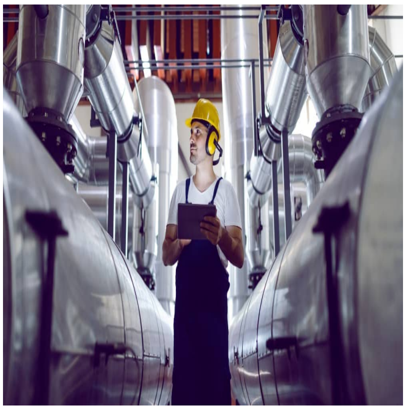

Suncor Stock: How High Could it Go in 2021?

Description

Suncor (TSX:SU)(NYSE:SU) is riding the wave of higher oil prices to better margins and improving profits. Investors who missed the rally in the stock off the 2020 lows wonder if Suncor stock is still undervalued.

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Suncor earnings

Suncor's Q1 2021 results clearly showed how the rebound in oil prices is helping the company bounce back from a brutal 2020. Suncor generated funds from operations of $2.1 billion in the quarter and used excess cash flow to reduce total debt by $1.1 billion. The company also repurchased 1% of the outstanding common shares, spending more than $300 million to take advantage of the weak share price.

The improved market conditions allowed Suncor to cancel $2.8 billion in bi-lateral credit facilities. For the rest of the year, management intends to allocate two-thirds of incremental free funds flow (excess cash) to additional debt repayments and one-third to share buybacks.

Investors might be upset that Suncor isn't raising the dividend after it slashed the payout by 55% last year to preserve cash. The dividend cut might be the reason the stock hasn't bounced back as much as some of its peers that either maintained their payouts or bumped up the distributions in 2021.

Suncor's payout provides a dividend yield of 2.8% at the current stock price near $30 per share.

WTI oil now trades at a two-year high above US$70 per barrel. At this price, Suncor's upstream operations have the potential to generate significant cash flow. Investors should see strong results for Q2 and the rest of the year. A return to dividend growth should occur in 2022, and the hikes could be significant.

Reopening upside

Canada is slowing removing restrictions on travel and businesses are putting plans in place to bring employees back to the office. South of the border, domestic travel demand is booming and firms are already seeing workers resume their commutes. Over the next few months, the process will accelerate in both countries, driving higher fuel demand. Suncor's downstream operations, including the refineries and retail stations, should benefit, completing the recovery across the various business units.

The International Energy Agency (IEA) said in its June oil market report that it now expects world oil demand to reach pre-pandemic levels next year. Previous predictions pegged 2023 as the timeline, but surging demand driven by rebounding economic activity is quickly consuming supplies.

In the report the IEA now says OPEC+ will need to "open the taps" to keep the market adequately supplied. If sanctions on Iran are lifted, the country could quickly add 1.4 million barrels per day to the market, helping feed the rising demand and keeping a lid on surging prices.

Overall, however, the oil market has a strong tailwind that should continue for some time.

Is Suncor stock a buy today?

Suncor's share price has doubled off the 2020 lows, but more upside should be on the way. Before the pandemic, Suncor traded near $44 per share. WTI oil was about US$60 at that point, well below the current price. Analysts widely think oil will top US$75 this year and could surge to US$100 at some point by 2025.

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Suncor stock still looks cheap today. It wouldn't be a surprise to see it hit $45 per share in the next 12-18 months. If you have some cash to put to work, Suncor deserves to be on your radar.

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