1 Top TSX Index Stock to Buy in August

Description

The **TSX Index** continues to trade near record highs, but some top Canadian stocks still trade at undervalued prices. Let's take a look at **Suncor** (TSX:SU)(NYSE:SU) to see why this contrarian stock pick could deliver huge gains in 2022.

Oil crash

Suncor (TSX:SU)(NYSE:SU) took a big hit last year when pandemic lockdowns hammered fuel demand. Airlines cut capacity by 90%, and commuters parked their cars in the garage. All three of Suncor's divisions felt the impact. The upstream or production business saw margins plunge as oil prices tanked. At one point, oil futures actually went negative. Suncor's downstream operations, which include refineries that make fuel and retail locations that sell gasoline, also suffered.

Suncor's board slashed the dividend by 55% to protect to help the company navigate the downturn. That decision upset long-term shareholders who relied on the stability of the payouts. Suncor had increased the distribution during the worst part of the financial crisis a decade ago, so the cut last year came as a surprise.

The stock tanked as a result, falling from above $44 per share before the pandemic to $15 last fall before oil began its rebound. Investors who bought near the bottom are already sitting on some nice gains, although the stock is back down to $24 at the time of writing compared to the 2021 high around $31.

Earnings

Suncor reported good Q2 2021 results that show the impact higher oil prices have on cash flow. The business generated $2.4 billion in funds from operations compared to $488 million in Q2 2020. Operating earnings came in at $722 million in the quarter. The company posted an operating loss of $1.345 billion in the same period last year.

Despite the positive results, the stock dipped on the earnings report. Suncor said production at its Fort Hills site will be lower in the coming months due to operational issues, but the situation should be sorted out by next year.

Management is using excess cash to reduce debt and buy back shares in 2021. The lack of a dividend hike in the Q2 report might be one reason the stock remains out of favour compared to some of Suncor's peers who decided to boost payouts this year.

Risks

WTI oil trades near US$68 per barrel. That's down from the 2021 high around US$76, but still high enough for Suncor to make good money. The White House is leaning on OPEC to boost supply to keep oil prices down in order to help support the post-pandemic recovery. Politics can influence the oil market, and there is a chance prices could fall further in the coming months.

The fourth COVID-19 wave is another risk, as the Delta variant spreads through unvaccinated segments of the population. There is a risk fuel demand will take a hit. Companies are delaying the return to offices and travel bans could remain in place if things get out of control again in key markets.

Should you buy Suncor stock now?

Near-term headwinds need to be acknowledged, but Suncor looks undervalued today near $24 per share. The next 12 months should see a strong rebound in fuel demand, and oil prices are unlikely to drop significantly lower than current levels. On the upside, there is a chance oil could soar to US$80 before the end of 2022 on tight supply.

Suncor's investors could see a generous dividend hike next year. If that happens, the stock would likely take off as income investors return. If you have some cash to put to work, I think Suncor deserves to be a top contrarian pick at this level.

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