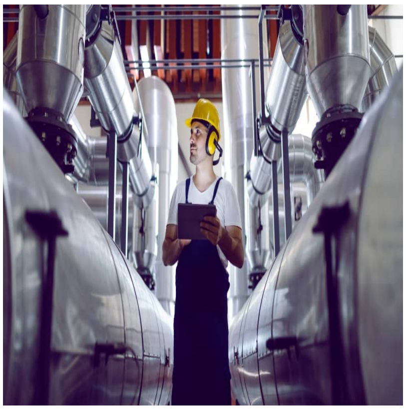

Should You Buy Suncor Stock at $23?

Description

Suncor Energy (TSX: SU)(NYSE:SU) took a beating this year to due to the pandemic. The share price is now off the 2020 low and contrarian investors want to know if Suncor stock should be on their 2021 buy list.

COVID impact on Suncor's operations

Suncor is Canada's largest integrated energy company. The oil production operations represent the biggest part of the business, but Suncor also owns four refineries and operates 1,500 Petro-Canada retail locations.

In the past, the downstream businesses provided a hedge against low oil prices, which makes sense. When oil gets cheap the input costs for the refineries also drop, giving the refining business an opportunity to boost margins, depending on the market price of the finished products. Suncor's refineries make jet fuel, gasoline, diesel fuel and asphalt.

In normal times, low fuel prices can also increase gasoline demand as people take more and longer trips or buy vehicles with larger engines.

The pandemic is a unique threat to Suncor in that the drop in oil prices occurred due to a drastic plunge in fuel demand. Historically, the volatility in the oil market typically arrives as a result of supply issues. Markets drive up the price of oil when geopolitical situations in the Middle East threaten supply. The oil price falls when too much supply hits the market. Demand plays a role, as we saw after the financial crisis, but not to the extent we witnessed this year.

Suncor slashed its dividend by 55% at the start of the pandemic. The board knew the situation was going to be ugly. That came as a surprise to investors who have enjoyed multiple years of strong dividend growth. Suncor continued to raise its payout in previous downturns. The current dividend should be safe and provides a 3.7% yield at the time of writing.

Suncor continues to make adjustments to reduce costs. The recent announcement that it will take over the operations of Syncrude is another step in that process.

Outlook for the energy sector

Near-term oil demand won't rise meaningfully according to the International Energy Agency (IEA). However, in its November report the IEA just raised its 2021 oil demand outlook, which bodes well for Suncor's upstream operations.

Regarding jet fuel and gasoline, it might be the second half of 2021 before the airlines see travel restrictions lifted and a meaningful increase in capacity. Commuter won't likely hit the highways again until COVID vaccines are widely available.

The second COVID wave is spiralling out of control in many developed countries, including the United States. As such, the recent surge in oil prices could be too optimistic. OPEC and Russia might decide to end supply cuts in January now that oil is moving higher. If that happens, the market could quickly reverse course.

Is Suncor stock a buy right now?

West Texas Intermediate (WTI) oil rallied more than 25% so far in November on market expectations that positive vaccine announcements signal light at the end of the COVID tunnel. WTI now trades near US$46 per barrel. Risks exist for a meaningful pullback. However, if oil can hold or extend the gains, Suncor should get a nice boost to cash flow in the next few months.

Volatility is expected, but the stock still appears oversold near $23. It wouldn't be a surprise to see Suncor hit $30 or $35 in 2021. If you are an oil bull, this might be a good time to start nibbling on Suncor stock.

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