Bullish on Oil Prices? Buy This 1 Cheap TSX Stock

Description

With oil up 3.34% over the last weekend, an optimistic energy investor might have been forgiven that a turnaround in fortunes was underway. Indeed, as the week has progressed, oil prices have continued to rise for their fifth straight week. Suppliers are holding back supplies, and production cuts are in the pipeline, to misuse a phrase. So, could this be oil's year? Or will the grinding economic effects of the pandemic cancel the party?

Singling out the best recovery stocks

While its outlook has analysts divided, **Suncor Energy** (TSX:SU)(NYSE:SU) is still one of the top stocks trading in the energy segment of the TSX. But can it generate wealth for investors? One way to gauge this is to look at whether Suncor is diversified enough to meet the challenges of a rapidly evolving energy space.

Suncor markets crude oil, natural gas, other related products, and also power. As with many big-name oil producers, Suncor additionally has a climate change action plan. Suncor's assets in that regard include a wind power generation portfolio with 100 MW capability, plus 200 MW sanctioned in 2019. Biofuels also feature prominently in Suncor's drive for sustainability, as does its electric vehicle charging network via Petro-Canada.

By this reading, Suncor emerges as at least an intriguing contrarian side bet. It's 76% undervalued in terms of potential cash flows, with a +80% earnings growth spurt estimated. Its 5.3%-yielding dividend might be the best covered in the energy space, and its balance sheet could be better. But there's the potential for at least a moderate comeback here.

Consensus price targets see only a low-balled 1% downside, but an optimistic 31% upside potential. Selling at book price, Suncor is also better valued than the average Canadian oil and gas stock, which typically trades with a P/B of 1.2 times book. For the capital gains investor seeking beaten-down names with rebound potential, Suncor could fit the bill.

A rocky road ahead for energy stocks

As with any commodity, the supply-demand is front and centre for oil. But while supply can be manipulated to some degree, little can be done about demand destruction. The unknown quantity here is the pandemic — particularly its duration and its evolving effect on the consumer sentiment of a locked-down society. Can Suncor's share price behaviour can offer some insight here?

In the last three months, Suncor has recovered by an impressive 40%. But that momentum has dried up during the second wave of the pandemic. On average, the last four weeks has seen Suncor trade more or less completely flat. Suncor is a moderate buy as a result.

Of course, for every silver lining there is a cloud. For example, the decision by Saudi Arabia to cut production could be optimistically viewed as a New Year's gift to the world. Or it could be a sign that further demand destruction is expected in the coming year. The take-home message for investors, then, should be to keep some cash on hand in case oil stocks do deteriorate in the near term.

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Date
2025/08/17
Date Created
2021/01/14
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