2 TSX Energy Stocks That Could Break Through the Roof in December 2022

Description

Energy has been the best-performing sector, beating broader markets by a big margin. TSX energy stocks have returned 60%, while peers south of the border have returned 65% so far in 2022. Even if oil prices have calmed down a bit lately, energy stocks have shown an apparent disconnect and have marched higher.

Note that crude oil and natural gas prices might continue to trade volatile because of the speculative movements. However, energy market fundamentals suggest concerning supply woes, hinting at higher oil prices. Plus, energy producers' improving fundamentals, particularly the balance sheets, will likely drive handsome shareholder returns going into 2023.

But how should investors place their bets when the entire sector looks attractive?

There are two factors that separate the best from the better. Those are valuation and assets. Here are two TSX energy stocks that will likely continue to outperform.

Baytex Energy

Baytex Energy (TSX:BTE) stock has returned 80% this year, notably beating its peers. Interestingly, despite the outperformance, the stock is trading at a price-to-earnings ratio of 3.6 and looks undervalued compared to peers. Moreover, it is trading at a free cash flow yield of 25%, which is way lower than peers. This indicates a significant discount and a massive growth potential.

Baytex intends to increase its production by 5% to approximately 88,000 barrels per day next year. A large part of this increase will come from the more economical Clearwater oil play, which is expected to obtain higher margins. Baytex saw handsome free cash flow growth in the last few quarters, which facilitated deleveraging.

Even if oil falls to $70 levels, Baytex is forecast to earn $400 million in free cash flows next year. This is in line with its 2021 cash flows and is way higher than its historical trend. Given the excess cash, it will likely keep repaying debt and improving its balance sheet. This should bode well for its profitability and, ultimately, for Baytex shareholders.

The levels around US$70 per barrel for West Texas Intermediate crude oil could act as crucial support. This is because those are the levels at which U.S. Strategic Petroleum Reserve starts refilling again.

Vermilion Energy

Vermilion Energy (TSX:VET) stock has dropped 33% since August. However, despite the drop, it is still sitting on handsome gains of 65% for the year, beating its peers.

Vermilion looks attractive both on the valuation as well as on the assets front. It is currently trading at a price-to-earnings ratio of 3.4 and offers a free cash flow yield of 35%. Both measures highlight a considerable discount compared to peers and could fuel the stock higher.

Vermilion's European assets could result in windfall gains next year, mainly due to higher gas prices in the continent. Even if these windfall profits attract higher taxes, it will likely see superior growth in 2023. Vermilion has further expanded its footprint in the continent with the recent Corrib acquisition. So, it will likely see the earnings-growth streak continuing next year as well.

Given the discounted valuation, strong earnings-growth prospects, and higher oil and gas prices, Vermilion looks well placed to drive meaningful shareholder value.

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Date
2025/07/19
Date Created
2022/12/03
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