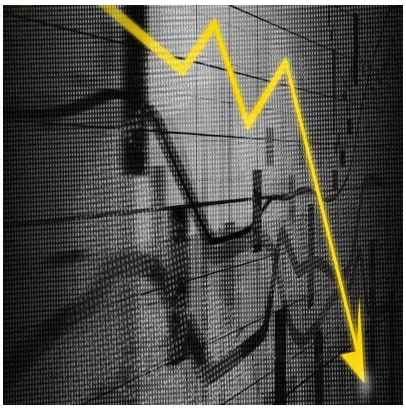

Why Tourmaline Oil Stock Plunged 13% in January 2023

Description

Canada’s largest natural gas producer **Tourmaline Oil** (TSX:TOU) had a terrific last year. It fired on all cylinders last year, be it the operational or financial growth or shareholder returns. However, it has changed course this year. It lost 13% of its market value in January and 25% in the last two months.

Why is TOU stock falling in 2023?

Its underperformance is quite noteworthy as almost entire markets have been upbeat so far in 2023. A weakness in natural gas prices has mainly caused the reversal in TOU stock. Almost 80% of its total production is focused on natural gas. The rest is crude oil and condensate.

The sudden drop in natural gas prices has largely been due to warmer weather and record production in the United States. It seems unlikely that gas prices will see a quick rebound soon due to oversupplied markets. However, they might again head higher later in the year, driven by an expected higher demand in Europe. So, gas-producing names like Tourmaline Oil could trade weakly in the short term.

But that does not make Tourmaline Oil a poor investment!

Should you buy TOU stock now?

Even if gas prices are lower this year, TOU could see a limited drawdown. To be precise, natural gas prices have tumbled 75% in the last six months, but TOU stock has fallen only 25% in the same period. It might continue to outperform relative to gas due to its exposure to condensate and fundamental strength.

Moreover, the company differentiates itself from the TSX energy peers on its low-production costs and sells its gas in some of the high-priced markets in the United States. This makes it less susceptible to Canadian gas prices, which usually trade at a large discount.

Tourmaline Oil saw substantial financial growth last year. It generated a boatload of cash last year, even after allocating capital for production growth. Hence, it repaid massive amounts of debt last year, also distributing the leftover cash to shareholders as special dividends. That made TOU stock investors' darling, explaining its outperformance in 2022.

Tourmaline oil and its dividends

Now, the company is well capitalized with significantly low leverage. That makes it relatively well placed even in the low-price environment. Also, Tourmaline has kept its special dividend streak intact, at least at the start of 2023. It paid a special dividend of $2 per share on January 12, even when gas prices are making new lows. This sends out a positive message to shareholders and speaks about its balance sheet strength.

And this is not a short-term thing, where the management has done a great job only by maintaining capital discipline and rewarding shareholders. This is Tourmaline's years of strong execution that's reaping the benefits now. Its several well-timed acquisitions over the years gave it a crucial scale that played out very well in the strong price environment.

Conclusion

TOU stock is currently trading at a free cash flow yield of 13% and looks appealing after the recent correction. It is trading 4.6 times its 2023 cash flows. The current valuation implies a premium compared to peers. However, the stretched valuation is justified because of its some of the strongest balance sheets in the sector and handsome dividends.

Tourmaline stock remains a risky bet due to its positive correlation with natural gas prices and cyclicality. However, its solid execution and free cash flow visibility make it an appealing bet.

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