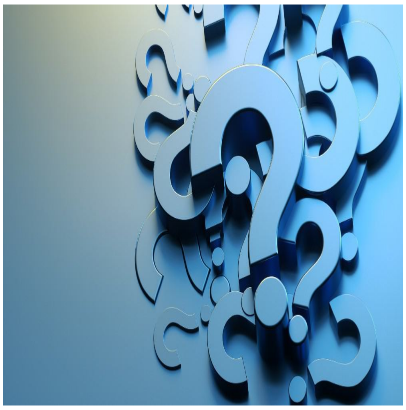

Should You Buy Suncor (TSX:SU) Stock for its 4.6% Dividend Yield?

Description

Shares of Canadian energy giant **Suncor Energy** (TSX:SU)(NYSE:SU) are trading at $18.2, which is 60% below its 52-week high. Suncor stock has, in fact, declined 67% since July 2018 and has burnt significant investor wealth.

However, Warren Buffett increased his stake in the energy infrastructure company, according to recent 13F filings. **Berkshire Hathaway** now owns 19.2 million shares of Suncor worth US$264.6 million, indicating a 1.3% stake in the company. This means Berkshire increased its holdings in Suncor by approximately five million shares in the June quarter.

So, as the Oracle of Omaha expects the stock to rebound, should you follow suit and take a position in Suncor?

Suncor stock has a forward dividend yield of 4.6%

While the markets have staged a spectacular V-shaped recovery since March, energy stocks continue to trade at a lower valuation. Energy companies have been impacted by lower-than-expected demand due to COVID-19 and the oil price war between Saudi Arabia and Russia.

This one-two punch led to massive disruptions for Suncor and peers, and energy stocks fell again amid the broader market sell-off in the last week. Oil stocks have been vulnerable, as there are questions raised with regard to the financial position of these companies.

The revival of oil prices has been sluggish since April, and Saudi Arabia recently said that it's cutting the price at which it sells oil for the next month, resulting in another round of sell-offs.

Is Suncor prepared to withstand a prolonged period of lower oil prices? The company has a market cap of $27.4 billion, and its debt balance stands at $22 billion. Its cash balance is close to $2 billion, which can be considered precarious, looking at the company's $600 million loss in the last quarter.

Suncor already cut its dividends by 55% earlier this year to boost liquidity amid an uncertain macroenvironment. Further, the unprecedented chaos in the oil sector led to Suncor lowering its capital expenditure forecasts by 33% to about $3.8 billion for 2020.

Suncor increased its dividend for 18 consecutive years prior to COVID-19. In fact, Suncor increased dividends by 10.7% in February before its dividend cut in March. It still provides investors with a forward yield of 4.6%.

Dividend payments are not a guarantee

Warren Buffett generally buys a stake in companies that generates cash flows that allows them to pay and increase dividends. However, the near-term volatility is bound to hurt Suncor's cash-generating ability.

In Q2, Suncor's sales fell by 58% year over year to $4.2 billion, while the adjusted loss per share stood at $0.98, below analysts' estimates of $0.6. In 2020, Suncor's sales might fall by 33%, while earnings might decline by 148%, according to consensus estimates.

What works in Suncor's favour is the company's huge presence in North America and its diversified asset base. It can easily take advantage of rising oil prices on the rebound by additional drilling or can hedge against weak pricing by leveraging downstream operations.

However, while oil prices remain subdued, Suncor stock will be range bound. There is a chance for the company to further cut dividends or suspend them entirely if the markets crash again, given its high debt levels.

Suncor stock is trading at a cheap valuation for these reasons. If you expect oil prices to recover, taking a position in Suncor makes perfect sense.

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Date
2025/09/13
Date Created
2020/09/14
Author
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