Which Energy Company Should You Buy for an Oil-Price Recovery?

Description

As oil prices make a slow recovery, energy stocks remain volatile. This was evident this week when the WTI oil price rose to about US$43 and energy stocks moved higher. Here are some notable price-gain differences between large-cap and mid-cap energy companies.

In the past three days alone, mid-cap companies such as **Whitecap Resources Inc.** (TSX:WCP) and **Vermilion Energy Inc.** (TSX:VET)(NYSE:VET) rose about 12% and 10%, respectively, while large-cap companies such as **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Canadian Natural Resources Limited** (TSX:CNQ)(NYSE:CNQ) only went up about 2% and 4%, respectively.

On the way down…

All four companies directly benefit from higher oil prices, but mid-cap oil producers benefit more than large caps. Since oil prices started falling in 2014, Suncor and Canadian Natural's share prices have only declined 24% and 29%, respectively.

On the other hand, Whitecap and Vermilion's share prices have fallen 37% and 46%, respectively. Since mid-cap companies fall harder on their way down, they also make stronger comebacks as oil prices rise again.

Vermilion or Whitecap?

Mid-cap energy companies should propel themselves higher than large caps because of their smaller sizes. If so, should you consider investing in Vermilion or Whitecap?

Vermilion focuses in the three core areas of North America, Europe, and Australia. So, it has an international pricing advantage against its peers, enjoying a higher oil price with its Brent exposure and higher European gas prices.

Since oil prices plummeted, Whitecap has focused on being a leaner company. It has maintained a sustainable dividend that's sourced from its funds flow without the help of a dividend-reinvestment program, which dilutes shareholders.

Additionally, Whitecap has focused on organic per-share growth. In the near term, it believes its organic per-share growth from its funds growth can reach 1-5%, and any acquisitions will add more growth.

Dividend

At $39 per share, Vermilion yields 6.6%. In addition, it has maintained its dividend throughout this period of low oil prices so far. On the other hand, Whitecap cut its dividend twice this year and now only yields 2.9% at $9.60 per share. Whitecap plans to use the funds from the dividend cut to help increase its capital program from $70 million to $148 million.

Conclusion

Vermilion enjoys premium prices from its oil and gas production outside of North America, so thus far it's able to maintain its dividend yield. However, it anticipates fund flows per share to fall another 28% this year.

Whitecap believes it can deliver long-term growth of 3-8%. Adding that to its dividend yield of 2.9% implies long-term returns of 5.9-10.9%, which is a wide range and indicates uncertainty and that the company depends on where oil prices go in the future.

Vermilion seems like a safer option for an oil-price recovery, but with further funds flow contraction this year, there's no need to hurry to buy it. Instead, interested investors should wait for dips to lock in a high yield.

For example, at $32, Vermilion would yield 8%, which may be a high enough compensation for investors to consider its shares and take on the risk of volatile energy prices.

CATEGORY

1. Dividend Stocks
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1. NYSE:CNQ (Canadian Natural Resources)
2. NYSE:SU (Suncor Energy Inc.)
3. NYSE:VET (Vermilion Energy)
4. TSX:CNQ (Canadian Natural Resources Limited)
5. TSX:SU (Suncor Energy Inc.)
6. TSX:VET (Vermilion Energy Inc.)
7. TSX:WCP (Whitecap Resources Inc.)

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