What's Next for Tourmaline Oil Stock After Massive Earnings Growth?

Description

Canada's largest natural gas producer **Tourmaline Oil** (TSX:TOU) has been an exception in the recent energy rally. While energy producers have primarily focused on share buybacks and less on dividends, Tourmaline has done the opposite. It has doled out massive cash to shareholders in the form of special dividends.

It's raining dividends at Tourmaline!

After reporting higher third-quarter earnings last week, Tourmaline issued another special dividend of $2.25 per share. It also increased its quarterly base dividend by 11% to $0.25 per share. So, for 2022, Tourmaline will pay a total dividend of $7.9 per share, implying a jaw-dropping yield of 10%.

Many energy producers have avoided paying higher dividends and instead opted for share repurchases. The latter allows a short-term surge for energy stocks and permits more flexibility for management. On the other hand, shareholders tend to prefer direct cash in their hands instead of buybacks.

Tourmaline has done exactly that and as a result, has been investors' favourite in this energy rally. Note that TOU stock has returned 125% this year, while TSX energy stocks have returned 70% in the same period. Since its pandemic lows, Tourmaline stock has returned nearly 1,000%.

Why Tourmaline stands tall among peers

Tourmaline Oil has been firing on all cylinders since the pandemic. Be it production growth, capital discipline, or acquisitions, it has performed well across the board. Coupled with a strong price environment, Tourmaline Oil has benefited tremendously.

For the third quarter of 2022, it reported cash flows of $1.05 billion, an increase of 38% from last year. The company has used its excess cash to repay debt over the last several quarters. As a result, its net debt dropped to $565 million at the end of Q3 2022, much lower than its long-term net debt target of $1 billion. Lower debt reduces interest expenses, ultimately increasing the company's profitability.

Tourmaline management has guided to allocate 50%-90% of its free cash flows to shareholder returns next year. That's been upped from 50%-70% from its earlier guidance, indicating management's confidence in the company's earnings potential. Also, Tourmaline has already overachieved its balance sheet strengthening target this year. So, it can very well afford to allocate a higher portion of its free cash flows toward dividends.

Tourmaline Oil derives 80% of its earnings from gas production, while the rest comes from liquids. Natural gas prices are expected to remain stronger next year as well, due to the war in Europe and ensuing supply shortages. So, leading gas producers like Tourmaline will likely continue to enjoy higher profits next year due to price strength.

The Foolish takeaway on TOU

TOU stock doesn't look overly attractive from a valuation perspective. It's already run up so much that it would be imprudent to expect similar movement going forward. However, the downside also looks limited due to its solid fundamentals and potential share buybacks. Plus, the company could continue to pay specials next year, given its upbeat guidance.

So, TOU looks like a smart investment choice among the TSX energy sector in the current environment. Higher earnings growth and dividend visibility will likely create superior shareholder value next year as well.

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