Is Suncor Energy (TSX:SU) Stock's Dividend Safe as Oil Crashes?

### Description

Integrated oil firm **Suncor Energy's** (TSX:SU)(NYSE:SU) stock price plunged 60% lower to hit historic multi-year lows in March, as investors fled to safety amid a market crash. However, income investors could be more concerned about a safe dividend than the day-to-day swings in share prices. Is Suncor's dividend still safe after the recent crude oil price crash?



Although Suncor stock has registered some price recovery lately, the current dividend yield still reads 8.6%. During normal economic times, dividend yields north of 7% are rated high risk and likely unsustainable. This may not be the case at this tried and tested dividend-growth giant right now.

Suncor is heavily invested in the oil value chain. The company owns oil production and refineries, and it boasts a strong portfolio of fuel service stations. Oil refinery assets should somehow enjoy lower input costs when crude crashes. Gas stations will roar back to life as soon as lockdowns are lifted. However, sustained national lockdowns and low oil demand won't spare the industry.

## An oil crash guarantees negative cash flows…

The company's assets and operations are designed to sustain production and dividend payments at an average oil price of US$45 per barrel, with Western Texas Intermediate (WTI) being the benchmark.

Operations generated nearly $11 billion in funds flow at higher crude prices last year. But the same can't be expected at WTI readings below US$20. The WTI benchmark read US$15 at the time of writing — a strong recovery from historic negative territory earlier this week.

The company will most likely lose money this year, and cash flows will be deeply negative.

That said, negative cash flows in 2020 will be bad, but they do not automatically mean that the company will cut its dividend.

## …but Suncor has some capacity to absorb the shocks

Management recently shored up the company's liquidity by $3.75 billion in April. The company now sits on over $10 billion in available liquidity, and it only has about $1.6 billion in debt maturities to 2022. The 2020 dividend could require a nearly $3 billion cash outflow.

The company still has very good financial flexibility to afford dividend payouts for the next two years, if it so desires. However, its net debt could have to increase modestly if oil prices remain depressed at today's levels.

Therefore, management has the choice of either maintaining the dividend with a modest debt increase or cutting the dividend but at the cost of disappointing the capital markets. I strongly bet they will choose the former path, as evidenced by the company's dividend policy.

## Is Suncor stock's dividend safe?

We should closely watch the company's dividend policy.

Although dividends are supposed to be paid out as a portion of annual earnings, companies long established that the paychecks would be highly uncertain, as they will fluctuate every year. Income investors don't like uncertainty. Rather, income investors like the bond-like cash flows from established Dividend Aristocrats.



Dividend-growth companies like Suncor have decided to smoothen their dividend payouts and declare annual increases to improve dividend certainty. This allows the company to serve its desired investor market, which includes large institutional investors like pension funds.

The truth is, executives don't want to unnecessarily mess with key stakeholders. There's a social contract between companies and the investor community as far as dividends are concerned. Investor trust enables dividend-growth stocks to command higher valuation multiples and low costs of capital, which results in higher profitability and positive internal rates of returns on capital projects.

I doubt if management would decide to mess the company's unbroken record of dividend payments this year. Income investors trust that the firm will honour its "dividend" obligations, more so during such tough times, as long as the company can sustainably do so.

As things stand today, Suncor still can.

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**Date**
2025/07/06
**Date Created**
2020/04/23
**Author**
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