



STOCKTRADES PREMIUM COMPANY SUMMARY

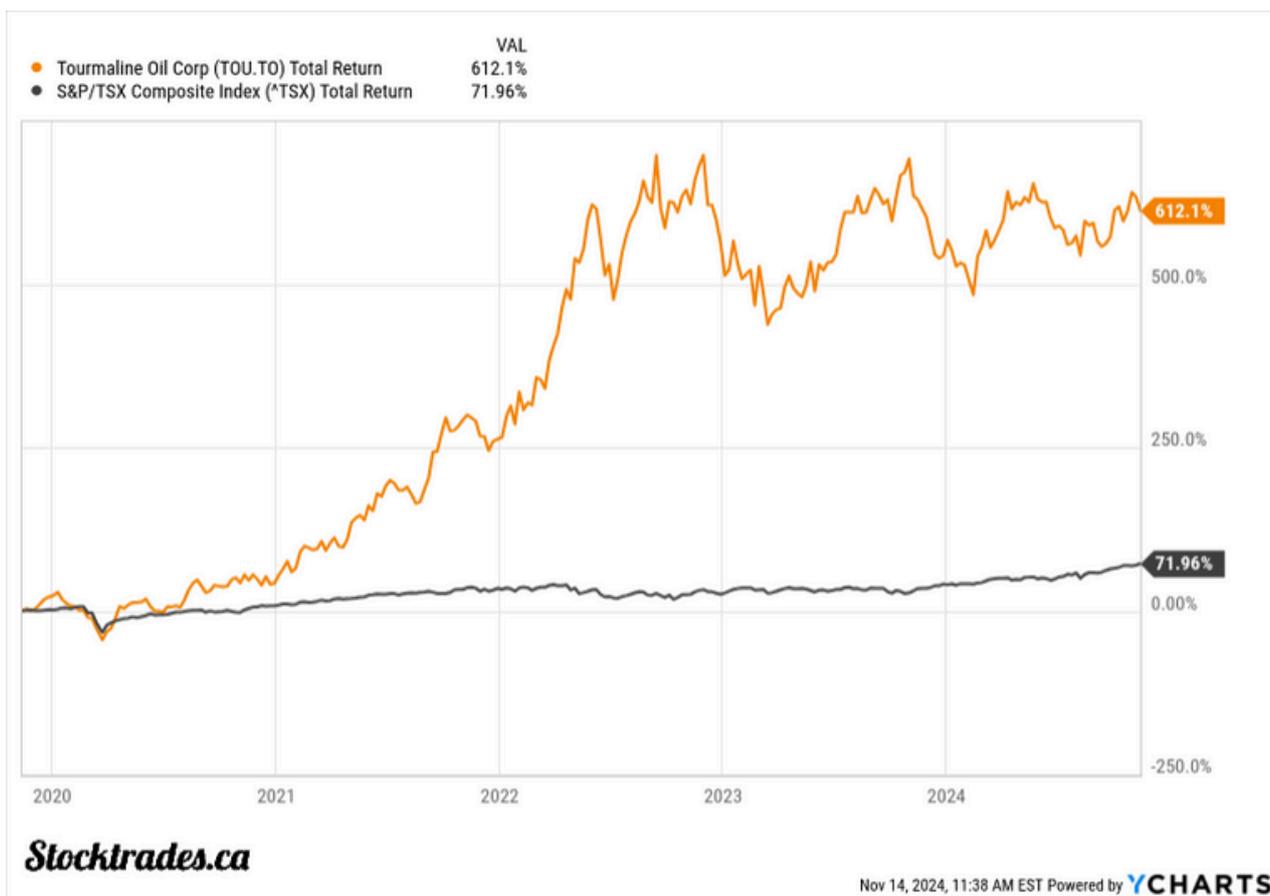
TOURMALINE OIL

TOU.TO

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Stocktrades Premium



Tourmaline Oil Corp is a Canadian energy company engaged in natural gas and crude oil acquisition, exploration, development, and production in the Western Canada Sedimentary Basin. It includes the Alberta Deep Basin, the Northeast British Columbia Montney, and the Peace River Triassic Oil complex.

Focus Areas	Score (0/100)	Focus Areas	Score (0/100)
Valuation	44	Dividend	41
Profitability	51	Outlook	57
Risk	70	Debt	69
Returns	42	Growth	82
Overall	48		

*Our Risk Rating: Our opinion of the overall risk an investment presents. Can be shown as Defensive (DEF), Moderate (MOD), or Aggressive (AGG). By no means is this an indication of future potential gains or lower volatility.

PROS

- Acquisition of Bonavista is expected to be immediately accretive to earnings
- The company aims to return 100% of excess free cash flow to investors via special dividends
- Due to these special dividends, the company's forward yield (in the high 1% range) is underrepresented. If the company hits 2024 cash flow expectations, its yield will be north of 8% at today's prices with special dividends
- Practically debt-free (debt makes up only 20% of annual free cash flow generation)
- The company is the largest and lowest-cost natural gas producer in the country
- Production is expected to grow at a 6% annual rate over the next 5 years
- The base dividend is sustainable even in sub \$2 natural gas pricing
- If the company hits cash flow targets for next year, it is trading at an attractive 12x free cash flow
- The company has one of the highest-quality asset bases and reserves on the planet
- Despite rocky natural gas prices, LNG (Liquified Natural Gas) has a strong future in Canada

CONS

- The negative stigma associated with the oil and gas sector results in lower investments in the industry, and as a result, valuations tend to never reflect the true quality of the company
- Natural gas pricing has been extremely volatile as of late. Tourmaline may still generate strong cash flow in multiple pricing environments, but its share price tracks the price of natural gas closely

OVERALL THESIS

We have been big fans of Tourmaline Oil for years here at Stocktrades. However, we typically shy away from cyclical-based companies on our Bull List. That said, with the bullish environment in terms of both natural gas and NGLs, coupled with the fact the company made what we feel is an outstanding acquisition at an attractive price, we couldn't resist putting Tourmaline on the Bull List.

The thesis is relatively simple when it comes to a company like Tourmaline. You're buying one of the best natural gas producers on the planet, one that can generate positive cash flows even in challenging pricing environments. In return, Tourmaline has stated it will return 100% of its free cash flows to investors, which are simply cash flows after capital expenditures plus any additional acquisition activity. As a result, its small yield on a forward basis is deceiving. We'll talk more about that in the dividend portion of this report.

The company holds North America's highest quality reserves and inventories, enabling it to achieve lower costs and, ultimately, higher profitability. It will also allow it to weather any downturns in pricing. When times are good with Tourmaline, investors should receive hefty special dividends. When times are bad, the company should be able to sustain and grow its base dividend until conditions improve.

The company's extensive cash flow generation should also allow it to continue to make strategic bolt-on acquisitions like the Bonavista one made in October of 2023. With Bonavista being a natural gas producer and operating in the same area where Tourmaline is already the largest producer, it should be a seamless transition. With the discounted valuations in the sector unlikely to improve due to sentiment, it should enable Tourmaline to continue making cheap, strategic plays like this and grow production and cash flows.

With the consistently increasing demand for natural gas, NGLs, and oil, it's hard not to be bullish on what we feel is the best quality producer in the country. Its balance sheet is pristine, its valuation is attractive, and its yield is much higher than it looks.

POTENTIAL RISKS

Tourmaline is practically a pure-play natural gas company (~80% of production), so it depends on the price of natural gas. Although the company can hedge against wildly fluctuating prices, there is no doubt that falling natural gas prices can impact Tourmaline's

ability to generate the cash flows it needs to pay the dividend, acquire companies, buy back shares, or issue special dividends, all of which are core to our investment thesis for the company right now.

Beta	1.2
Alpha	38
Our Risk Rating	Mod*
Max Drawdown	82.2%

There are also additional risks regarding

outside investments in the oil and gas industry. As we transition to a greener future, natural gas is undoubtedly part of that future. However, it often gets lumped in with other inefficient hydrocarbons that many environmental activists and governments are trying to eliminate.

For this reason, growing cash flows by Tourmaline may not be reflected in higher share prices if industry valuations continue to decline. Companies generating the cash flows that Tourmaline does in other industries would trade at significantly higher pricing multiples. However, the average multiple the market is willing to pay for an oil and gas company continues to decline. This is why the return of 100% of free cash flows back to investors is an attractive proposition when looking at oil and gas companies.

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There is also a high likelihood of further mergers and acquisitions in the space. Generally, wise management can make moves that will benefit shareholders. However, there is always the added risk of synergies not materializing and capital being ill-spent on acquisitions. In this case, shareholders would be negatively impacted.

VALUATION

	TTM	5 Year Average	Industry Average
P/E	14.6	9.08	11.64
P/S	4	3.05	1.91
P/B	1.7	1.44	1.53
P/FCF	24	20	10.8
PEG Ratio (FWD)	0.48	N/A	N/A

Oil and gas valuations are certainly interesting. With free cash flow (FCF) yields expected to be north of 8% for Tourmaline for the foreseeable future, you would think the company would command high double-digit price-to-earnings and price-to-FCF multiples. However, at this point, they sit in the low double, or high single-digit range.

One element to note about valuation is that Tourmaline realized an extensive amount of FCF over the last 18 months. For this reason, it used to trade at a significant discount to historical multiples. Now that we've gotten into some lower quarters of cash flow generation, it has normalized and is trading at a slight premium to averages.

Tourmaline is trading at a premium valuation relative to other natural gas producers. However, we feel this valuation is more than justified due to the blue-chip nature of Tourmaline. The situation was similar when we added Canadian Natural Resources to our Foundational Stock List despite trading at premium valuations relative to other producers. Canadian Natural Resources has been one of the best-performing oil and gas companies in 2024, and it just goes to show you that buying quality is often the better path to go down rather than attempting to chase bargains or speculative plays.

Tourmaline is expected to generate anywhere from \$5.10-\$5.50 in free cash flows in Fiscal 2024. This puts the company at a 11.6x FCF multiple at today's prices. Considering that 100% of those cash flows will be returned to investors over the next 5-6 years, this makes Tourmaline an attractive proposition from a valuation standpoint.

Tourmaline is a company we'd deem to be fairly valued. We don't expect to see any multiple expansion (the company is currently trading above its current price-to-earnings multiple). So, for the underlying share price to grow, it will need to increase earnings itself, which is heavily dependent on the price of natural gas and overall inflation.

COMPETITOR ANALYSIS

	TOU	OVV	ARX
P/E	14.6	5.9	12.05
P/S	4	1.2	2.69
P/B	1.7	1.11	1.93
P/FCF	24	7.4	40

As we mentioned, Tourmaline trades at a significant premium to other natural gas producers here in Canada due to the company's low operating costs, high-quality reserves, and generally just being a more dominant company in the industry overall. Although all 3 companies have solid balance sheets, Tourmalines stands out as the best in class and is certainly the company with the most attractive asset base out of the three. This should allow it to drive stronger growth over the next half-decade than its peers.

DIVIDEND ANALYSIS

Annual Dividend	Earnings Payout Ratio	5 Year Dividend Growth %	Dividend Growth Streak
\$1.40	84%	23.2%	7

In the table above, we've included Tourmaline's base dividend, which is \$0.35 per quarter. The company has increased this for 7 straight years at an impressive 20%+ annual pace.

With its current base dividend, the company's forward yield, what most investment data platforms show, is 1.93%. This is low enough to possibly deter some investors who prioritize income from ever really looking into the company. However, when we look at the dividend, including special issues, this is a high-yielding company that should be able to provide high yields for the foreseeable future.

In Fiscal 2023, the company paid out north of \$6.55 per share in dividends, the bulk of which were special issues. This works out to be a TTM yield over 10% at current price levels. In the company's latest quarter (Q3 of Fiscal 2024), the company issued yet another \$0.50 per share special dividend.

When we consider the immense pressure on natural gas prices at this point in time, Tourmaline's ability to continue to pay special dividends is remarkable.

One word of caution is that these are special dividends. They're by no means guaranteed. If natural gas prices continue to dip, FCF will dip, and the company could return less to shareholders. Additionally, the company could see a major acquisition worth taking on, and as a result, cash flows would come in lower. In this case, we'd have to trust management with the ability to integrate acquisitions that would ultimately lead to larger cash flows for shareholders in the future at the expense of cash flows today.

But, if everything goes to the company's plan in 2024, investors should see dividends in excess of \$4.40 (just shy of 7% yield at today's prices), making Tourmaline an attractive proposition for income investors right now.

RECENT EARNINGS

Earnings Estimates	2023	2024	2025
EPS	\$3.24	\$6.44	\$5.12
Revenue	\$5.5B	\$7.4B	\$7.3B
EBITDA	\$3.3B	\$4.7B	\$4.4B
EBITDA Margin	61%	63%	61%

Tourmaline reported a relatively strong third quarter. Revenue of \$1.38B was right in line with expectations, and although earnings estimates missed by a wide margin, I'm more so concerned with the free cash flow generation of the company.

In addition to this, we need to take into account the significant pressure natural gas prices are facing when it comes to cash flow and revenue numbers. The company is realizing some significantly lower year-over-year benchmark prices for its commodities. As a result, cash flows remain strong but are taking a hit compared to previous years.

The company's realized prices on natural gas declined by 30% on a year-over-year basis, and when we look to the first 9 months of 2024 compared to 2023, they're down 34%. The company has been able to offset this a bit with a 10% increase in year-over-year production in terms of natural gas; however, with 75%~ of its business coming from natural gas, it's going to be impacted by pricing.

As a result, operating cash flows have fallen by 20% year-over-year, and free cash flow came in 16% lower. Fortunately, the company's operational efficiency allows it to not only maintain its dividend but also issue special dividends at natural gas prices above \$2. As a result, it continued its trend of issuing a 50-cent special distribution on the quarter. It has now paid out nearly \$3 a share in dividends in 2024, working out to be a yield of 4.6% through the first 9 months of the year. I'd expect this to close out near the 6% mark when it reports fourth-quarter earnings.

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