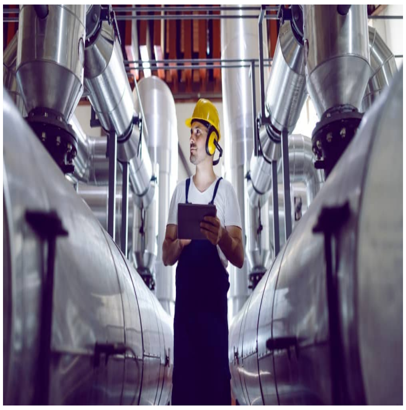

Should You Buy Suncor Stock for its 4% Dividend Yield?

Description

Canadian companies that are part of the energy sector have outpaced the broader markets in the last year. Since April 2021, the S&P 500 has gained 8%, while **iShares S&P/TSX Capped Energy Index ETF** has returned 114%. Comparatively, shares of **Suncor Energy** (TSX:SU)(NYSE:SU) are up 71% in the last 12 months. Despite its stellar returns, Suncor Energy offers investors a forward dividend yield of 4%.

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Let's see if Suncor should be part of your dividend portfolio right now.

The bull case for Suncor Energy

One of the largest companies on the TSX, Suncor Energy is valued at $61.5 billion by market cap and $77 billion by enterprise value. It produces oil from the Canadian oil sands, which means it mines oil-drenched earth (known as bitumen), which is then processed to extract oil. It's a different process compared to drilling for oil.

While creating an oil sands mine is not cheap, costs are sustainable once the mines are operational. Further, the reserve life for an oil sands mine is much higher when equated with a fracked well. In fact, Suncor has stated it can cover operational costs as well as dividends if West Texas Intermediate crude is priced at US$35.

In Q4 of 2021, Suncor's adjusted funds from operations stood at $3.1 billion, or $2.17 per share, which was a quarterly record. Further, its downstream business generated $800 million of adjusted funds from operations. Higher oil prices have resulted in robust cash flow, allowing Suncor to reduce net debt by $4 billion in 2021. Suncor also returned $4 billion to shareholders via share repurchases and dividends.

In 2021, Suncor's funds from operations grew to $10.3 billion, with its regional oil sands contributing $6.9 billion, despite the largest maintenance program in company history.

Suncor expects to plow in $4.7 billion towards capital expenditures in 2022, which should expand its base of cash-generating assets. In terms of capital allocation, Suncor will allocate its free cash flow equally between buybacks and debt reduction, after accounting for dividends and capital expenditures. So, investors can expect a similar cash return in 2022 on current strip prices.

What’s next for Suncor stock?

Oil prices recently touched all-time highs and have gained significant momentum in the last two years. The relaxation of COVID-19-related restrictions has encouraged consumer and enterprise spending, resulting in higher demand for oil.

There is a good chance for oil prices to remain higher in the near term, as supply will be impacted amid Russia’s invasion of Ukraine.

Analysts now expect Suncor sales to increase by 31.3% to $51.33 billion in 2022, while adjusted earnings per share are forecast to more than double to $5.73 per share. Despite its market-thumping gains for Suncor since April 2021, the stock continues to trade at an attractive multiple.

Suncor stock is valued at a forward price-to-2022 earnings of 7.5, which is quite reasonable. Analysts remain bullish on Suncor and have a 12-month average price target of $47, which is 8.5% above its current trading price. After accounting for its dividend, total returns will be closer to 12.5% in the next year.

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