TSX Energy Stocks: Dividends or Share Buybacks?

Description

2022 is turning out to be another blockbuster year for Canadian energy stocks. They have returned 50% this year, while the **TSX Composite Index** has dropped nearly 5%. Apart from the capital gain, energy-producing companies are paying massive dividends over the last few quarters, making them some of the favourites among investors.

TSX energy stocks outperform

Thanks to rallying oil and gas prices, companies are seeing some of the best financial growth ever. The second quarter (Q2) of 2022 saw record free cash flow growth for them as oil breached the US$130-a-barrel level. Notably, what's making the difference is producers' capital discipline. Even if they are sitting on loads of cash, energy producers are allocating more towards debt repayments and shareholder returns.

Canadian Natural Resources (TSX:CNQ)(NYSE:CNQ), the country's biggest energy company by market cap, has spent nearly $6.4 billion on shareholder returns this year. Of that money, $2.4 billion went to dividends and $4 billion went to share buybacks. For 2022, the company is expected to pay a total dividend of $4.50 per share, indicating an annualized yield of 6%.

Share buybacks or special dividends?

Both share repurchases and cash dividends are methods to distribute excess cash among shareholders. While investors have more inclination towards dividends, share buybacks offer some vital benefits to the management. First, it reduces the total outstanding number of shares. So, the per-share earnings automatically increase, even if the net profit remains the same.

Plus, share buybacks tender more flexibility to the management that cash dividends do not. Regular dividends may enforce a long-term commitment to management, which might not maintain when business cycles invert.

Share buybacks also boost stock prices in the short term, as selling pressure is reduced to some extent. In case of TSX energy stocks, management began buying back their shares close to their record highs. However, considering the recent weakness, the buying may accelerate, indicating the expected multi-year strong price environment.

Moreover, if the total outstanding number of shares is reduced, it ultimately reduces the total future dividend outgo for the company. So far this year, CNQ has bought back 56 million of its shares, or nearly 5% of its float. CNQ stock has soared 35% year to date.

There are many Canadian energy companies that are taking on a combination of both buybacks and dividends. However, one mid-cap name, **MEG Energy** (TSX:MEG), has been aggressively buying back its common shares.

During the first two quarters of 2022, it bought back 7.2 million shares, representing 2.4% of the 2021 float. Interestingly, as the stock continues to trade at lower levels, the management may accelerate the repurchases in August and September.

MEG stock has returned 55% this year. Notably, it is among the very few that have not hedged its exposure to oil and gas prices. So, as energy prices continue to soar, MEG will likely see steep earnings growth and margin expansion. It also opens up a downside for MEG, but that seems a low probability, at least at the moment.

The Foolish takeaway

Be it dividends or share buybacks, both indicate the superior financial health of the company and higher shareholder return potential. And who knows that better than Canadian energy investors? TSX energy investors will likely continue to see robust returns, driven by strong earnings growth, solid balance sheets, and undervalued stocks.

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3. TSX:MEG (MEG Energy Corp.)

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