This 6% Dividend Stock Is a Unique Oil Bet

Description

Calgary-based **Computer Modelling Group** (TSX:CMG) has managed to cut out a truly unique niche in the global oil and gas sector. The company provides reservoir modelling software and technical consulting services to energy companies from around the world.

CMG's business model is relatively straightforward. It spends a ton of cash on research and development (R&D) to create unique software solutions for companies that explore, drill for, or distribute oil. These software packages are then licensed out to corporations either on an annual renewal or perpetual use basis.

In other words, CMG gets paid either once a year for a set amount of time or gets paid a hefty sum upfront for access to its software in perpetuity. This framework isn't uncommon in the software and top-tier enterprise software industries, but it is somewhat unique in the oil and gas sector.

After 38 years in this niche industry, CMG is now widely considered a market leader. While the technical support center is based in Calgary, the company also has offices in Houston, Bogota, London, Dubai and Kuala Lumpur. CMG's 617 corporate clients are spread across more than 60 countries.

However, the oil and gas market hasn't been the best market to dominate in recent years. **West Texas Intermediate** (NYMEX) crude oil is now trading around $52.92. The price has been cut in half since 2014. In fact, the price is down 18.4% in just the last twelve months.

Unsurprisingly, CMG's stock price is also down 31.6% over the same 12-month period. The stock hit its peak the same time oil prices did – in 2014, suggesting that the price is heavily correlated with the commodity.

Of course, oil and gas companies will have smaller budgets for software and consulting services when the market is down, but I would argue that the demand for efficiency in reservoir management is greater when the market is tight. This, coupled with the fact that CMG contracts are long-term and the company continues to innovate by spending on R&D, should offset the impact of oil prices.

Alas, my theory isn't borne out by history. CMG's revenue peaked in 2015 and has been steadily declining ever since, which means the company needs a sudden spike in the commodity to restart its growth engine.

I'm not an oil expert and I think it's dangerous difficult to try and predict where the price will be a few years from now. Instead, I'll assume that the price remains stable for the next few years. CMG's relentless R&D investments should help it protect its dominance and preserve margins at 37%.

In this case, the company will continue to generate tremendous cash flow. Assuming the payout ratio is also stable, investors can expect a steady stream of dividends every year. At the current market price, CMG offers a 6.08% dividend yield.

Bottom line

CMG has managed to capture and dominate a niche in the oil and gas sector. While its market price and revenue is closely correlated with the commodity, the company's R&D spending should help it sustain the lead and keep generating cash.

For investors who believe the price of oil has bottomed or likely to remain stable for the next few years, this could be an excellent dividend stock. For investors who believe the price of oil will spike, CMG is the sector's most unique undervalued opportunity.

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