This High-Yielding Oil and Gas Stock Is Easily the Most Undervalued Stock on the TSX

Description

Investing in Canadian oil and gas producers has proven to be a tough sector for investors the last five years.

Some of the only companies that are really investable at this point are those that have diversified their operations, whether it's buying an integrated energy company or one with assets in a number of other countries and regions.

The Western Canadian energy industry has a number of well-documented problems that have no simple fix and will likely take years to fully sort out.

In the meantime, companies have had to find other ways to grow and sustain their businesses. One of the best companies at doing that has got to be **Vermilion Energy** (TSX:VET)(NYSE:VET).

Vermilion has worked hard to diversify its operations and now has assets in Canada and the United States as well as Europe and Australia, although two-thirds of its production still comes from North America.

Its business model is focused on organic growth first and only relying on acquisitions for growth when it's strategic and adds a lot of potential value.

One of the main focuses of the company is to provide a stable and growing monthly dividend that is funded by internally generated cash flow. To do this, it's had to find stable operations that can grow production each year.

Vermilion has executed that well, and from 2003 to 2012, its production grew at a compounded annual growth rate (CAGR) of 6%, which is pretty impressive. However, Vermilion took it a step further, and since 2013 it's increased its production at a 15% CAGR.

In North America, it's focused on light oil and liquids rich natural gas plays, while in the Netherlands and Germany, it's focused on producing natural gas. In France, it is the largest domestic producer of oil with roughly three-quarters of the domestic industry.

Vermilion expects to produce roughly 100,000 barrels of oil equivalent per day (BOEPD) in 2020, with a capital budget of approximately $450 million.

Its geographic diversification doesn’t mitigate its commodity exposure completely but does reduce the volatility in its cash flows, which is key for long-term shareholders and the stability of the dividend.

Roughly half of its free cash flow will come from WTI pricing in 2020, with another quarter exposed to Brent pricing and the last quarter exposed to European gas prices.

Its total expected expenditures to expected funds from operations (FFO) in 2020 will be roughly 100% — the optimal amount Vermilion plans to spend. Roughly 50% of its total expenditures will be made up of the cash dividends and dividend-reinvestment program with the other 50% coming from its capital expenditures.

This is in line with its expectations to do around $900 million in FFO in 2020 based on its commodity price assumptions, which look to be on the safe and conservative side.

Vermilion has strong operations across the board, which provided it with strong after-tax netbacks of nearly $25 in 2019.

In an effort to add more predictability to its cash flows, Vermilion hedged about 50% of its production in 2019. Going forward, it has about 35% of its production hedged for 2020 so far and could increase that into the new year.

It has a strong balance sheet with manageable leverage ratios, such as its debt to FFO, which has been between two times and three times since 2015. Its interest coverage ratio is also strong at 13.4 times.

The dividend today yields a shocking 14.1% and, according to Vermilion’s estimates, should remain sustainable through 2020.

The stock is clearly undervalued, trading at just 8.8 times earnings and 1.1 times its book value, so picking up some shares today will set you up with huge potential, as Vermilion is clearly the most undervalued stock on the TSX.

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