Suncor (TSX:SU) Stock Trades Above $36: Should You Buy or Sell?

Description

Suncor Energy (TSX:SU)(NYSE:SU) stock is trading above $36 after making a new 52-week high of $38.62 on February 2, the day of its fourth-quarter earnings. Oil prices are trading at a seven-year high. These high oil prices helped Canada's largest integrated oil company post its best earnings in many years. Suncor's fourth-quarter earnings per share (EPS) rose to $1.07, compared to -$0.11 last year. Its adjusted funds from operations surged 157% year over year, to $3.14 billion.

Suncor Energy's current fundamentals look bright

Suncor made the most of the oil market uptrend. It used the significant surge in 2021 cash flows to:

- Reduce net debt by $3.7 billion to the 2019 level of $16.1 billion
- Pay $1.6 billion in dividends, bringing dividend per share to the 2019 levels
- Repurchase 5.5% of its outstanding shares.

In 2022, Suncor plans to buy back another 5% to 7.4% outstanding shares and grow its dividend while reducing debt levels. This is because it expects oil prices to jump another 14%-15% in 2022. It expects Brent crude oil's price to surge from US$73/barrel to US$84/bbl, and WTI oil's price to surge from US$70/bbl to US$80/bbl. WTI crude is already trading at US$91/bbl in the spot market at the time of this writing. This means more EPS and cash flows for Suncor through 2022.

Suncor aims to meet its promise of growing dividends at an average annual rate of 25% by 2025. Most of this growth will likely come while the company enjoys higher oil prices (in 2021 and 2022). The company has already increased its dividend by 100% in 2021 and could increase it by another 20% in 2022.

Should you buy Suncor stock at $36?

This year should be a strong one for oil stocks. Oil prices surged over 51% in 2021. We are unlikely to see similar growth in 2022 as oil companies might increase their output over the anticipation of a recovery in demand from the aerospace vertical. It will be difficult for Suncor to replicate the 2021 growth story, but there is likely to be growth in 2022.

Suncor has returned its balance sheet and cash flows to 2019 levels, which means the stock price should also return to the 2019 level of $40-$43, representing a 15% upside from its current levels. However, do not forget that the oil sector is in a long-term downtrend as major governments shift funding from oil and gas development to renewables. The 2022 growth story is not sustainable in the long run once the energy crisis eases.

As a fundamental analyst, I would not suggest buying Suncor closer to its 52-week high of $36. You have to factor in the cyclicality of oil stocks. The company is closer to its cyclical peak. Once the oil supply increases, oil prices will normalize, and so will Suncor’s profits and cash flows. However, it is a buy at a price below $30, as that gives you a bigger upside.

What should you do with oil stocks?

Oil has once again become the talk of the political arena. As demand uncertainty from the pandemic-induced lockdowns subsides, another unstable variable is pushing up the oil price. The peace talks going on between Russia and Ukraine could significantly impact oil prices. These countries have rich oil reserves, and Europe depends heavily on Russia for natural gas.

If you already own Suncor and other Canadian oil stocks, keep holding them. You can book some profit from Suncor uptrend at $39-$40 price. You could buy Suncor shares later at a lower price of $28-$30. That would also give you a higher dividend yield than 4.58% at present. But I would not buy this cyclical stock at $36 as there is a 14% upside ($42) but a 16% downside ($30). I expect Suncor stock to fall or remain flat past 2022.

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