COVID-19: Fear of 2nd Wave Could Hurt Suncor's (TSX:SU) Recovery

Description

Oil prices continue to reel under pressure, as fear of the second wave of the pandemic grips the market. Earlier, Beijing reported a spurt in new coronavirus cases and is conducting extensive tests to contain the virus. Meanwhile, countries that are hit the worst by the virus continue to report a higher number of cases, which dragged oil prices down and dashed hopes of recovery.

Amid such a scenario, investing in oil companies, including **Suncor Energy** (TSX:SU)(NYSE:SU), could prove to be a risky bet, and investors should stay away from oil stocks at least in the near term.

What's behind recent jubilation?

Shares of Suncor Energy recovered sharply from the March low of $14.02 as OPEC+ countries reached a consensus in April to cut down on oil production. Earlier, this month, OPEC+ nations further agreed to extend the production cut till July end, which drove Suncor stock even higher. Meanwhile, governments' stimulus packages around the world and the optimism over the reopening of the economy further supported oil prices.

Also, Suncor's integrated business model mitigates some of the price risks. Its downstream business continues to support the cash flows. Meanwhile, Suncor's mix shift toward the higher-priced light crude and distillates and reduction in operating costs further support its margins and reduces breakeven costs.

A high degree of uncertainty

Despite the recent recovery in oil prices, I have long maintained that the high degree of uncertainty surrounding the economy is likely to restrict the upside in Suncor's stock price. Oil prices could continue to remain volatile in 2020, and only cutting back on supply will not help in stabilizing its prices. Meanwhile, the reappearance of the virus in China is no good sign for oil companies and indicates that the recovery in demand could take longer than what the markets anticipated.

The uncertainty overhang continues to remain a significant drag on Suncor's stock price. Shares of Suncor Energy dropped about 13% in the last five trading days, reflecting a decline in WTI (West

Texas Intermediate) prices.

Now what?

In my view, Suncor is a great company, but it is simply not the right time to buy its stock. The company's integrated business model, cost-cutting measures, and strong liquidity could help it to remain afloat amid turbulent times.

However, it would take a lot of time for Suncor to recover and trade at pre-pandemic levels, which keeps me at bay. Further, I find Suncor's current valuation unattractive. Shares of Suncor trade considerably higher than the industry average. The Suncor stock trades at the next 12-month EV-to-EBITDA ratio of 9.8, which is well above the industry average of 2.7.

Suncor's unattractive valuation and a tough operating environment could continue to restrict the recovery in its stock.

Forget Suncor

Given the challenges associated with investing in Suncor stock, investors willing to invest in energy companies could consider buying shares of the pipeline companies like **Enbridge** and **Pembina Pipeline**. While both these companies are witnessing volume pressure, their low-risk and diversified business model makes them a solid long-term bet. Besides, consistent dividend growth makes them ideal income stocks.

The businesses of both these companies are supported by the contractual framework and have low direct commodity exposure, which helps them to generate healthy cash flows and cover their payouts.

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