Forget Suncor (TSX:SU): Buy This Cash-Rich Energy Stock Instead!

Description

It has been another challenging year for **TSX** energy stocks. **Suncor Energy** (TSX:SU)(NYSE:SU), one of Canada's largest integrated oil producers and refiners, has had a particularly difficult year in 2020. Year-to-date its stock is down 60% and it is only trading 13% above its March crash lows. The company cut its dividend by 55% in May, and has failed to create any real stockholder returns since the pandemic.

Tough markets could challenge Suncor stock for a while

Unfortunately, global oil markets continue to remain unbalanced. Production and stockpiles continue to outweigh supply. If OPEC+ follows through with its plans to taper production cuts, the price of oil could drop dramatically. Global demand has flatlined and travel-related consumption may not return for many years. Consequently, refining margins are challenged and there is still a glut of fuels in the market.

This environment does not bode positively for Suncor's stock. While Suncor benefits from its integrated value-add strategy, it is getting hit on both side of its oil production and refining operations. Although the company does have a strong BBB+ credit rating, it still has a relatively high debt burden of $21 billion and debt to equity ratio of 60%. If comparable to any other sector, this is pretty high.

Suncor will survive, but can it thrive?

Fortunately, Suncor can produce oil at a very low cost and has a fund flow from operations break even (covers enterprise operating costs, sustaining capital, and dividends) of only West Texas Intermediate (WTI) US$35/bbl. Combine its long life assets, its integrated operations, and its low cost of production and the company will undoubtedly survive this crisis. However, when investing, I don't want to own companies that are just surviving. I want exposure to businesses that can prosper, even in difficult markets.

The reality is, Suncor's stock and the entire oil sector is very cheap. Suncor trades at a 26% discount to book value. At some point, the world will likely recover and oil demand could return to a healthier level. At that time, the stock could have some attractive upside. Yet for me, at the moment, I would choose to keep my money on the sidelines.

Forget Suncor stock, this energy play is sweet

There are a couple of other energy stocks I would prefer to play an energy recovery over Suncor. One notable stock is **Parex Resources** (TSX:PXT). Parex operates and produces ~45,000 bbl of crude exclusively in Colombia. While there is some regional risk, Parex has been operating in Colombia for years and has a high level of expertise in the region. What I love about this energy stock is that it has zero debt and $339 million of available cash ($2.45/share). I can't think of any other energy producer with such an attractive balance sheet!

Due to its location and light sweet crude, it garners premium Brent Crude pricing. At US$33/bbl the company still earns a ~US$10/bbl netback. Consequently, in its recent second quarter, Parex still earned a positive $0.28/share profit and produced $33 million of free cash flow.

Unlike Suncor, Parex still found a way to reward shareholders in the crisis by buying back over $33.5 million of stock. In fact, since December 2019, it has bought back 5.6 million shares- that is almost 4% of the outstanding share count.

Since it is a relatively small and nimble producer, it can increase or decrease production as the market demands. Consequently, it can preserve its reserves in tough markets and maximize its resources in strong markets.

All around, Parex is a great energy company in a tough market. If you want to play an energy turnaround, forget owning Suncor's stock and buy little-known Parex while it is still cheap.

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