How Safe Is This Energy Stock's Big Dividend?

Description

The fact that **Vermilion Energy**'s (TSX:VET)(NYSE:VET) dividend yield has crept above 8% (which doesn't occur very often) has some shareholders worried that it might cut its dividend. The last two times Vermilion got to an 8% yield was in the market crash of 2008/2009 and in 2016.

The yield on its own isn't really a good indicator of if the dividend will be sustainable or not. Still, Vermilion's dividend-paying track record shows that management is quite supportive of the dividend.

Why Vermilion yields over 8%

Certain yield points may serve as some sort of support for dividend stocks. For Vermilion, the 8% yield point is certainly one of those yield points. However, during the last market crash, it did offer a dividend yield as high as 10%.

Currently, the stock offers a yield of 8.34% as of writing primarily because the stock has fallen rather quickly, about 21%, in roughly a month. The stock price decline has more or less tracked the WTI oil price decline of about 25% from roughly US$76 to US$56 per barrel.

Other than the rapid decline in stock price, Vermilion's big yield is also attributable to the fact that the energy stock has increased its dividend per share over time without any dividend cuts since 2003.

How safe is Vermilion's dividend?

Vermilion generates operating cash flow from its oil and gas producing operations in North America, Europe, and Australia. It gets premium pricing from its European gas and Brent oil production compared to its North American commodity pricing. Cash flow may be used for a number of things, including paying out dividends, capital development programs, paying interests and debt and acquisitions.

Management prioritizes the uses of cash flow. When commodity prices are as low as they are now, it makes it more challenging to juggle the uses of cash flow.

In the first nine months of this year, Vermilion generated $616.3 million of fund flows from operations. The company declared 46% of the cash flow as dividends, which was an improvement of 9% compared to the same period in 2017.

Since 2003, Vermilion's payout ratio ranged between 26% and 72%. In most years, its payout ratio was about 45-55%.

In summary, Vermilion aims to maintain a low payout ratio with the expectation that the ratio will increase during low commodity price cycles. However, if low commodity prices remain for an extended period, Vermilion will need to decide how best to utilize cash flow, and in the extreme case, a dividend cut is possible.

I don't think we're in the extreme case scenario currently, as Vermilion's payout ratio is at the low end of the 45-55% range.

Investor takeaway

Although investors should never fully trust the dividend safety of oil and gas producers, Vermilion's dividend is among the safest in the mid-cap space. At about $33 per share, it offers an 8.3% yield with a recent operating cash flow payout ratio of 46%.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:VET (Vermilion Energy)
2. TSX:VET (Vermilion Energy Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Date
2025/07/19
Date Created
2018/11/21
Author
kayng