A High-Yield, Defensive Energy Stock

Description

When it comes to defensive energy stocks, investors will probably first think of **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) or **Canadian Natural Resources Limited** (TSX:CNQ)(NYSE:CNQ). Although both companies just increased their dividends generously, they still only offer yields of ~3.5%.

For investors who are looking for an energy stock that offers a bigger yield and is more defensive than many other energy stocks, they can consider mid-cap **Vermilion Energy Inc.** (TSX:VET)(NYSE:VET).

Just to be clear, if you view volatility as risk, then all three of the mentioned stocks are risky. For Vermilion Energy in particular, you'll notice how volatile the stock is if you look at its long-term stock price chart. It can't be helped because the company's business performance and stock price will be tied to the ups and downs of commodity prices. That said, Vermilion Energy should fare better than most other peers across the full cycle.

Vermilion Energy has an international advantage

Vermilion Energy has an advantage over its North American peers in that it has assets outside North American from which it enjoys premium pricing.

This year, the company is expected to get premium pricing from 54% of its production mix, which is estimated to contribute 67% of its funds from operations (FFO).

Commodity mix

In 2018, management estimates that the company's production mix will be 24% Brent oil, 16% WTI oil, 30% European gas, 23% Canadian gas, and 7% natural gas liquids. The company's FFO contribution is estimated to be 32% Brent oil, 28% WTI oil, 35% European gas, and 5% Canadian gas and natural gas liquids.

In 2017, Vermilion Energy increased its production volumes by 7% (3% on a per-share basis) to

~69,000 barrels of oil equivalent per day. This led to sufficient FFO that covered for capital spending, the dividend, and some debt reduction.

Dividend

Vermilion Energy has at least maintained its dividend every year since 2003 (and in fact increased it four times, including the most recent increase). It offers a yield of 6.3%, but the board has already approved a dividend hike of nearly 7% for its April dividend, which will be paid in May. This implies a forward yield of 6.8%. Its 2017 payout ratio was 88%, and the management seems committed to keeping the dividend safe.

Investor takeaway

Analysts think there's strong upside for the stock. The analyst consensus from **Thomson Reuters** has a 12-month target of $52.90 on Vermilion Energy, which represents ~30% upside potential from the recent quotation of ~$40.50 per share. Moreover, the company's big +6% yield will also add to the returns.

Vermilion Energy's production growth in the Netherlands and Ireland should increase the company's cash flow generation, which should increase the safety of its dividend.

If you decide energy stocks aren't for you, there are other stocks to consider.

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