Could Suncor Energy (TSX:SU) Cut its 7.5% Dividend?

Description

Suncor Energy (TSX:SU)(NYSE:SU) is Warren Buffett's preferred way to play the Albertan oil patch. Although the company is under pressure from the unprecedented rout in oil prices, the balance sheet is still top notch and is arguably in the best shape of all firms in the oil sands. Amid oil's coronavirus-induced, demand-driven collapse, Suncor stock fell over 65% from peak to trough, and its dividend swelled to heights not seen since the Financial Crisis.

Suncor shares have since posted a partial recovery, but the dividend yield is still ridiculously high at 7.5% at the time of writing. While the dividend looks safe, with a payout ratio of 90%, it has become stretched in recent months. And should low or nearly free oil prices, with the occasional dip into the negatives, become the new normal, one has to wonder about the long-term sustainability of Suncor's dividend.

Suncor Energy looks like the best player on a sports team that stinks

Just because Suncor has one of the best balance sheets in the business doesn't mean the dividend is as solid as a rock, especially with the massive oil glut and severe supply shortages. Should the insidious coronavirus (COVID-19) spark even more lockdowns over the next few years, investors had better get used to an era of single-digit oil prices, because it could take many years for demand to recover.

In an era "nearly free" oil prices, even the best-in-breed oil integrated oil firms could stand to fall to their knees. And with potentially long-lasting damage to energy demand, no dividend in the oil patch should be viewed as safe by investors.

Royal Dutch Shell drops a bombshell, slashing its dividend for the first time since WWII

Royal Dutch Shell (NYSE:RDS.A)(NYSE:RDS.B) is a premier oil and gas (O&G) company that's known as one of the world's O&G "supermajors." The company certainly doesn't have a dismal balance sheet, but that didn't stop the company from slashing its dividend on Thursday, an unprecedented move that caught many investors by surprise.

Many shocked investors threw in the towel on the name, likely viewing the move as unforgivable, causing shares of Shell to plunged over 10% on the day. The unprecedented dividend cut also sending a shockwave across the sector on a day that oil prices actually bounced back around 25% to the high teens on easing storage worries and additional production cuts.

Could Suncor Energy follow suit?

If a dominant big oil firm like Shell can cut its dividend, so too can some of Canada's premier oil players, including Suncor, which pulled back 6.2% on the day. As such, investors should be skeptical about high yields that could present themselves in the oil patch over the coming weeks and months should this sell-off worsen.

That said, Suncor Energy is a ridiculously cheap stock that young investors may want to consider if they're looking for deep value and are willing to hold for at least five years. The dividend is theoretically safe, but with the longer-term outlook of the oil patch taken into consideration, I'd say it's not as safe as it seems based on the encouraging financials, especially after Shell's dividend reduction.

Heck, a dividend reduction may be the best course of action to ride out this pandemic.

Foolish takeaway

The stock trades at 0.97 times book and 1.1 times sales, which is bottom-of-the-barrel pricing for arguably the best company in the oil sands. In an era of nearly free oil, I'd expect more budget cuts from Suncor, as the firm looks to free up more financial flexibility.

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