Top Mid-Cap Energy Stocks Positioned for a Turnaround

Description

Last year's commodity price declines can be difficult to stomach for investors holding energy stocks, including big names such as **Suncor Energy Inc.** and **Canadian Natural Resources Limited**. However, if you're thinking about capitalizing on the turnaround of the energy sector, mid-cap companies can be more lucrative and less risky than small caps.

Two mid-cap energy dividend stocks look particularly resilient to low oil and gas prices because they have maintained their dividends from the 2014 downturn, while many of their peers have slashed theirs.

Vermilion Energy Inc. (TSX:VET)(NYSE:VET) has a diversified set of high netback businesses in Europe, North America, and Australia. Specifically, this year it expects its funds from operations (FFO) to contribute as follows: 42% from oil (Brent), 12% from oil (WTI), and 40% from European gas. So, Vermilion Energy benefits from differentials between Brent and WTI prices and higher gas prices in Europe, which was two to three times that of North American prices at the end of 2015.

In the last quarter Vermilion Energy had a low financial leverage 2.27 times. Further, its net debt-to-FFO ratio was 2.8 times in 2015 compared with the peer average of 4.3 times. This year Vermilion Energy expects that ratio to reduce to 2.1 times, while the peer average is expected to increase to 4.5 times.

These factors make Vermilion Energy a less risky investment compared with its peers.

At the end of 2015, in which commodity prices tumbled, directors and officers still owned 6% of the company. Most importantly, since 2003 Vermilion Energy has maintained its dividend and even increased it three times. At $32, Vermilion Energy yields over 8%.

Peyto Exploration & Development Corp. (TSX:PEY) is focused on being the lowest-cost and most efficient natural gas producer. Its goal is to profitably grow assets.

According to Peyto's latest presentation, it "operates 99% of its production and processes 98% of that production through its nine owned and operated gas plants." Concentration and control is how it achieves low costs.

The cost difference is prominent. The average gas industry operating costs per barrel of oil equivalent doubled from $4 in 2002 to $8 in 2015. Yet Peyto's only rose from under $2 to under $3.50.

At the end of 2014 over 87% of Peyto's land base remained undeveloped, so it has lots of growth potential left. Peyto's 2016 capital program is $600-650 million. Peyto continues to look for ways to improve its profitability and targets a 33% profit for 2016 amid lower commodity prices.

In November Peyto's enterprise value was worth $27 per share. Additionally, as of February 2014 insiders owned 4% of outstanding shares.

Since 2000 Peyto has paid out cumulative distributions, which is below that of cumulative earnings. Whatever it does to the dividend, it'll be for the benefit of the business. At $24.40, Peyto yields over 5.4% and is priced at a 10% discount.

In conclusion

Both companies' dividends are covered by their cash flows. However, low commodity prices will place downward pressure on their prices, so there's no turnaround in sight yet. Further, dividends that are reliant on commodity prices are not foolproof.

However, interested investors can ease in to their positions at opportune, desired yields as both of these mid-caps are positioned better than their peers.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:VET (Vermilion Energy)
2. TSX:PEY (Peyto Exploration & Development Corp)
3. TSX:VET (Vermilion Energy Inc.)

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