Will Suncor Energy (TSX:SU) Stock Hit $40 in 2021?

Description

If you have been observing the stock market over the past couple of months, shares of the beaten-down energy stocks have witnessed strong buying. Investors' optimism over the economic reopening and positive vaccine data drove strong double-digit growth in most of the top energy stocks listed on the TSX.

Notably, shares of **Suncor Energy** (TSX:SU)(NYSE:SU) have surged over 40% in two months, and the recovery rally is far from over. While Suncor Energy stock recovered sharply, it is still down about 45.3% year to date. In comparison, the WTI (West Texas Intermediate) crude has recovered most of its losses and is trading around US$48/bbl (down about 20% from the pre-pandemic phase).

I believe the vaccine distribution in 2021 could lead to the return of economic activities at pre-pandemic levels, suggesting an improvement in demand for crude oil and driving Suncor Energy stock higher. However, the pace of recovery could accelerate in the second half of 2021.

What to expect in the near term

The EIA (U.S. Energy Information Administration) sees Brent crude to average US$49/bbl in 2021, reflecting a 14% improvement from the expected average price of US$43/bbl in Q4 of 2020. While the forecast reflects higher crude prices in 2021, large global inventories and surplus production could limit the further upside, EIA added.

While oil prices could face upward pressure in 2021, Suncor is likely to benefit from its low underlying cost structure. The company's cost-savings measures and additional structural reductions are likely to keep its breakeven cost at a WTI price of US$35/bbl in 2021.

Suncor's earnings could improve in 2021

Reduced economic activity amid the COVID-19 pandemic weighed heavily on energy companies. However, economic reopening and cost-reduction measures led to a sequential improvement in the operational and financial performance of the energy companies, including Suncor.

Suncor’s financial performance improved significantly on a quarter-over-quarter basis in Q3, thanks to unlocking measures that supported the crude oil prices. Its funds from operations soared 129% to $1.2 billion in Q3 from $0.5 billion in Q2. Meanwhile, its operating loss narrowed drastically to $302 million compared to $1.5 billion in Q2.

The company said that the gradual uptick in demand and its lower cost base led to a sharp sequential improvement in its bottom line.

I believe the economic revival following the distribution of the COVID-19 vaccine could lead to the normalization in demand and drive its cash flows. Meanwhile, its focus on reducing operating, selling, and general expenses could continue to cushion its bottom line and help the company report profit in 2021.

Bottom line

As oil prices are expected to get better in 2021, Suncor could be one of the key beneficiaries . Suncor is a well-managed company with a strong balance sheet. Its integrated business model and long-life assets provide a competitive edge. Improvement demand and cost-reduction initiatives are likely to support its margins and drive its stock higher.

However, extensive global inventories and production ramp-up could play spoilsport and restrict its stock price below $40. Also, the 12-month average analyst target price stands at $27.82 and implies upside potential of about 24% from its closing price of $22.36 on December 17.

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