



## WAIT! Consider These Risks Before Buying Suncor Energy (TSX:SU) Stock

### Description

**Suncor Energy** ([TSX:SU](#))([NYSE:SU](#)) stock fell 5.4% on October 28, while energy stocks tumbled 3.9%. The **TSX Composite Index** fell 2.7%, as the COVID-19 resurgence tightened travel restrictions and dampened recovery in oil demand. WTI crude price fell to \$35.9/barrel, its lowest level in nearly a month, raising an alarm of another market crash.

### Suncor Energy's risk/reward ratio

Suncor Energy, in its [investor presentation](#), stated that it needs a WTI pricing of \$35/barrel to meet its operating cost, capital expenditure, and dividend payments. And this is after the oil giant cut its dividend by 55%. If the WTI price doesn't increase fast, Suncor might announce another dividend cut. Warren [Buffett's investment in Suncor](#) raises hope that the stock will pay off in the next five years. But the first two years will be the toughest.

At \$15, Suncor is trading at 47 times its next 12-month earnings per share. This doesn't look like an attractive valuation for a company that is making losses. But that is the nature of a cyclical stock like Suncor. If oil prices rebound, the company will move from millions of dollars of losses to profits. In the first nine months of 2020, Suncor's net loss widened to \$4.15 billion against a profit of \$5.23 billion in the same period last year.

Before considering buying Suncor stock, look at these three things.

### WTI crude oil price volatility

The oil price governs every single aspect of an oil company. As an oil company can't determine oil prices, it reduces costs and changes the product mix to boost profits. The pandemic reduced crude oil and crack spread benchmarks by more than 50% in the second quarter, when WTI crude oil was US\$27.85/barrel. This spread benchmarks reduced by more than 25% in the third quarter when the WTI crude oil was US\$40.95/barrel. The higher the spread, the lower the profit.

If the oil price falls below US\$40/barrel, Suncor will lose money from selling oil. Hence, the company is reducing its operating expense by \$1 billion, capital expenditures by \$1.9 billion, and dividends by 55% to bring down its cost to \$35/barrel. It is also increasing the mix of synthetic crude oil, which commands a higher price. But if the oil price falls to US\$35, more dividends and cost cuts might be needed.

For taking this risk, Suncor will reward you with higher dividend yields. How? If Suncor cuts dividends, its stock price will fall significantly, thereby inflating its dividend yields. When the oil price surges to US\$40/barrel or above, its stock price would surge to \$22, representing an upside of 47%.

If you invest \$500 in Suncor share now, you will get a reward of \$230 when the oil price returns to US\$40/barrel. And the oil price will rise as OPEC+ will adjust the supply to meet the demand dynamics. OPEC+ increased the oil price per barrel from -US\$37 in April to US\$43 in August.

## Foreign exchange rates

Suncor is benefitting from a weaker Canadian dollar, as it sells oil in U.S. dollars but incurs expenditure in Canadian dollars. It reported \$290 million in unrealized foreign exchange gain in the third quarter, which reduced its net loss to \$12 million.

However, this foreign exchange rate doesn't bode well for Suncor when it comes to debt. It has 64% of its debt in U.S. dollars, which means it has to pay more Canadian dollars.

## Suncor is a long-term bull

Suncor has \$9 billion in liquidity, which will help it sustain losses for another two years. It is using this time to reduce its cost and improve its operating efficiency. It plans to complete an interconnecting pipeline between its Oil Sands Base Plant and Syncrude in the fourth quarter. The pipeline will improve operating efficiency and generate \$2 billion in free funds flow. When oil prices recover to more than \$50 in the long term, Suncor will generate higher margins that it used to earn before the pandemic.

Suncor's short-term risks can put your portfolio in red, but long-term rewards can more than double your money in five years. However, there are lower-risk stocks that are better positioned to fight the pandemic.

### CATEGORY

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2. Dividend Stocks
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2. TSX:SU (Suncor Energy Inc.)

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