Suncor Energy (TSX:SU) Stock: Great Buy or Value Trap?

Description

By some metrics, **Suncor Energy** (TSX:SU)(NYSE:SU) is a very cheap stock. Thanks to the beating it sustained from COVID-19, the stock trades at about 0.7 times book value and 0.8 times sales. Those are the kinds of metrics that get value investors excited.

Warren Buffett has doubled down on the stock in 2020, probably because he perceives it as cheap. Evidently, value investors smell a bargain here. But is Suncor actually a bargain or a classic value trap?

Terrible earnings

The first thing you need to know about Suncor Energy is that it hasn't been "unjustly" beaten down. It was beaten down because of two consecutive terrible quarters: one with a $3.5 billion loss; the other with a $614 million loss. Both of those quarters also saw negative operating earnings. The second quarter saw a net operating cash outflow of $768 million.

There's no way to deny it: these are terrible results. Earnings are down, as is cash flow. It's a bad picture.

With that said, it's possible that Suncor could bounce back. In the first and second quarters, demand for gasoline was suppressed by COVID-19. With Canadians sheltering at home, there was little need to drive. This negatively impacted sales at Suncor's Petro Canada stations.

It was a rough time. But the factors behind these tanking earnings were temporary. With the economy picking up, people are starting to drive more. Gasoline is up significantly since April. Some petroleum-intensive industries, like airlines, are still in the gutter. But Suncor mainly sells gasoline directly to motorists. It shouldn't be too impacted by other oil and gas market issues.

A cheap stock

There's no way to deny that Suncor Energy stock is cheap. It's currently trading for less than its book value and less than a year’s sales. On the earnings front, it’s more complicated, because the company’s earnings are negative for the year. But as outlined above, they should bounce back.

The interesting question is whether Suncor will sustain lasting damage from its past two quarters. Sometimes, when companies run losses for extended periods, they have to borrow or issue equity to stay afloat. That dilutes shareholder value. However, Suncor had $20 billion in net debt against $36 billion in equity in the second quarter. That gives the company a pretty low debt-to-equity ratio of 0.55, or 55%.

Basically, its balance sheet isn’t over leveraged. The company also had $1.8 billion in cash on hand. That’s enough to cover operating expenses with zero revenue for a little less than one quarter. This isn’t a company can sleepwalk its way through a crisis, but it’s no **Air Canada** in terms of solvency risks.

The bottom line

Suncor Energy is undeniably cheap compared to book value and sales. The question is whether the company can recover enough to make it a worthwhile buy at today’s prices. It really all depends on oil and gas prices. If they rise then the company should be fine. But it’s in trouble if they fall. If you buy SU, remember that you’re largely betting on a commodity price. There are less-volatile businesses out there.

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