Why Suncor (TSX:SU) Stock Could Be a Bargain

Description

Suncor (TSX:SU)(NYSE:SU) stock was seen as a blue-chip stock until it shaved its dividend during the pandemic last year.

What can investors do? Investors can't do anything about dividend cuts other than diversifying their portfolio to spread the risk around from the start. They can also avoid sectors or industries that are known to produce volatile earnings.

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Specifically, Suncor cut its dividend by about 50% on a trailing 12-month basis. Along with its dividend cut, the energy stock was also dragged down a lot. Specifically, it's more than 40% below its 2019 highs of about $45 per share.

The movements of energy prices will still have an impact on Suncor stock, despite it being an integrated oil and gas company with refineries and gas stations.

How big of an impact was the pandemic?

Instead of just focusing on Suncor stock's price and dividend cut, let's take a closer look at the actual impacts of the pandemic.

Last year, the large-cap energy stock ran into some bumps. It experienced revenue decline of close to 36% to $24.7 billion. Gross profits were $14.1 billion, down 42% year over year. It also posted a net loss of $4.2 billion.

At the end of 2020, Suncor's cash and cash equivalent levels remained at similar levels from a year ago, falling only about 4%. The debt-to-asset ratio rose from 53% to 58%. And the debt-to-equity ratio went from 1.1 times to 1.4 times.

So, there were some impacts to the balance sheet, but there was no serious damage. S&P still rewards Suncor stock with an investment-grade credit rating of BBB+.

Why Suncor stock could be a bargain

In 2020, Suncor generated operating cash flow of $2.7 billion — a whopping cut of +70% from its normal levels of +$10 billion. Imagine the stock's operating cash flow recovered to more normalized levels. It would nearly quadruple its cash flows from the 2020 levels!

Investing is forward looking. The large-cap energy behemoth's balance sheet is still intact. On recovery of its operating performance to more normalized levels, the stock will certainly rebound to more normalized levels as well.

This will probably come with its dividend snapping back to at least close to where it was before. A dividend increase will probably be the cue for a hoard of investors to get back into the stock.

Suncor has set its priorities for its capital allocation. Its top priority is to maintain its core business and dividend. Its secondary priorities are to repay debt, buy back shares, and increase dividends.

Management estimates a 2021 breakeven WTI oil price of US$35 per barrel, which covers operating costs, sustaining capital, and its current dividend. This is a very low breakeven price, as the WTI oil price is above US$62 per barrel at writing.

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Analysts currently have a 12-month price target of $33.74 on Suncor stock for about 33% near-term upside potential. The stock also provides attractive income with a yield of 3.2%.

The Foolish takeaway

Suncor stock's balance sheet remained pretty much intact, despite the far and wide impacts of economic lockdowns from the pandemic.

That said, investors are better off not holding Suncor stock long term due to its above-average volatile nature. Instead, consider it as a value play for nice capital gains potential in the near term.

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