Top 2019 Energy Stock Pick

Description

Western Canadian Select (WCS) and various oil blends in Canada continue to see massive discounts, making for a very desperate situation for the energy sector, energy companies, and energy stocks.

The situation is so bad, in fact, that Canadian Natural Resources Ltd. CEO Darren M. Fichter has publicly stated that he believes that the government should limit production of those barrels that are being produced at a loss in order to provide some support.

These temporary production cuts would help to ease the situation as market forces work to resolve the issues plaguing the industry.

Perhaps this year is a write-off for energy stocks? Which is fine given that we're long-term investors.

But how can we position ourselves for 2019?

Let's start by considering **Freehold Royalties Ltd**. (TSX:FRU), a low-risk, 6.88% dividend-paying energy stock that's been hit hard along with energy stocks in general.

But as we have seen again in the company's third-quarter results, this weakness isn't justified.

Here's why Freehold is a top pick for 2019:

Well-diversified production base

Freehold's diversified production base has exposure to light oil, heavy oil, natural gas, and natural gas liquids, a production base that insulates it from current issues and results in relatively predictable cash flows.

At this time, the company's exposure to the increasingly strong natural gas market and natural gas liquids is sheltering it from the pressures in the energy sector, as we can see in its third quarter cash flow numbers.

Natural gas production accounted for just under half of total production in the quarter.

Cash flow strength

Operating cash flow was up 27% year-over-year and 5% from last quarter, as cash netback increased 39% versus last year and 9% versus last quarter. The company's free cash flow as a percentage of revenue is well north of 20%.

Balance sheet strength

Freehold's balance sheet is a pillar of strength, a definite asset at any time but especially so in difficult, uncertain times such as these.

With a debt to capital ratio of a mere 10%, Freehold clearly has financial flexibility to ensure that is not only survives this downturn, but that it also thrives.

Furthermore, Freehold's payout ratio is in the 50% range and its valuation has not been this cheap in ages.

Patient investors can start building positions for the long term, as pipeline expansions and crude-by-rail are both increasing takeaway capacity and should slowly start to drive Canadian oil prices higher, and as Freehold stock can increasingly be expected to benefit from its low risk business model.

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TICKERS GLOBAL

1. TSX:FRU (Freehold Royalties Ltd.)

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