



TSX Energy Stocks Have More Going for Them Than Just High Oil Prices

Description

Be it tech stocks, gold, or even cryptocurrencies, all have lost immense value amid turmoil this year. One sector that has comfortably flourished is oil and gas. The TSX energy sector has returned a massive 70% this year, while the **TSX Composite Index** has lost 8% in the same period. The outperformance is quite noteworthy, especially in these kinds of markets. And notably, TSX energy stocks could continue to trade strongly, at least for the next few quarters.

Why are energy stocks outperforming in 2022?

To take it from the top, we all know that the Russia-Ukraine war pushed oil prices higher this year. Yes, that's certainly the case. But apart from that, what's fundamentally troubling the global energy markets is the supply woes. And that's because of the underinvestment in the sector for years.

The supply has been concerningly lower to cater to the rising global oil demand. Even if the energy transition is gaining pace, we just can't switch from [oil and gas](#) altogether instantly. So, more than the war in Europe, the chronic demand-supply imbalance has been keeping oil prices higher.

When oil prices rise, energy producer companies see higher earnings and increased dividends. Among many TSX energy stocks, Canada's largest energy stock, **Canadian Natural Resources**, is an apt example. In the first half of 2022, CNQ reported free cash flows of \$6 billion, an increase of 71% compared to the same period last year. As a result, it's rewarded shareholders with generous dividends this year. Including dividends, it has returned 80% so far this year.

A bigger reason behind the energy rally than oil prices

However, this energy rally has been quite different than previous ones. Energy producers have shown great capital discipline since the pandemic. Even when they are sitting on excess cash, despite higher oil prices, producers are not assigning capital to increase production. Instead, they have rapidly repaid debt and saved the rest of the cash for shareholder returns.

Consider Canada's biggest natural gas producer, **Tourmaline Oil** ([TSX:TOU](#)). It had net debt of \$1.7 billion at the end of 2020. Thanks to surging oil prices and its profits, its net debt has fallen to \$470 million at the end of the second quarter of 2022. Moreover, Tourmaline paid over \$4 per share in dividends this year, indicating a juicy 5% yield.

And it was not just Tourmaline. Almost all energy stocks have preferred to repay debt and kept their purse string tight for capital expenses. Declining debt will ultimately improve profitability as debt-servicing costs get lower.

Energy stocks were some of the indebted companies before the pandemic. However, as their balance sheets have notably strengthened in the last few quarters, they have become some of the investor-favourite areas.

TSX energy stocks had an average net debt-to-EBITDA (earnings before interest, tax, depreciation, and amortization) ratio close to three before the pandemic. It has now fallen approximately to 0.5. The ratio is a popular leverage measure and indicates how many years a company would take to repay its net debt.

Is it too late to buy TSX energy stocks?

Yes and no! Canadian energy names have already been multi-baggers. They have returned approximately 1,000-2,000% since the pandemic. However, their rally seems far from over, considering the oil price trend and the valuation.

TSX energy names still look well placed to march higher, particularly on their third-quarter earnings. Apart from the higher earnings growth, further net debt reduction and buyback announcements could drive them higher. These growth factors do not have baked in entirely, given their [current valuation](#).

So, even if you missed the previous leg of the rally, it still makes sense to bet on them, considering their improving balance sheets and rallying oil prices.

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