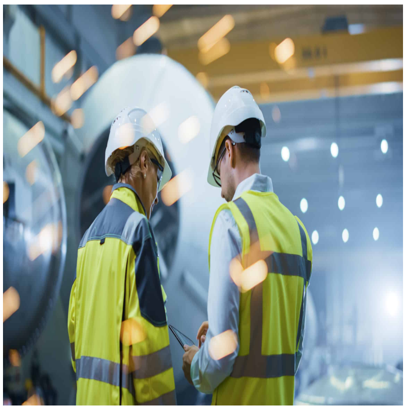

Is Suncor (TSX:SU) Stock Still a Buy at $50?

Description

Suncor (TSX:SU)(NYSE:SU) is finally starting to catch up to its peers after a dismal underperformance over the past two years. Investors who missed the recent rally are wondering if Suncor stock is still undervalued and a good buy for their TFSA or RRSP portfolios.

Oil market

Oil surged above US$100 per barrel earlier this year and remains in triple digits, as a global demand surge bumps up against Russia sanctions and underinvestment by international producers.

The drastic cuts to exploration and development budgets in 2020 and 2021 have resulted in the current tight supply situation. OPEC is taking the position that it wants to bring additional supply on gradually to maintain a stable market. The reality, in the opinion of some analysts, is that OPEC producers are already providing as much supply as possible due to the lack of investment during the pandemic.

It will take time for global oil producers to ramp up output. In fact, most are content right now to keep production steady and use the cash windfall to reduce debt and reward shareholders. Looking ahead, ESG pressures will make it harder for big new projects to get the green light, and companies with net-zero targets are less motivated to boost output.

The result is that US$100 oil could be the new normal for several years.

Should you buy Suncor stock?

Suncor is generating significant profits at current oil prices. The company reported strong Q1 2022 results that indicate the margins being enjoyed in this environment. Suncor generated record funds from operations of $4.1 billion in the first quarter.

The company reduced net debt by $728 million and bought back $827 million in shares. Suncor raised its share buyback target to 10% of the outstanding common stock under the current repurchase plan.

Suncor also increased the quarterly dividend by 12% to $0.47, completing a dividend-rebuilding process after the company slashed the payout by 55% in 2020 to ride out the pandemic.

That decision is a big reason investors have avoided the stock in the past two years, favouring Suncor's peers who maintained payouts in 2020 and raised them in 2021.

Suncor increased the distribution by 100% late last year, but the market still didn't warm up to the stock until the recent announcement that a large activist shareholder wants to shake up the board and the senior management team.

The pressure should benefit investors, even as the rest of the business appears set for a solid recovery.

Suncor's downstream operations, which include refineries and roughly 1,500 Petroleum-Canada retail locations should perform well in the second half of 2022. Fuel demand is rising, as airlines boost capacity and commuters start heading back to work.

Suncor stock still looks cheap. The shares trade near $50 at the time of writing. In early 2020, Suncor traded for $44, when WTI oil was about US$60 per barrel. Today, WTI sells for US$114 per barrel.

Volatility should be expected, but Suncor stock should move higher. The Q2 results will likely be better than Q1, and as net debt comes down more cash will flow to shareholders. If you have some money to put to work in a self-directed TFSA or RRSP, Suncor deserves to be on your radar.

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