



Should You Chase the Suncor Energy (TSX:SU) Downturn?

Description

Suncor Energy ([TSX:SU](#))([NYSE:SU](#)) stock dipped 28% since mid-June when the oil price fell over disputes around increasing oil supply. The stock underperformed other oil stocks like **Cenovus Energy** and **BP** that fell 24% and 13.5%, respectively. One reason is Warren Buffett [exited](#) his position in Suncor in June. Buffett followers executed a sell order and pulled down the stock. But the stock continued the downward path, breached the 200-day moving average, and entered the oversold category.

The oil bears

The bearishness around Suncor got many value investors wondering whether or not to chase the two-month downturn? I keep saying Suncor is a stock to buy the dip. But it is also true that the stock is in a long-term downtrend. How to make profits from this stock? To understand this, you have to understand the risks and opportunities Suncor presents so that you know whether an event can have a material impact on the stock or not.

How Suncor earns money

Suncor is an integrated oil company, which means it extracts oil and refines it into gasoline and diesel. During the pandemic peak, the sudden dip in oil demand pushed Suncor into losses. The company temporarily shut down production to balance oil supply with demand. It used this opportunity to complete turnaround and maintenance activities in the refineries. This effort paid off in the second quarter of 2021 as its production improved when the oil price increased.

The average price Suncor received for its raw bitumen jumped 2.6-fold to \$46.41 in the first half of 2021 from \$17.65 a year ago. Its output from Alberta oilsands mining and underground extraction increased 10% to 652,700 b/d (barrels/day) from 591,900 b/d a year ago. Moreover, demand for gasoline and diesel recovered significantly. It was just 13% below the 2019 level in the second quarter of 2021 and 6% below in July.

The increase in demand, supply, and price of oil reversed Suncor's \$4.14 billion loss in the first half of 2020 to a profit of \$1.69 billion in the first half of 2021. The company used its cash flows to buy back

shares and pay [a dividend](#). Suncor intends to increase its dividend at a 25% compound annual growth rate (CAGR) between 2021 and 2025. This could probably compensate shareholders for the dividend cut last year.

Why is Suncor stock falling?

The recovery made Suncor an attractive investment and pushed its stock up 3% post-earnings. But the growth was short-lived as the West Texas Intermediate (WTI) crude price [fell](#) from US\$75.15/barrel on July 2 to US\$62.14/barrel on August 20. The oil price fell as rising Delta variant cases brought a hiccup in the travel demand recovery.

Three factors significantly impact Suncor's earnings:

- Oil price
- Oil demand
- Production capacity

The Delta variant uncertainty impacted the first two factors. But in Suncor's case, production issues at Fort Hills oilsands mine delayed planned capacity output to the third quarter. It expects the mine to start full production by early 2022. Hence, the stock underperformed other oil stocks.

Should you buy Suncor on the dip?

But Suncor's production issues are short-lived. Moreover, the economic recovery won't be smooth until 90% of the world population is vaccinated before the virus mutates into a variant immune to the vaccine. There will be waves, and they will create uncertainty around oil demand, thereby impacting oil prices.

But once the economy starts a stable recovery, there is no looking back as there is pent-up demand for travel and manufacturing. The oil demand will increase, and so will the price. If Suncor manages to fix its production issues by then, significant cash inflow is on its way.

In every investment, you've got to take some degree of risk. At least in Suncor, you know there is pent-up demand waiting to be fulfilled. Even if I take a conservative estimate and expect the stock to never return to the 2019 level of over \$40, it can still surge to its June high of \$30. This represents an upside of 27%. Staying invested in the stock would be beneficial as the company plans to announce significant dividend growth.

In any case, Suncor is a buy-and-hold at the current levels.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Energy Stocks
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Author

pujatayal

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