



Is This Canada's Top Upstream Oil Stock?

Description

Higher crude is proving to be a boon for Canada's beaten-down energy patch. The North American benchmark West Texas Intermediate, or WTI, is trading at over US\$57 per barrel, while the international benchmark Brent has surged to US\$63 per barrel. At these prices, many upstream oil producers are capable of breaking even and returning to profitability.

There are signs that crude will continue to rally because of growing supply constraints, notably in the Middle East, falling global oil stocks, and growing demand sparked by a stronger than expected global economy. While U.S. shale oil companies are popular among investors betting on a sustained rally in crude, one of the best options for investors is internationally diversified upstream oil company **Vermilion Energy Inc.** ([TSX:VET](#))([NYSE:VET](#)).

Now what?

Vermilion owns and operates a diversified portfolio of oil as well as natural gas assets across North America, Europe, and Australia; it holds 290 million barrels of oil reserves. The intermediate upstream oil producer has continued to invest in its operations, despite sharply weaker oil, allowing it to steadily grow production.

For the third quarter 2017, production grew by 6% year over year to 67,403 barrels daily, which was also a modest increase on the previous quarter. That solid growth is expected to continue with Vermilion forecasting that 2018 oil production will be roughly 8% higher than 2017.

Production growth will be supported by Vermilion's drilling program, where it invested \$70 million during the third quarter and drilled 14 wells. As oil rises higher, Vermilion's cash flows will grow, allowing it to invest further in developing its existing assets to expand production.

This is a crucial ability in an environment where the price of crude is rising, because it allows Vermilion to take full advantage of higher prices to boost earnings and, ultimately, its bottom line.

One key advantage that Vermilion has over many of its North American peers is that 26% of the oil produced by the company is sold on international markets, meaning that it is benchmarked to Brent,

which is trading at a US\$5.50 premium to WTI. When considered with growing production, this will give Vermilion's earnings a healthy lift, which should eventually translate into a higher stock price.

Impressively, unlike many of its peers, Vermilion has not cut its dividend because of sharply weaker oil prices. The upstream oil company has maintained its monthly dividend of \$0.215 per share, which, even after accounting for significantly lower oil prices, comes to a sustainable 42% of funds flow from operations. The dividend gives Vermilion a very appealing 6% yield in an industry where dividends have become virtually non-existent.

Furthermore, Vermilion has been able to maintain a strong balance sheet regardless of the slump in crude, maintaining its dividend in the harsh operating environment that has existed since late 2014. Net debt at the end of the third quarter was \$1.4 billion, which is a manageable 2.5 times operating cash flow. That, along with \$42 million in cash, leaves Vermilion in a position where it can continue to weather weak oil prices for the foreseeable future.

So what?

Vermilion remains one of the most attractive plays on higher crude. Its solid balance sheet, high-quality assets, and growing production have helped to shield it from the prolonged slump in crude, while leaving it well positioned to benefit from higher oil prices. With oil showing signs of a sustained rally, now is the time to add Vermilion to your portfolio.

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Date

2025/07/21

Date Created

2017/12/11

Author

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