Is Vermilion Energy Inc. (TSX:VET) Canada's Best Play on Higher Oil?

Description

Oil has pulled back sharply in recent days to see Brent slipping well below US$75 a barrel over concerns of rising U.S. oil output and signs that both OPEC and Russia are considering boosting production. This has dampened claims that Brent will reach US$100 a barrel before the end of 2018.

Nonetheless, that shouldn't prevent investors from bolstering their exposure to crude, because there is a range of indicators that higher oil is here to stay. Because Brent is trading at over US$70 a barrel, the majority of upstream oil companies with operations outside North America will experience a solid lift in profitability in coming months. One driller that stands out is one of the very few that didn't slash or even eliminate its dividend in response to the prolonged slump in crude: **Vermilion Energy Inc.** (TSX:VET)(NYSE:VET).

Now what?

Vermilion owns and operates a globally diversified portfolio of oil and natural gas assets across North America, Europe, and Australia. That acreage gives it net oil reserves of 270 million barrels valued at $4 billion, or $32 per share, after income taxes and the application of a 10% discount rate in accordance with industry methodology. While that is almost $13 less per share than Vermilion's market price, it shouldn't deter investors.

You see, Vermilion, unlike many of its peers, has been trading at a premium to its reserves, because it has not experienced any of the issues or committed the same errors that they have.

Contrary to **Baytex Energy Corp.** or **Pengrowth Energy Corp.**, it didn't overload its balance sheet with a significant amount of debt, leaving it precariously exposed to sharply weaker oil. And unlike **Crescent Point Energy Corp.**, which has a long and controversial history of issuing equity to fund acquisitions, it isn't a serial diluter of existing shareholders.

Furthermore, the value of Vermilion's oil reserves is poised to expand significantly. The two acquisitions it completed this year will increase its volume, further boosting its value.

Concurrently, the value of Vermilion's reserves will increase because the assumed oil prices used to calculate their value, $59 a barrel for West Texas Intermediate (WTI) and US$65.50 for Brent, are lower than the market price for both benchmarks.

As the value of Vermilion's oil reserves grows, it will push its share price higher.

The company's value will also grow because earnings are expected to rise at a rapid rate. Not only has Vermilion steadily expanded production from existing operations, but the May 2018 purchase of **Spartan Energy Corp.** for $1.4 billion and an earlier January deal will give annual production a solid lift.

In fact, 2018 oil production is forecast to average as high as 90,000 barrels daily, which represents an impressive 32% increase over 2017 average daily production of 68,021.

Vermilion's profitability also remains high, despite a slight increase in first-quarter operating and transportation costs compared to a year earlier. For the first quarter, it reported an operating netback of $31.05 per barrel produced compared to $20.71 for Baytex and Pengrowth's $24.04. That higher profitability can be attributed to the quality of its assets, the absence of deeply discounted Canadian heavy oil from its production mix and ability to access Brent pricing, which trades at a premium of almost US$9 a barrel compared to WTI.

So what?

Vermilion is a very attractive play on higher oil because of its ability to grow production, the rising value of its oil reserves, its solid balance sheet, and its ability to access Brent pricing for a proportion of its oil production. While investors wait for those attributes to give its stock a long-awaited boost, they will be rewarded by its sustainable monthly dividend, which yields a juicy 6%.

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