Even at $60 Oil, These Energy Stocks Are Still Ridiculously Cheap

### Description

Prominent oil buyers across the world have collectively decided to cap the price of oil exported from Russia. Last week, members of the G7 and European Union bloc of nations decided to implement a US$60 price cap on crude oil exported from Russia.



Will this new cap have any impact? What does it mean for Canadian oil stocks? Here's a closer look.

## Oil price cap

West Texas Intermediate (WTI) crude currently trades at U.S.$74. However, crude exported from Russia (Ural) is much cheaper, currently trading at US$62. That's because most G7 and E.U. nations already have a ban on Russian crude. That has compelled the country to sell its resources to China and India *at a discount.*

The new price cap isn't much lower than the current price of Russian crude. However, it does prevent oil tankers from getting insurance on their vessels if they accept Russian crude at higher prices. U.S. and European financial institutions dominate over 90% of this insurance market.

The price cap also gives Russia's biggest customers — India and China — an excuse to pay less. So, the cap could have some impact.

Nevertheless, the global energy market is still supply constrained. Crude oil could be expensive for the foreseeable future. And Canadian oil stocks are still relatively cheap.

## Canadian oil stocks

Eric Nuttall, a partner and senior portfolio manager at Ninepoint Partners, calculated the profitability of Canadian oil producers under the assumption that a barrel of WTI would settle at US$70. Based on his analysis, the average Canadian oil stock generates a free cash flow yield of roughly 19% at these prices.

In other words, Canadian oil companies are immensely profitable and undervalued, even if oil isn't trading at a record high.

Smaller producers such as **Tamarack Valley Energy** (TSX:TVE) and **Baytex Energy** (TSX:BTE) are cheaper than their peers. Tamarack Valley produces a free cash flow yield of roughly 23% if WTI is at US$70. Baytex, meanwhile, generates a yield of 19% at similar levels.

Both stocks have outperformed the TSX Index this year. Tamarack is up 16.4% year to date, while Baytex is up 56.7% over the same period. This outperformance could continue in 2023.

Of course, this is the base-case scenario. These oil stocks are undervalued and lucrative at current levels. The price of oil could surge higher if global supply is disrupted or another geopolitical issue emerges. It could also decline if the upcoming recession is more severe than we expect.

Investors need to carefully consider both these scenarios before investing in Canada's energy sector.



## Bottom line

Oil prices have declined in recent months. The G7 and E.U.'s new price cap on Russian crude could have a small impact, too. However, Canadian oil stocks have already priced in these factors. They're arguably undervalued. If you're seeking passive income or a contrarian bet on global energy, take a closer look at this sector.

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