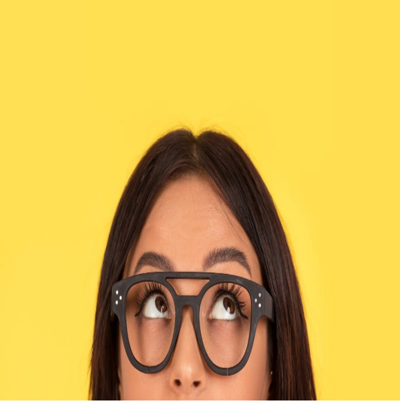

Suncor Energy (TSX:SU) Stock Dips to $15: Should You Buy?

Description

Energy stocks fell in October as oil prices fell below $40/barrel after the COVID-19 cases increased in the U.S., Europe, and Canada. **Suncor Energy** (TSX:SU)(NYSE:SU) stock dipped 5.24% and hit the bottom at $15, but up 6.7% from its 52-week low. The stock fell even after the company reported slightly better third-quarter earnings, which showed improvement in losses and funds from operations.

How oil prices impact energy companies' margins

Oil is a commodity, and no single company can dictate the price. The oil price is determined by the market forces of demand and supply. Hence, when there is oversupply, oil prices fall, and demand rises. OPEC+ helps oil companies adjust their production as per the demand to maintain the oil price at a level (above $55) where companies can make a profit.

Oil companies benefit when oil price rises as their profit margins improve. However, they stand to lose when the oil price falls below the cost of production. The company with the lowest production cost stands to benefit the most. This explains why **BP** reported a US$100 million net profit, while Suncor reported a $12 million net loss in the third quarter.

The pandemic-driven oil crisis

Now, the COVID-19 pandemic imposed transportation restrictions that reduced diesel and gasoline consumption and caused a sudden dip in oil demand. This created huge oversupply, to the level where oil companies were struggling to store their production.

Hence, oil prices dropped to negative US$37/barrel in April. OPEC+ asked companies to cut production as the priority was to use up the inventory. Oil companies had to sell their oil at lower prices, which resulted in millions of dollars in inventory losses.

As the economy reopened, demand improved, and oil prices recovered slightly to US$40/barrel. Now, this price didn't put many companies to profit but at least helped them breakeven operating costs. This is reflected in Suncor's third-quarter earnings.

Suncor Energy's third-quarter earnings highlights

In the second quarter, Suncor's crude oil and crack spread benchmarks declined by more than 50% year-over-year (YoY), which resulted in an operating loss of $1.49 billion. (This spread is the difference between the cost/barrel and the price/barrel.) Suncor initiated plans to cut operating costs by $1 billion and capital expenditure by $1.9 billion to narrow the spread.

In the third quarter, spread benchmarks declined by more than 25% as oil prices rose. The narrowing of the spread, combined with Suncor's cost-reduction program, helped it cut down its operating loss to $302 million. The increase in demand and reduction in loss improved its funds from operations to $1.16 billion from $488 million in the previous quarter.

The resurgence of COVID-19 and Suncor

Suncor's third-quarter figures show a financial recovery. But the resurgence of COVID-19 cases dampened oil demand and pulled down oil prices to US$38/barrel.

Suncor Energy, in its presentation, stated that a WTI pricing of $35/barrel will help it cover its operating expense, the necessary capital expenditure, and dividends. When the price fell below $35 in the second quarter, Suncor cut its dividends by 55%. In the third-quarter earnings, Suncor revised down its full-year guidance for price/barrel of different grades of crude oil.

A lower oil price means the company will continue to struggle to make ends meet. As Suncor is Canada's largest integrated oil company, its weak oil price outlook impacted stocks of other oil stocks. **Canadian Natural Resources** and **Imperial Oil** stock prices fell 2.7% and 3.2%, respectively.

Should you buy Suncor stock at $15?

The lower oil prices have pushed Suncor stock to its March low of $15 and inflated its dividend yield to 5.6%. The next two years will be a roller coaster ride for Suncor. If the oil price falls below $35 again, another dividend cut could be in the cards. While there is a risk, there is also a reward.

Suncor has strong liquidity and balance sheet to withstand the crisis. Moreover, it is increasing its operational efficiency. As I said earlier, the company with a lower cost will stand to benefit. Hence, Suncor's cash flows will increase faster when the oil price recovers. The third-quarter earnings give a snapshot of how recovery will look.

If you buy and hold the stock for five years, it will pay off.

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