Why Did Suncor's (TSX:SU) Stock Price Crash 48%?

Description

Suncor Energy (TSX:SU)(NYSE:SU) is one of Canada's largest companies. In February, the company was valued at nearly $70 billion. In recent weeks, however, a sudden stock price decline has brought its market cap down to $35 billion.

Value investors are starting to pay attention. Last year, Warren Buffett purchased a 10.8-million-share stake in the company at *much* higher prices. If you want to follow Buffett at a discount, the argument goes, then Suncor stock is for you.

But shares have fallen dramatically for good reason. That doesn't mean Suncor stock isn't a buy, but before you jump in, make sure you understand the details.

Here's what happened

The biggest story is the collapse in crude oil prices. You've likely heard about oil prices turning *negative* in recent weeks. It turns out that this was a bit of a fluke, as these prices actually reflected the valuation of a specific futures contract for a single month.

Negative prices *didn't* reflect the actual long-term price of oil, but that's not much of a consolation, as negatively priced futures were only made possible by a collapse in demand and a surge in supply.

At the start of 2020, oil prices were around US$60 per barrel. Today, they're closer to US$20 per barrel. Suncor makes most of its money by selling oil, so this was a terrible result for the company's bottom line.

The demand side of the equation is easy to understand. You've likely limited your travel severely since the year began in response to the coronavirus pandemic. The rest of the world has done the same. Air traffic has plummeted, while vehicle transportation has also fallen off a cliff. Business activity is lower, and consumption as a whole has decreased.

All of this has resulted in the most rapid drop-off in oil demand in history. But lower demand is only half of the story. Suncor has also been hit by surging industry supply.

We've seen this happen before. In 2014, oil prices were cut in half as cheap U.S. shale oil flooded the market. Today, it's a *global* supply glut, with Saudi Arabia leading the way with record production. Falling demand plus rising supply can only mean one thing for Suncor: lower selling prices.

Time to buy Suncor stock?

Many investors are buying Suncor stock as a bet that oil prices will rebound post-pandemic. This is a reasonable investment thesis. If conditions normalize, oil prices could quickly surpass US$50 per barrel. In this scenario, Suncor stock would be a screaming buy.

But rising oil prices alone won't save Suncor. Every oil producer has what's deemed a "breakeven price." That's what the company needs to turn a profit.

Suncor is aided by its midstream assets — like pipelines and refineries — but its upstream assets are some of the most expensive in the world. Its massive oil sands projects likely need oil to surpass US$40 per barrel to turn a cash profit. For a true economic profit to be realized, oil prices may need to move above US$50 per barrel.

If oil prices don't rise considerably, Suncor stock may barely budge. Just take a look at its historical trading range. The stock now trades at the same price as it did in 2005! Apart from dividends, shareholders have made a 0% return in 15 years.

High breakeven prices aren't a problem when oil prices are commensurately high. But in today's environment, Suncor is likely racking up multi-million-dollar losses on a *daily* basis. Unless you're a giant oil bull, stay away from this stock.

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