment-grade credit ratings and a $37 billion valuation. The recent market crash, however, sent shares lower by nearly 40%.

Some investors are jumping in, especially since Buffett purchased Suncor stock in recent months. Other investors remain wary that Suncor will ever produce long-term positive results. After all, shares now trade at 2005 levels, meaning buy-and-hold investors have accrued a 0% return over a 15-year period.

So, which is it? Should you follow Buffett and buy Suncor stock? Or should you stay far, far away?

More than one market crash

Suncor is not a low-cost producer. Few Canadian energy companies are. That's due to the structurally higher refining costs that some Canadian oil requires, particularly oil sands.

Global competitors like Saudi Arabia can break even at prices below US$10 per barrel. U.S. shale oil largely breaks even around US$25 per barrel, although some mega-projects are targeting breakevens of US$15 or less.

With oil prices now stuck in the US$20-US$30 range, many large producers like Saudi Arabia continue production unabated. Most U.S. shale plays are also continuing to pump. But what about Canadian producers like Suncor?

Suncor needs to generate $3.3 billion in free cash flow every year simply to maintain its current infrastructure. Adding the dividend increases, that breakeven amount to $5.9 billion.

The coronavirus pandemic and the oil market crash have created a double-whammy for oil producers. Suncor had been hoping to produce nearly $11 billion in cash flow this year, which would have handily covered capital expenses and dividend payments. That estimate assumed US$57-per-barrel oil, however. With oil under US$30 per barrel, it's likely that Suncor is generating big losses.

What's the future?

Here's the question that every investor wants to answer: what's the future? We know that Suncor is likely racking up huge losses in the current environment. Will that continue, or should you be buying while there's blood in the streets?

What we do know is that Buffett thought shares were attractive last year when he reported a 10.8 million stake in the company. These purchases were likely at a 40-50% premium to today's prices. If you want to follow Buffett at a discount, this is your chance.

But I wouldn't be too quick to follow suit. Last March, before the oil market crash began, I'd explained why Suncor would be a losing bet over the long term.

"Unless oil prices can sustain long-term pricing above US$70 per barrel, oil sands companies like Suncor will find it difficult to turn a profit," I wrote. "On a cash basis, many oil sands projects have breakeven levels above US$40 or US$50 per barrel. Adding corporate, exploration, and debt costs make the math difficult to justify."

Jeremy Grantham, a well-known co-founder of GMO Asset Management, predicted years ago that oil sands projects would ultimately end up as "stranded assets." That's because these projects are positioned at the high end of the cost curve. As we're seeing today, these assets may end up being abandoned long before their reserves are depleted. It's simple economics.

Fortunately, Suncor stock won't go all the way to zero. It has valuable diversification with its refinery and midstream assets. But make no mistake: Suncor is one of the riskier integrated oil stocks that you can buy today. The longer the current oil market crash continues, the closer this stock price will get to $0.

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