Why I Own Freehold Royalties Stock

Description

Having exposure to energy stocks is crucial when diversifying your portfolio, as energy is one of the most important sectors in our economy. And while there are numerous energy stocks that you can consider, especially in Canada, my top energy holding is **Freehold Royalties** (TSX:FRU).

What's tricky about the energy industry is that it's essential to our economy, but commodities are also known to be cyclical. Therefore, although there are plenty of energy stocks to choose from, finding high-quality companies that you can feel confident owning for the long haul will take a fair amount of research.

So with that in mind, here are a few reasons why I own Freehold Royalties stock and have the confidence to hold the energy company for the long haul.

Freehold Royalties is a lower-risk energy stock

When it comes to buying energy stocks, companies range from pipeline and infrastructure which are much less volatile, to highly leveraged producers that are significantly influenced by the price of oil and gas.

But while a low-risk and low-volatility stock will better protect your capital when energy prices are falling, they offer nowhere near the capital gains potential of an energy producer when prices are rising.

Freehold Royalties is an attractive stock because, in my view, it offers the best of both worlds. It's a lower-risk energy stock than most producers, but it still offers significant capital gains potential, as evidenced by its performance over the last few years. Since the stock bottomed below $2.50 at the start of the pandemic in March 2020, it's earned investors a total return of more than 650%.

Freehold is lower risk than many of its peers because it doesn't produce any oil and gas itself. Instead, it owns the land that other companies use to produce energy in exchange for a royalty.

There are several benefits to this business model. First, it lowers counterparty risk through partnerships with hundreds of producers. Secondly, Freehold doesn't need to spend any capital on expanding production, especially in this environment where North American producers are expected to ramp up production over the next year.

Freehold stock will receive increased royalties as production rises without spending a dime of its own money. Furthermore, when it does decide to invest cash in growing its operations, Freehold has the flexibility to acquire land anywhere. And recently, much of its land purchases have been south of the border, which diversifies its operations but also exposes the company to regions with more attractive economics.

Plus, because the stock is constantly bringing in tonnes of cash, it's a top dividend stock to own.

Freehold is an attractive investment for passive income seekers

Freehold is constantly bringing in tonnes of cash flow as it receives royalty payments, and it's therefore able to pay a significant dividend to investors. Even after the stock's strong rally in recent weeks and the fact that it trades less than 5% off its high today, Freehold's dividend still has a yield of roughly 6.5%.

Furthermore, that dividend is expected to account for just 50% of Freehold's cash flow over the next four quarters which demonstrates how safe the dividend is.

Plus, in addition to maintaining a margin of safety with the dividend, the more capital that management can save, the more it can invest in buying new land for Freehold and ultimately expand its long-term growth potential.

Therefore, given that Freehold Royalties stock has lower-risk operations than many of its peers, pays an attractive dividend, and has almost no debt on its balance sheet, it's my top energy pick and one of my portfolio's top holdings.

CATEGORY

1. Energy Stocks
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