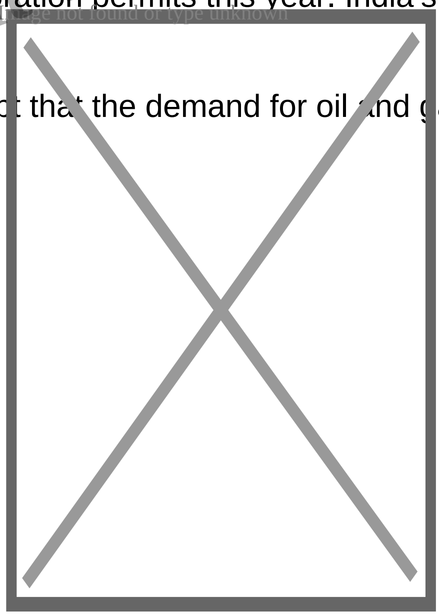
Why Energy Stocks Have Been Weak

Description

Energy stocks have been weak in the last couple of months. This at least has partly to do with France's plan to stop selling gasoline and diesel cars by 2040, which followed India's more aggressive plan of doing the same thing by 2030.

France is doing this to combat global warming. It seems the country is serious about this as it also plans to stop issuing new oil and gas exploration permits this year. India's objective is to lower the fuel-import cost and running cost of vehicles.

No matter what the reason, there's no doubt that the demand for oil and gas will decline no matter what level of decline will occur in the number of gasoline and diesel cars.



Is Vermilion Energy's yield in danger?

France's actions will have a direct impact on **Vermilion Energy Inc.** (TSX:VET)(NYSE:VET), an international oil and gas producer which produces about 17% of its oil in France and generates 23% of its fund flows from operations there.

With the latest developments, Vermilion Energy shares have dipped below $39 per share and now offer a yield of 6.6%. I don’t think Vermilion Energy’s yield is in danger right now. It’ll take time for countries to phase out of gasoline and diesel cars for electric cars.

Vermilion Energy estimates it will generate about $595 million of fund flows from operations this year. Based on the company’s outstanding shares of 120.9 million and its annual payout of $2.58 per share based on the current monthly dividend of $0.215 per share, it’ll pay out almost $312 million in dividends. This equates to a payout ratio of 52.4%.

If we subtract the exploration and development capital spending of $295 million, the company’s payout ratio will roughly be 104%.

The company has had payout ratios of more than 100% before, but it has still maintained and increased its dividend three times since 2003. So, it shows management is committed to the dividend. Moreover, Vermilion Energy has a dividend-reinvestment program that will give it some cushion as well.

Investor takeaway

The decreasing demand for oil and gas in France and India can worsen the oversupply situation and push oil and gas prices lower. That’s why most oil and gas stocks continue to be weak. For example, year to date, shares of Vermilion Energy, **ARC Resources**, and **Suncor** have declined 31%, 27%, and 16%, respectively.

Investors are better off being underweight in oil and gas, and if they must have exposure, stick to more defensive names, such as **Enbridge** and **Suncor**.

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