Why Suncor Energy (TSX:SU) Stock Crashed Last Week

Description

Suncor Energy (TSX:SU)(NYSE:SU) stock crashed last week in an abrupt reversal to a year-long pattern of market-beating gains. Crude oil futures trended downward for most of last week, as the Federal Reserve raised interest rates by 75 basis points. The large interest rate hike was thought to have had the potential to cause a recession, which may have led to traders betting on less demand for oil in the future.

In this article, I will explore the main reason why Suncor Energy stock crashed last week and ask whether it could rise again in the future.

Oil prices collapse

The major culprit for SU's crash last week was lower oil prices. SU's most recent earnings release was very good, but lower oil prices will lead to lower earnings in the future. Suncor's earnings are directly correlated with the price of oil. There are other factors in the mix, too, like output and costs. But the price of oil is a direct contributing factor. The higher the price of oil, the higher an integrated energy company's earnings, holding other factors constant.

This can be seen by looking at Suncor's recent earnings results. In 2020, when the price of oil was low (at one point negative), SU ran four consecutive losing quarters. In the most recent quarter, when the price was high, Suncor delivered

- $4 billion in adjusted funds from operations, up nearly 100%; and
- $2.9 billion in net income, up 259%.

The difference was night and day. Most likely, the high prices of oil observed in Q1 were behind it. When oil prices rise, integrated energy companies earn more profits without incurring more costs. So, their margins improve.

A long way to go until earnings

Can Suncor Energy stock rise even with oil prices lower?

My personal feeling is yes.

Suncor Energy stock currently trades at just six times free cash flow, suggesting a very cheap valuation. If it were to merely replicate its second-quarter earnings for two more quarters, then it would produce cash flows that would take that ratio even lower — assuming, that is, the stock price didn't change.

It doesn't look like oil stocks are currently "pricing in" the high price of oil being observed. Even if oil prices just stay flat from this point onward, oil stocks are likely to deliver earnings that exceed what analysts are expecting. That could push their prices higher, even if oil itself doesn't move.

Foolish takeaway

2022 has been a banner year for Suncor Energy. With a rising stock price, rising earnings, and a higher dividend, the company appears to be doing everything right. Partially, this is luck: rising oil prices created a windfall that nobody could have anticipated last year. But even if oil prices just stay around $100, the stock could do well, as it is still extremely cheap. Investors might want to brace for short-term volatility, though, because oil stocks do correlate with oil prices on a day-to-day basis. As long as oil stays in a supply crunch, then Suncor should do well.

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