Dividend Investors: This Energy Stock Yields an Eye-Popping 9%

Description

Many income investors have chosen to avoid Canada's energy sector, especially after many of the industry's previous dividend leaders chose to cut their payouts.

While most companies emerged from the crisis period intact, a second round of sub-$50 oil has arrived at perhaps the worst possible time. If today's conditions continue for months, we really could see a wave of oil and natural gas producers file for bankruptcy protection.

The good news for long-term investors is today's conditions could prove to be a fantastic entry point. I'd recommend sticking to the safer names this time around. Yes, a safe stock might not offer as much upside potential if things recover, but it'll also do a much better job protecting your capital if the sector doesn't immediately recover.

There are even a few energy producers that pay you to wait.

One of these, **Vermilion Energy** (TSX:VET)(NYSE:VET) will be the focus of this article. Let's take a closer look at why you should check out this oil giant today.

Diversified assets

Vermilion has assets spread out across the world. It has operations in Alberta, Saskatchewan, the United States, across Europe, and offshore Australia. Approximately 60% of production comes from North America; however, the majority of cash flow comes from the European holdings, which benefit from production getting Brent crude prices and a nicely sized natural gas weighting. Remember, both oil and natural gas in Europe consistently trade at higher prices versus North American benchmarks.

Investors should love this diverse base. It has allowed the company to largely avoid the problems plaguing Alberta-focused producers.

A cautious expansion plan

Vermilion is focused on light oil plays with low production costs. This allows it to still expand, even when the underlying price of the commodity is low. A hedging program helps as well.

In 2019, the company plans to spend approximately $500 million in capital expenditures. If oil prices can average $67/barrel (Brent prices) for 2019, the company will generate some $1 billion in funds from operations. That would represent a 67% increase from 2017’s FFO numbers, which came in at approximately $600 million.

Although cash will be spent to expand operations all over the world, Vermilion’s main focus will be its operations in southeastern Saskatchewan. These wells are cheap to drill and offer attractive return on investment potential, even if local prices languish at $55/barrel.

Vermilion’s main focus is to expand while being able to self-fund the new production and the dividend. It has a long-term plan to increase production from approximately 100,000 barrels per day in 2019 to 125,000 barrels per day by 2023.

Solid financial footing

Vermilion has one of the best balance sheets in the entire energy sector.

It currently has $1.8 billion in debt versus $6 billion in assets. There’s nothing wrong with that ratio. Looking at it another way, the debt-to-FFO ratio is approximately three times, which is within acceptable parameters.

Most of the debt ($1.4 billion worth) comes due in 2022, with the rest scheduled to be paid off in 2025. This provides the company plenty of time to wait for crude prices to recover.

A safe dividend

As previously mentioned, Vermilion seeks to be self-funding. This means management doesn’t want to have to borrow to expand or maintain the dividend.

This is reflected in the company’s 2019 financial plan. It plans to spend almost every penny of cash flow on capital expenditures and the generous 9% dividend.

Note that Vermilion was one of the few energy giants to not cut its payout during the 2015-16 crisis. It kept the payout steady at $0.215 per share on a monthly basis. It then hiked the dividend during 2018 to today’s levels of $0.23 per share each month.

Management is serious about maintaining the dividend, and it shows.

The bottom line

There’s a lot to like about Vermilion Energy. It has diversified production, including attractive assets in Europe. It has a solid balance sheet. And that 9% yield is a nice reward while waiting for the price of oil to recover.

Vermilion offers capital appreciation potential while collecting one of the best dividends out there. That’s the kind of combination that should get income investors a little bit excited.

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