



## Which Is a Better Value Stock: Suncor Energy (TSX:SU) or Air Canada (TSX:AC)?

### Description

The **TSX Composite Index** fell 4% since its peak in September, and **Suncor Energy** ([TSX:SU](#)) ([NYSE:SU](#)) and **Air Canada** ([TSX:AC](#)) were among the biggest decliners. They lost 22% and 12%, even after trading at a 60% discount since March sell-off. The two stocks came at the lower end of their price range of \$15-\$22 and \$14-\$20, respectively, but neither of them breached the support.

Investors are afraid of riding on the bears of the two stocks, even though they are trading at their multi-year lows. But what's interesting is that value investor Warren Buffett is [holding Suncor](#) and has sold all his airline stocks.

### Correlation between Suncor Energy and Air Canada

Fuel connects AC and Suncor. Jet fuel is made from crude oil. Suncor extracts oil and refines it into jet fuel, and supplies it to airlines. Airlines spend around 24% of their revenue on fuel alone. Hence, when the pandemic grounded planes and airlines operated at just 5% capacity, jet fuel demand plunged significantly. All oil companies, including Suncor, were left with large inventories and no space to store them. Hence, oil prices dipped to negative \$37/barrel in April.

OPEC+ asked oil companies to cut production to balance supply as per the demand. The air travel improved slightly in the third quarter, with U.S. airlines operating at 30% capacity, increasing their operating expense because of a rise in fuel expenses. An improvement in the demand and supply balance increased WTI crude oil to \$40/barrel.

The world was expecting a recovery in air travel in September. On these expectations, OPEC+ increased oil production. But air travel demand slowed after the Labour Day, thereby reducing oil price below \$40/barrel. Hence, AC and Suncor stock have been going downhill, falling 9% and 22%, respectively, since September.

## Suncor Energy or Air Canada?

Suncor will release its third-quarter earnings on October 28. In the first half, it reported a loss of \$4.4 billion as a negative \$37 oil price pushed the entire oil industry in the red. The hopes are high for the third quarter as the oil price recovered to \$40, and there was some recovery in demand, if not significant. One of the biggest oil companies [BP reported a US\\$100 million profit in the third quarter](#), indicating that the oil companies will return to profit when demand recovers.

Suncor is trading at 31.7 times its earnings per share for the next 12 months, which is higher than BP's forward price-to-earnings (PE) ratio of 12.2x. But Suncor stock has a better value than AC, which is trading at -9.5 times its forward PE ratio.

AC will release its third-quarter earnings on November 3, where its losses could cross \$2 billion, increasing its first nine month's loss to \$5 billion. Its U.S. peers have all reported higher losses despite an increase in revenue. This is because airlines need to operate at 75%-80% capacity to break-even. And airlines are currently operating at 25%-30% capacity.

The air travel demand is showing signs of weakness once again as the COVID-19 cases are surging in the U.S., Canada, and Europe. As airlines can't boost demand to fill the available seats (current capacity), they are reducing the seats. This way, they can achieve break-even in a few years. Suncor at least has a profit in the midterm, but AC has no profit in sight for the next three years.

## Investor corner

An investor earns from stock in two ways; one is through dividends, and the other is through capital appreciation (increase in stock price). Suncor has dividend yields of over 5%. And as the oil demand returns, the stock price would surge. If it returns to the pre-pandemic level in five years, it will deliver a 170% capital appreciation.

As for AC, it has no dividends and no capital appreciation, at least for the next five years. For both stocks, capital appreciation hinges on the profit, and AC has no profit in the mid-term.

In conclusion, Suncor is a better value stock than AC.

### CATEGORY

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

### TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:AC (Air Canada)
3. TSX:SU (Suncor Energy Inc.)

## **PARTNER-FEEDS**

1. Business Insider
2. Koyfin
3. Msn
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