Income Investors: Is the 12% Dividend Yield at Vermilion Energy (TSX:VET) Safe?

Description

Sometimes cheap stocks get a lot cheaper.

Vermilion Energy (TSX:VET)(NYSE:VET) just reported Q2 2019 results that apparently didn't please the market. The stock had already been on a downward trend in the days leading up to the report but fell 8% to $22.35 per share on the release, driving the dividend yield above 12%.

What's going on?

Vermilion Energy said a 12% drop in funds flow from operations compared to Q1 primarily resulted from a refinery outage in France caused by a pipeline issue. The company had to secure other means of getting its product to market, including the use of trucks and barges. Vermilion Energy is an interesting player in the Canadian energy sector due to its oil and gas production assets located in Europe and Australia as well as the sites in Canada and the United States.

On a year-over-year basis, commodity prices were lower in the quarter, but funds flow rose 14% due to increased production compared to Q2 2018.

Debt

Vermilion Energy finished Q2 with net debt of $1.95 billion. Based on annualized funds flow, the debt appears manageable and shouldn't be too much cause for concern.

Growth

Vermilion Energy ramped up its exploration efforts in Europe in the second quarter, drilling wells in Germany, Hungary, and Croatia. Four of the five wells were successful, and the company aims to complete the Croatia drilling in the coming months and begin exploration in Slovakia later in the year.

Vermilion Energy also just secured two licences in Ukraine.

Hedging

Vermilion Energy has hedges in place on about 70% of its summer 2019 gas production at prices that are above current spot levels. The company also has 65% of the 2020 gas production hedged at prices that should generate strong free cash flow on the projects.

Share buybacks

Vermilion Energy just announced plans to set up a share-repurchase program that would see the company buy back up to 5% of the outstanding shares. This probably makes more sense than bumping up the dividend, especially with the stock price at current levels.

Vermilion Energy says it intends to keep allocating extra free cash flow to debt reductions.

Dividend safety

Vermilion Energy pays a monthly dividend of $0.23 per share. The dividend and capital program used up about 88% of funds flow from operations in Q2, so the company should be able to cover the dividend while maintaining the drilling program.

Should you buy Vermilion Energy?

The weak quarterly results appear to be driven by a one-off event combined with weaker commodity prices. However, investors should be careful chasing the 12% yield. Management says the company is committed to maintaining the payout, but the market isn’t convinced and continues to punish the stock.

Vermilion Energy traded as high as $70 per share five years ago, and the stock appeared to be very cheap just two weeks ago at $28. Contrarian investors might want to start nibbling on the hopes the bottom has finally arrived, but I would keep any position small. Income investors who step in today shouldn’t rule out a potential dividend cut if the stock price goes lower.

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Date
2025/08/20
Date Created
2019/07/30
Author
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