Is Freehold Royalties Stock a Buy at $13.50 a Share?

Description

Energy stocks such as producers, but even lower-risk royalty stocks like **Freehold Royalties** (TSX:FRU), have had quite a few ups and downs in the last two-and-a-half years.

During the early half of the pandemic, all the economic shutdowns and uncertainty weighed heavily on energy prices, and energy stocks were some of the worst-impacted businesses.

Then the industry recovered, and many of these stocks gained a ton of momentum and saw massive recoveries in their share prices.

That rally and momentum carried into this year when they again exploded in value, as Russia invaded Ukraine and several sanctions were subsequently instituted.

But recently, the price of oil and natural gas has pulled back over economic fears, bringing these energy companies like Freehold stock along with it.

Therefore, after the high-potential energy sector has pulled back recently, now is a great time for investors to add to their positions, especially if you're under-exposed to energy.

But is Freehold stock one of the best to buy at these prices today?

What does Freehold stock do?

Unlike many energy producers that extract oil, natural gas, or both from the earth, Freehold's business model is much simpler: it acquires the land that these producers are using.

This way, Freehold doesn't have to have any of its own operations. Instead, it simply holds the land and collects its royalty, as other companies use its real estate.

This is a much lower-risk business to buy, but Freehold stock is certainly still exposed to commodity prices. However, there is far less execution risk and less that can go wrong for the company.

Furthermore, a royalty business has incredibly attractive economics, especially in this environment as global energy markets have been shifting.

For example, in the first quarter of 2022, Freehold saw a 25% increase in production on its lands, due in large part due to producers increasing their activity, as prices rise and more energy is demanded from western markets.

But what's so attractive about other companies increasing production is that Freehold has to spend no money and yet continues to reap the rewards and earn royalties on all that increased production.

So, if Freehold stock has no capex to spend, what does it do with all the cash it's bringing in? In recent years, the stock has been expanding its portfolio rapidly, especially south of the border. This is crucial, because it helps Freehold diversify its land ownership but also exposes it to more growth potential.

Therefore, with the stock offering tons of attractive qualities, it's certainly a high-quality energy stock to buy and hold. However, is roughly $13.50 a share a significant enough deal to buy Freehold stock?

Is Freehold a buy at $13.50

Because of Freehold's attractive business model, the company has unbelievable financials. The cash flow that Freehold is bringing in allows it to pay a significant dividend and keep cash on the sidelines for future land acquisitions.

In fact, right now, Freehold's dividend yield has risen to over 7.1%, as the stock has pulled back in price in recent weeks. However, even with a massive dividend yield of more than 7%, Freehold's payout ratio is currently below 60%, and that's using conservative estimates of commodity prices this year.

In fact, Freehold could continue to earn positive cash flow, including after paying its dividend, even if oil prices fell to US$40 for WTI.

Therefore, it's no surprise that Freehold's average target price is around $19.25 and a roughly 50% premium to Monday's closing price.

So, if you're looking for high-quality energy stocks to buy as the industry pulls back, Freehold is one of the most impressive stocks that you can buy today.

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