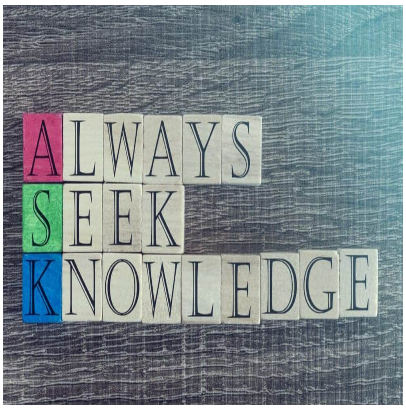

2 Beaten-Down Dividend-Paying Oil Stocks to Buy and 1 to Avoid

Description

Oil continues to surge as a combination of firmer-than-expected demand and supply constraints drive its price higher. The North American benchmark West Texas Intermediate (WTI), has gained a stunning 42% since the start of 2019 to be trading at over US$64 a barrel. Despite oil's notable appreciation, investors have yet to jump on board and start making significant investments in energy stocks. This, along with the positive outlook for crude has created an opportunity to acquire quality oil stocks at a deep discount to their intrinsic value.

Let's take a closer look at two quality dividend paying upstream oil producers and one to avoid.

Vermilion Energy (TSX:VET)(NYSE:VET)

Vermilion is a globally diversified intermediate oil producer, one of the few that didn't eliminate its dividend when the oil rout began. Since the start of 2019, it has trailed behind oil gaining only 23% compared to oil's massive 42% increase. The driller's assets are in stable jurisdictions in North America, Europe and Australia, which are responsible for 62%, 33% and 5%, of its production, respectively.

What makes Vermilion particularly attractive in the current operating environment, aside from its quality oil reserves totalling 437 million net barrels, is its ability to expand production at a solid clip. For 2019, Vermilion anticipates that its oil production will average between 101,000 and 106,000 barrels daily**,** which at the midpoint is 19% greater than 2018. This along with higher oil prices and a focus on controlling costs will give its earnings a healthy lift.

Unlike its peers operating solely in North America Vermilion can access premium Brent pricing because of its international operations. With Brent trading at almost US$8 a barrel more than WTI, this gives the driller a significant financial advantage. Those factors will support the sustainability of Vermilion's dividend, which is currently yielding a very juicy 8%.

Surge Energy (TSX:SGY)

Surge, like Vermilion continued to pay a dividend despite oil's collapse and that payment is yielding a very tasty 6.5%. The driller has gained a mere 4% since the start of the year, which is roughly a tenth of the massive increase in value posted by WTI. Surge is focused on the production of light and medium crude, meaning that it is not exposed to the considerable headwinds which are facing oil sands producers.

For 2018 Surge reported that production had grown by 21% year over year to an average of 18,058 barrels daily. It is anticipated that amount will expand to 22,000 barrels daily for 2019 which is a healthy 22% greater than a year earlier. In an operating environment where crude has firmed and will rally higher this will give Surge's earnings a solid lift which will boost the sustainability of its dividend and market value.

The driller has a proven history of also expanding its oil reserves. As at the end of 2018 Surge's proved plus probable reserves had grown by 29% year over year to 123 million barrels which is 86% weighted to oil and other petroleum liquids. They have been determined to have a net asset value (NAV) of $5.58 per share or almost four-times greater than Surge's share price, highlighting the considerable upside available to investors.

Cenovus Energy (TSX:CVE)(NYSE:CVE)

Canada's second largest oil sands producer, which has a dividend yield of 1.5%, enjoyed a bumper start to 2019 gaining 41% since the start of the year. While many pundits are bullish on the company, I don't share those sentiments.

Cenovus took on considerable debt to acquire ConocoPhillips oil sands assets in 2017. Those operations are not only of questionable quality, but face an uncertain future compared to other forms of petroleum. A combination of weak bitumen and natural gas prices, which are responsible for 75% and 18% of Cenovus' production respectively, weighed heavily on the company's 2018 results.

While Alberta's production cuts have boosted the price of Western Canadian Select (WCS), there is every likelihood that prices could collapse once those cuts are wound-down. It is also worth noting that those production cuts caused WCS to rally so high that it became uneconomic to ship bitumen by rail.

Cenovus finished 2018 with a massive $8.5 billion of long-term debt, which is a worrying five times trailing 12 months funds flow from continuing operations, thereby indicating that the company is vulnerable to another oil price collapse. While Cenovus will make further gains as oil rallies, it's facing a multitude of headwinds, including the uncertainty surrounding oil sands, making it a less desirable play on higher oil.

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2. Energy Stocks
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