



Suncor Energy (TSX:SU): Is the Stock Now Oversold?

Description

Suncor ([TSX:SU](#))([NYSE:SU](#)) stock is down, as energy investors book profits after big gains in the first half of 2022. Is the stock [undervalued](#) or is more downside on the way?

Oil market

WTI oil trades for less than US\$110 per barrel after pulling back from above US\$122 last week. Traders are less convinced oil will extend the rally amid fears a global recession could hit the recovery in demand.

The oil market was due for a dip after the monster run over the past few months, but the big picture in the sector hasn't really changed. Sanctions against Russia will likely remain in place for at least a couple of years, if not longer, depending on how the war in Ukraine ends. At the same time, global producers are not in a hurry to raise output to fill the gap. Even if the industry decides to ramp up investment again, it will take time for the exploration and development spending to translate into higher oil supply.

Refining capacity is another, and potentially more important, thing to consider. Crude oil has to be processed to become gasoline, diesel fuel, and jet fuel. Refineries are capital-intensive businesses that require significant maintenance to stay in operation. The pandemic forced companies to reduce refining capacity at some plants and completely shut down others. Getting these sites back up to 2019 levels takes time and is expensive. Building new refineries requires billions of dollars of investment and significant time.

On top of all the operational challenges, oil producers and refiners are trying to meet net-zero goals as part of their [ESG](#) initiatives. That's difficult to do if the company is building new production sites or ramping up refining capacity.

Additional volatility should be expected and WTI oil might slide back to US\$100, but the pullback could simply be a brief pause before oil prices surge back to the US\$120 mark. If that happens, oil stock should rocket back to their 2022 highs.

Is Suncor stock a buy?

Suncor trades near \$44 per share. That's where the stock sat in early 2020 when WTI oil was US\$60 per barrel. The downstream refining and retail businesses continue to recover, so the stock looks undervalued.

Suncor raised the dividend by 100% late last year and just bumped it up another 12% to move the payout to a new high. At the current share price the stock provides a 4.2% yield. Additional dividend increases should be on the way for 2023, if not sooner.

The company is also reducing debt and buying back stocks with excess cash. Suncor's existing repurchase plan will see the company buy back up to 10% of the stock over a 12-month period.

The Q2 results will likely beat the record Q1 numbers, despite the recent dip in the oil price. The market might not fully appreciate how much money Suncor is generating in this environment. Even if oil settles in at US\$100 per barrel, Suncor remains a free cash flow machine.

If you are an oil bull and have some cash to put to work, this stock deserves to be on your buy list.

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