2 Top Energy Stocks to Invest in for 2018

Description

At ~US$60 per barrel, the WTI oil price is the highest it has been in two years. It might just break above US$60 going into 2018.

Natural gas prices have bounced from their lows, but it remains to be seen whether it's a dead-cat bounce or a real turnaround.

If you're bullish on oil or gas, here are two relatively safe energy stocks to consider.

Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ) is a large oil-weighted producer. Its production mix is estimated to be 25% natural gas in 2018.

The company is expected to generate strong free cash flow. Scotia Capital estimates that its debt-adjusted free cash flow yield will be the highest at about 8.8% in 2018 compared to 13 peers.

Moreover, Canadian Natural Resources's sustaining capital-reinvestment breakeven WTI price is about US$30. If you include its dividend, it'll break even at just below US$40 oil.

The analyst consensus from **Thomson Reuters** has a 12-month target of $51.40 per share on the stock, which represents upside potential of ~14% in the near term from the recent quotation of ~$45 per share. Adding in the dividend yield of ~2.4%, a near-term total return of ~16% is possible.

Vermilion Energy Inc. (TSX:VET)(NYSE:VET) is a mid-cap oil and gas producer whose high netback business has a diversified commodity mix and is spread geographically.

The company generates 33% of its funds from operations from Brent oil (22% from France, 1% from Germany, and 9% from Australia), 38% from European gas (3% from Germany, 20% from Ireland, and 16% from Netherlands), 29% from WTI oil (26% from Canada and 3% from the United States), 3% from Canadian natural gas, and 3% from natural gas liquids.

Vermilion Energy typically benefits from premium pricing in Brent oil (versus WTI oil) and European gas (versus Canadian gas). According to Scotia Capital, compared to 29 peers, big and small, Vermilion Energy has the lowest-sustaining capital-reinvestment breakeven WTI price of below US$15 per barrel. If you throw in its dividend, it'll break even at US$40 oil.

The company is expected to generate strong free cash flow. Scotia Capital estimates that its debt-adjusted free cash flow yield will be more than 8% in 2018, which is quite high.

The analyst consensus from Reuters has a 12-month target of $51.40 per share on the stock, which is, coincidentally, the same as Canadian Natural Resources's target price and represents upside potential of ~12% in the near term from the recent quotation of ~$45.70 per share. Adding in the dividend yield of ~5.6%, a near-term total return of ~18% is possible.

Investor takeaway

Energy stocks have largely underperformed in the last year. With higher commodity prices, these stocks can outperform in 2018. Particularly, investors should focus on companies that generate strong free cash flow and have clean balance sheets.

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1. Dividend Stocks
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2. NYSE:VET (Vermilion Energy)
3. TSX:CNQ (Canadian Natural Resources Limited)
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