Oil Market Crash: Will Suncor Energy (TSX:SU) Cut its Dividend?

Description

Oil is now at its lowest price in two decades.

Most investors want nothing to do with the sector. Contrarian types, however, see some opportunities.

Suncor Energy (TSX:SU)(NYSE:SU), for example, comes up as a popular potential pick, but people want to know if the dividend is safe.

Oil price crash

At the time of writing, West Texas Intermediate (WTI) oil trades at US$11 per barrel. That compares to US$63 in January. In the past month, the coronavirus pandemic essentially put the global economy on hold and oil demand fell off a cliff.

People are not driving. Planes are grounded. Factories are closed.

The United States is the planet's largest oil consumer. Oil demand in the country is down by as much as a third over the past four weeks, according to one report. Refineries in the United States have reduced processing by 20%, but fuel stocks continue to build.

Storage facilities for crude oil are rapidly approaching capacity in the United States and around the world. In its weekly update put out April 15, the U.S. Energy Information Administration (EIA) said current storage levels are at a record for this time of the year.

Assuming the other OECD economies reduce oil consumption by the same amount as the United States, a cut of about 16 million barrels per day (bpd) of demand is expected. OECD countries account for about half of global oil consumption.

The demand crash in the OECD alone is well beyond the roughly 10 million bpd supply cuts recently announced by OPEC and Russia. This is why the price of oil remains under pressure.

Most of the developed world remains under lockdown orders. Oil and refined product demand will not rebound until the pandemic passes and economic activity returns to normal.

Is Suncor's dividend safe?

Suncor Energy is Canada's largest integrated energy firm with production, refining, and retail operations. The downstream businesses normally serve as a good hedge against falling oil prices, but that isn't the case right now.

Suncor raised its quarterly dividend from $0.42 to $0.465 per share at the start of the year. The company maintained the payout through the Great Recession and has not cut the dividend in two decades.

The stock currently trades near $21.50 per share, putting the dividend yield at roughly 8.5%.

Suncor has a strong balance sheet and can ride out a rough patch for some time, so the dividend appears safe in the near term. Management will likely avoid cutting the dividend as long as the company sees an economic recovery on the horizon for the second half of 2020.

That said, persistent lockdowns or a second wave of the pandemic could keep oil below US$20 into 2021. In that scenario, investors should be prepared for a potential distribution cut.

Should you buy Suncor shares?

Suncor traded at $45 in January, so there is solid upside potential when the global economy recovers. The company's size and strong financial position give it the power to make strategic acquisitions at discounted prices.

Suncor went on a shopping spree when oil plunged in 2014-2015, so it wouldn't be a surprise to see new deals announced in the coming months. Adding reserves during a crash can pay off significantly when the market recovers.

Contrarian investors might want to start nibbling at this level. Ongoing volatility is expected, and Suncor could retest the $15 mark it hit in March, but the stock appears very cheap right now, especially if the economic recovery occurs in 2021 as anticipated.

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