Is This Monster 10% Yield Safe?

Description

Energy stocks are once again under pressure because of oil's latest price collapse, which sees the North American benchmark West Texas Intermediate (WTI) trading at around US$43 per barrel. While there is every sign that the bear market in crude could persist for some time, it shouldn't deter investors from bolstering their exposure to quality oil stocks.

A stock that stands out is intermediate upstream producer **Vermilion Energy** (TSX:VET)(NYSE:VET). Vermilion was among the very few Canadian energy stocks that didn't slash its dividend, despite the calamitous collapse of crude and the prolonged oil slump, which has had a notable impact on the financial performance of many drillers.

In fact, the company hiked its monthly dividend by 7% at the end of the first quarter 2018 to $0.23 per share. That sees it now yielding a monster 10% after its stock plunged in recent weeks, because of oil's latest price collapse — down by 43% for the year to date. That has sparked concern that the dividend may not be sustainable, and Vermilion will be forced to cut it so as to shore up its balance sheet and maintain crucial cash flows in the current difficult operating environment.

Regardless, this should not deter investors from acquiring the stock. Vermilion has a globally diversified portfolio of oil and gas assets spanning North America, Europe, and Australia. Those properties give it net oil reserves of 270 million barrels, which are 45% weighted to higher-margin light and medium oil.

Vermillion has proven that it can grow production at a rapid clip. For the third quarter 2018, the driller's oil output shot up by an impressive 43% year over year to an average of 96,222 barrels daily, leaving the company on track to achieve its 2018 full-year production guidance of 86,000-90,000 barrels daily. That allowed it to take advantage of higher oil prices during the quarter. Higher production will also help to offset the revenue lost because of weaker oil since mid-October 2018.

For the third quarter, Vermilion's profitability grew significantly because of higher crude combined with lower costs because of the driller's focus on realizing efficiencies across its operations. Those lower costs will improve Vermilion's prospects of weathering the current price collapse.

Of some concern, because of the harsh operating environment now being witnessed, is the health of Vermilion's balance sheet. The company finished the third quarter with $1.7 billion of debt, which is two times funds flow from operations. While that ratio is within manageable boundaries, it would be good to see Vermilion reduce its debt in coming months, especially because it reported a net loss for the last two quarters.

It is this which is creating disquiet about the sustainability of the current dividend payment in an operating environment where WTI is trading at US$45 a barrel. Vermilion reported a $51 million net loss for the first nine months of 2018 compared to a $53 million profit for the same period a year earlier. That loss doesn't bode well for the dividend remaining untouched if oil's current weakness, which sees WTI trading at under US$50 a barrel, continues.

Nonetheless, at the height of the oil slump, when crude crashed below US$30 a barrel in early 2016, Vermilion left its dividend untouched. The overall dividend-payout ratio as a proportion of funds flow from operations for the nine months ending September 30, 2018, is a very manageable 45%, indicating that Vermilion could look to cut expenditures elsewhere to sustain the dividend.

There is also the prospect of oil recovering in coming weeks once OPEC implements its latest round of production cuts starting in January 2019, which would lift Vermilion's earnings, thereby bolstering the sustainability of its dividend.

Why buy Vermilion?

Vermilion is an attractively valued play on higher crude and the looming rally, especially once its juicy dividend yield, quality assets, and growing production are considered. While there is some risk that the driller could reduce the dividend, particularly if oil remains weak for a prolonged period, it is still a highly appealing opportunity to play higher oil.

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
2025/08/23
Date Created
2018/12/27
Author
mattdsmith