# This 5.9% Dividend Stock Is the Safest Oil Bet

**Description**

The Canadian oil and gas industry is in a precarious position. Years after the oil price collapsed and new government policies were implemented, Canadian oil stocks are trading at record-low valuations.

Considering the geopolitical and economic risks, some of these companies arguably deserve their lower valuation. However, investors seem to have tossed the baby out with the bathwater by punishing energy-related stocks with fundamentally different business models.



Niche software provider **Pason Systems** (TSX:PSI) is a prime example. Like the rest of the energy sector, Pason has been ruthlessly punished since 2014. The stock is down 62% over the past five years. In fact, the stock is down 27% since mid-September alone.

While the stock was plummeting, Pason's underlying fundamentals were steadily improving. The company's underlying business model and international diversification put it in a favourable position to withstand the headwinds of the global oil and gas sector. Here's a closer look.

## Higher-margin services

Instead of exploring and drilling oil, Pason develops software that oil and gas giants across the world can use to track their operations. In other words, it's a software-as-a-service business focused on the oil sector.

As one of the few players in this industry, Pason has little competition and defensible advantages. That's reflected in its higher-than-average margins. In its most recent quarter, the company reported a 43.7% operating margin.

## International diversification

Although the company is based in Calgary, its services are deployed across the world. Pason operates either a regional office or headquarters in most major oil-producing nations, including the United States, Argentina, Australia, Bolivia, Brazil, Colombia, Dubai, Ecuador, Mexico, Peru, and Saudi Arabia.

For the 12 months ended December 2018, less than 23% of the company's revenue was generated domestically in Canada. In fact, the largest proportion of sales (67%) was generated in the United States.

This level of global diversification insulates Pason Systems from domestic energy policies, international trade wars, and the varying price of oil production in different parts of the world. In other words, Pason is likely to remain profitable so long as the world needs oil from anywhere.

## Strong balance sheet

Pason's sales, profits, and dividends have been slowly rising since 2016. Adjusted earnings before interest, tax, depreciation, and amortization (EBITDA) has nearly quintupled over the past three years. Free cash flow expanded 30% from 2017 to 2018.

Over the nine months to September 2019, the company reported $66 million in free cash flow (FCF). Annualized, the company could generate roughly $100 million in FCF. That's more than enough to cover the firm's generous dividend yield of 5.9%.



In fact, Pason has a track record of either increasing or maintaining dividends since 2003, which means the company avoided a dividend cut, even when the oil market collapsed in 2014-15.

At the moment, Pason's stock trades at 20 times forward earnings and 10 times free cash flow per share. In my view, that's fairly priced for a software company with a high dividend yield.

## Foolish takeaway

A robust business model, global diversification, and steady cash flows make Pason Systems the ultimate dividend stock in Canada's beaten-down oil market.

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vraisinghani