Should You Follow Warren Buffett and Buy Suncor (TSX:SU) Stock?

Description

Suncor Energy (TSX:SU)(NYSE:SU) stock is in the dumps. Since the bear market began, shares have fallen by nearly 50%. If you want to follow Warren Buffett, Suncor should be at the top of your list. That's because he bought shares months ago at a *higher* price.

If markets normalize, it's not hard to see how this stock could double in price. But it's not all good news. Under some scenarios, Suncor could be headed for deep trouble.

What will the future hold, and, more importantly, is this your chance to profit?

What Buffett was buying

Last year, Buffett's holding company, **Berkshire Hathaway**, took a 10.8-million-share stake in Suncor. The purchase was good for nearly 1% of the company's total shares.

According to the *Financial Post*, "Berkshire's investment puts the Buffett stamp on Suncor and could be seen as a positive for the Canadian energy sector. The move comes at a time when global investors have been pulling away from Canada because of its carbon-intensive oil sands and struggle to approve pipelines."

It's important to understand the context behind Buffett's Suncor stake. In months prior, the Canadian energy sector was roiled with a supply shock. Industry-wide production surged unexpectedly, overloading pipeline capacity.

Without a way to ship their output, producers bid to the death to secure pipeline space. This caused local prices to fall as low as US$15 per barrel. U.S. oil prices, meanwhile, remained above US$50 per barrel. The trouble was a purely Canadian phenomenon.

Suncor, however, is an integrated oil company. That means it controls its own pipelines and refineries. Suncor stock was hit hard during the crisis, despite its ability to sidestep trouble completely. This is likely what caught Buffett's eye.

Is Suncor stock a buy?

At the time of Buffett's purchase, Suncor stock was trading at roughly $40 per share. Today, it's approaching $20 per share. Should you follow Buffett and buy at a discount?

In a typical environment, it might be prudent to follow the Oracle of Omaha. Unfortunately, this time might be different.

Earlier this year, Saudi Arabia moved to cut global oil supply to prop up prices. Other members of OPEC, specifically Russia, refused to comply. To retaliate, Saudi Arabia actually *slashed* prices and *increased* production.

Russia requires high oil prices to balance its budget, and the current environment is likely very painful for the country. Once Saudi Arabia reaffirms that it is in control, oil prices can normalize. At least that's what oil bulls are arguing.

Another potential future is that Saudi Arabia keeps oil prices depressed through the entirety of 2020. What would this accomplish?

For years, Canadian oil sands and U.S. shale projects have flooded the market with more supply. This has pushed pricing down significantly year after year. Saudi Arabia may try to keep prices low until these higher-cost producers permanently exit the market. It would be trading short-term pain for long-term gain.

In this scenario, Suncor would be in dire straits. The company needs to produce $6 billion in cash flow every year to support its existing operations and pay its dividend. Even eliminating the dividend still requires $3.3 billion in annual cash flow. At today's prices, the company is falling significantly short of this target. And remember, this still leaves *nothing* left over for growth initiatives.

If the pricing war continues, the dividend will be slashed. Long-term growth spending will also be cut. What's left is a company vying for survival.

How long will Saudi Arabia sustain the pricing war? No one knows. But what we do know is that it's entirely in that country's control.

Value investors can capitalize by purchasing this Buffett stock at a sizable discount, but that bet also requires Saudi Arabia's cooperation. With so many other bargains available, that's not a bet I'm willing to make.

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