Should You Buy This 1 Warren Buffett Stock at the Dip?

Description

Suncor Energy (TSX:SU)(NYSE:SU) is one beaten-down stock because of the oil crisis, and the pandemic just made things worst. But it still has the support of Warren Buffett. Suncor is Canada's largest integrated energy company, having exposure to exploration, refining, and retail operations. The company's integrated business model worked well for it in the past. When things were low in exploration, its retail operations were strong, and vice versa. But the pandemic brought a halt to all three operations, leaving Suncor with nothing but losses.

Suncor's near-term headwinds

Things were already tough on the exploration front, as shale gas exploration reduced oil prices. But Suncor handled the situation well, as lower oil prices boosted revenue in the refining and retail operations. But the pandemic reduced oil demand and dropped oil prices to negative in April. Oil companies around the world were paying to store oil.

To balance the demand and supply, OPEC+ asked companies to reduce production, thereby impacting Suncor's exploration operations. The grounding of airlines worldwide and reduced road travel have impacted demand for fuel and gasoline. This has impacted its refining and retail operations.

The airline industry will remain in the doldrums for another year or two until people start traveling again. The future of air travel hinges around the discovery of the coronavirus vaccine. The recent expectations are that a vaccine should be available by the end of the year, but it could be delayed to next year.

Suncor's efforts to withstand the pandemic crisis

Suncor knows that these near-term headwinds would have a lasting impact on its business. The pandemic has already put its return on capital employed (ROCE) into negative 7.5% in the second quarter. The ROCE turned negative, as Suncor has been reporting losses for the last three quarters.

To reduce its losses, Suncor has reduced its production by cutting capital expenditures by $1.9 billion. The company is also cutting costs to break even with the WTI price of US$35 per barrel. It plans to reduce its operating expense by $1 billion by cutting 10-15% of its workforce in the next 18 months. It has slashed dividends by 55% and increased liquidity by $4 billion. These efforts will help Suncor withstand the crisis in the short and mid-term.

No company can sustain losses for a long time. If oil demand doesn't return in the next three years, its next big challenge would be the $21 billion debt sitting on its balance sheet.

Why does Warren Buffett hold Suncor shares?

Liquidity, losses, low demand, and no control over the demand situation are the challenges even airlines face. Even then, the billionaire value investor Warren Buffett sold his airline stocks but increased his stake in Suncor. His actions show that he believes oil prices will surge in the long term and drive Suncor stock.

Suncor and **Air Canada** are currently facing similar headwinds. What sets them apart is the nature of their assets. Air Canada's assets are its aircraft, which are fast depreciating. If the planes don't fly, their value will depreciate faster. That's not the case with Suncor. Its oil fields have long lives and depreciate slowly. This is probably the reason Buffett is holding on to Suncor.

Should you follow Warren Buffett and buy Suncor?

Even though Buffett likes Suncor, he has made investment mistakes. I would suggest you stay away from Suncor. In the next three years, the only return Suncor stock could give is a 5% dividend yield. However, looking at the rate at which its losses are widening, even these dividends could be at risk. When buying a dividend stock, you should look at three things: profits, cash flows, and dividend history.

In the second quarter, Suncor's funds from operations more than halved to $488 million, of which it spent $320 million in dividend payments. Hence, it slashed its dividends by 55%. If cash flow doesn't improve, dividends would be the first to take another hit. Remember, a loss-making company doesn't pay dividends.

There are better dividend stocks that are still profitable and churning positive cash flows. Instead of a 5% yield, you can get a more than 8% yield from **Enbridge** or a more than 9% yield from **RioCan REIT** . Even their assets have a longer life, and their stocks will surge when the economy recovers.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Energy Stocks
4. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)

2. TSX:SU (Suncor Energy Inc.)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Coronavirus
2. Dividend Stocks
3. Energy Stocks
4. Investing

Date
2025/08/24
Date Created
2020/10/13
Author
pujatayal