Oil Prices: Should You Buy Suncor Stock Right Now?

Description

Suncor (TSX:SU) (NYSE:SU) is off its 2022 high. Investors who missed the big rally earlier this year are wondering if SU stock is now undervalued and a good buy for a TFSA or RRSP portfolio.

Suncor overview

Suncor is Canada's largest integrated energy company with production, refining, and retail assets. The downstream refineries and gas stations historically provided a good hedge against dips in oil prices. Lower input costs bumped up refining margins on the finished products and low gas prices often led to more visits to retail locations.

The pandemic, however, triggered a crash in fuel demand that hammered all of Suncor's business units, causing the share price to crash with the rest of the energy sector. Suncor has underperformed its oil sands peers through much of the rebound off the 2020 market plunge. Operational and safety problems are part of the reason for the underperformance. A 2020 dividend cut also drove away investors that historically supported the stock through challenging times.

Pressure for change

These ongoing troubles led to an activist investor, Elliott Investment Management, making demands in recent months for a strategic review of the downstream assets. The firm has also pushed for changes at the executive and board levels. It now appears the pressure worked. Suncor's CEO recently resigned and the company just announced plans to add new board members. Suncor will also look at the potential sale of the retail operations that include roughly 1,500 Petro-Canada sites. Analysts estimate the division could fetch more than $10 billion. This would unlock significant value for shareholders and potentially drive up the stock price.

Is Suncor stock now a buy?

Even if Suncor decides to keep the retail business the stock still looks cheap. Suncor trades near $40 per share at the time writing, compared to $53 in early June. Oil prices have dropped from US$120 to the current price near US$97, but this is still a very profitable price for oil producers and the share prices probably don’t fully reflect the upside. To put things into perspective, Suncor traded for $44 per share at the beginning of 2020 before the pandemic when oil traded for close to US$60 per barrel.

Suncor’s refining and retail businesses will benefit from the ongoing recovery in fuel demand through the end of this year and into 2023 as commuters hit the roads again and airlines ramp up capacity.

The board raised the dividend by 100% late last year and increased the payout by another 12% when Suncor announced the Q1 2022 results. This brings the dividend to a new all-time high. Investors should see another generous increase in 2023, if not sooner, assuming oil prices hold near the current level. Suncor is also buying back up to 10% of its outstanding stock. This means loyal investors will get a larger slice of the overall profits.

At the current share price investors can pick up a 4.7% dividend yield.

Suncor should be a solid long-term TFSA or RRSP pick. Oil demand is expected to remain strong and prices could remain near existing levels for several years due to the lack of investment in new production caused by the pandemic and the ongoing pressures on oil producers to reduce their emissions.

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