My Top Energy Stock Pick for 2020 Hasn't Missed a Dividend in 118 Years

Description

The last few years have not been good for energy investors.

The sector hasn't seen carnage this bad since the 1980s. Previously rock-solid oil and natural gas producers first saw their share prices decline, and then dividends were cut. Some of the weaker names eventually succumbed to bankruptcy, while even some of the stronger names are currently fighting for their lives.

Amid all this chaos, who would even want to invest in the energy sector, anyway?

But today is the perfect time to start nibbling. The sector is so destroyed that even small pieces of good news can have a big impact on the underlying share price. This is the time where fortunes are made, not when the consensus is bullish.

Let's take a closer look at my top energy pick for 2020, a stable name that should provide plenty of downside protection while investors wait for the energy market to recover.

Go for the best

Many investors are drawn by the seemingly attractive risk/reward ratio of the most depressed names in the energy sector. They like the 300% to 500% upside potential, and are perfectly willing to accept 100% downside risk for that return profile.

There's just one problem. If one stock has a one-in-ten chance of returning 500% and a nine-in-ten chance of going to zero, that's a money-losing proposition over the long-run. You'd have to get awfully lucky to do well.

Instead, I advocate investors look at the finest stocks they can find in the sector. And you won't do much better than **Imperial Oil** (TSX:IMO)(NYSE:IMO) and it's grade-A balance sheet.

First, let's talk about Imperial Oil's production. The company produces some 400,000 barrels of oil each day, with the majority of that coming from three large oil sands developments. It also has conventional oil assets in the Motney and Duvernay fields close to Grande Prairie.

One of the things I really like about Imperial's oil sands assets is you know what you're getting. They have such a long reserve life there's zero risk of having to continually acquire new acreage. These assets should continue producing at their current rate for decades.

It also hopes to expand in the region, with various developments in various stages of planning. Aspen, which is the project slated to begin production first, will add 75,000 barrels of oil to current production when it comes online.

Downstream operations

While I like Imperial's oil sands operations, profits from oil production are largely dependent on the price of crude. Investors need the market to cooperate for that part of the business to really skyrocket.

The downstream operations are different. They produce steady cash flow no matter what the underlying price of crude does.

Imperial's main downstream assets are three refineries, located in Edmonton, Sarnia, and Nanticoke. Together, these refineries have production capability of more than 400,000 barrels of oil per day, or all of Imperial's production. Fuel produced by these refineries are then delivered to more than 2,000 Esso, Mobil, and other service stations across Canada.

These downstream operations – which also include jet fuel and asphalt production – generated nearly $3 billion in cash from operations in 2018, and should post similar numbers in 2019. That's easily enough to cover the company's dividend.

Get paid to wait

There aren't many energy dividends left on the TSX, and most of the remaining ones look to be pretty shaky.

Imperial Oil is a notable exception.

The current payout is $0.22 per share on a quarterly basis, a dividend that has been increased for each of the last 25 years. That's a pretty impressive start.

In fact, Imperial has paid a dividend each year since 1891. That's before Standard Oil – which eventually became **Exxon** – took a big investment in the company in 1898, a stake that continues to this day.

After years of paying a dividend in the 1% – or even lower – range, recent weakness in the share price has helped prop up the dividend. The current yield is 2.6%.

And remember, investors don't have to worry about the payout. The downstream operations easily generate enough cash flow to cover the entire dividend. Excess cash can be funneled to the share buyback program, which has repurchased some 100 million shares over the last three years.

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