1 Oversold Dividend Stock (With a 6.8% Yield) to Buy in January 2023

Description

Oil prices touched multi-year highs in 2022 but have since cooled off, dragging energy stocks lower in recent months. Several oil and gas companies trading on the TSX are currently valued at a lower multiple and in oversold territory. As stock prices and dividend yields are inversely related, you can now buy energy stocks with tasty dividend yields, too.

One such oversold dividend stock in the energy sector is **Freehold Royalties** (TSX:FRU). Let's see why this TSX stock should be part of your equity portfolio right now.

What does Freehold Royalties do?

A diversified oil and gas royalty company, **Freehold Royalties** (TSX:FRU) has assets in five Canadian provinces and eight states south of the border. It aims to acquire and actively manage royalties, resulting in a steady stream of dividend income for shareholders.

Freehold Royalties has one of the largest portfolios of royalty lands on the continent, with land holdings totalling more than 7.3 million gross acres.

The company has successfully driven oil and gas development through lease-out programs on its properties. It continues to acquire quality assets with acceptable risk profiles and long economic lives, allowing Freehold to increase royalty payments over time.

A dividend yield of 6.8%

Due to its asset-light business model, Freehold Royalties enjoys an operating margin of more than 90%. Its high-profit margins allow the company to pay shareholders annual dividends of $1.08 per share, translating to a forward yield of 6.8%.

Freehold Royalties claims it can sustain current dividend payments until prices of WTI (West Texas Intermediate) crude oil fall to $40 per barrel.

In Q3 2022, Freehold Royalties increased production by 26% year over year while funds from operations rose 68% to $80.8 million. With a payout ratio of just 47%, Freehold Royalties has enough room to increase its dividends, lower debt, and focus on accretive acquisitions.

In the last nine quarters, the company has increased dividends six times. These payouts have increased at an annual rate of 12.5% in the last five years.

What next for investors and FRU stock price?

Investors are worried that the double whammy of rising interest rates and inflation in 2023 could negatively impact sales and profit margins for companies across sectors. But Freehold has maintained it is not exposed to capital or operating costs. The company enjoys a significant margin advantage compared to upstream oil and gas companies.

According to Freehold Royalties, a 15% to 30% rise in costs and operating inflation will have no influence on its cash flow profile, which is quite remarkable. In an inflationary environment, its operating margin will remain flat, indicating the company enjoys significant pricing power.

Freehold Royalties has maximized royalty interests via a robust audit program. It has a strong balance sheet with a net debt-to-funds from operations multiple of below 1.5 times.

In the last two years, Freehold has increased its assets in the United States by $500 million. Further, its funds from operations are also on track to more than double in 2022 compared to 2020.

Analysts remain bullish on FRU stock and expect shares to gain over 40% in the next year. After accounting for its dividend yield, total returns will be closer to 50%.

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