



This Oil Stock Yielding 13% Is Poised to Rally in 2020

Description

Despite crude rallying significantly toward the end of 2019, many Canadian energy stocks have failed to make significant gains. One upstream oil producer that has been roughly handled by the market is **Vermilion Energy** ([TSX:VET](#))([NYSE:VET](#)), which has lost over 28% since the start of 2019 compared to oil gaining a stunning 36%. Vermilion's annual dividend payment yields a monster 13%, which has sparked considerable conjecture that it isn't sustainable and may be cut in coming months. While a very juicy 13% yield is a compelling reason to buy Vermilion, particularly if it can be sustained, there are other reasons to buy the driller.

Attractively valued

The company is trading at a [deep discount](#) to its net asset value (NAV). Vermilion's copious proven and probable oil reserves totalling 437 million net barrels have been independently determined to be worth \$6.8 billion after tax. After deducting long-term debt, deferred tax liabilities, decommissioning costs, and lease obligations, Vermilion has an after-tax NAV of \$24.69 per share on a diluted basis, which is 17% higher than its current share price.

This highlights that there is significant upside available for investors, particularly when it is considered that value was calculated using a forecast average for West Texas Intermediate (WTI) of \$56.25 per barrel for 2019 and \$63 for 2020. Based on the increased bullishness in global energy markets, those forecasts certainly appear achievable, indicating that Vermilion's stock will appreciate over the course of the year. If WTI soars higher than those price estimates, the value of Vermilion's oil reserves will expand, leading to even greater upside.

Vermilion's exploration and development program will also see the volume of its oil reserves grow, especially when it is considered that it reported a proven and probable reserve replacement rate of 187% for 2018. Vermilion is adding more oil to its reserves through exploration and development drilling than is being depleted by production, indicating that its oil reserves will continue to grow.

The driller also has a long history of steadily growing its oil production with it expanding by an

impressive 23% year over year for the first nine months of 2019 to an average of 101,193 barrels daily. This bodes well for further earnings growth in an operating environment where oil is rallying to see WTI trading at over US\$60 per barrel.

Dividend sustainability

While a double-digit dividend yield usually indicates that the payment is unsustainable, this isn't the case for Vermilion. Aside from its CEO toward the end of 2019 announcing that the dividend would remain untouched, Vermilion is more than capable of maintaining the payment in the current operating environment.

Based on a 2020 forecast international Brent price of US\$63.95 and US\$56.85 for WTI, the driller expects to have a total payout ratio, including the dividend as well as exploration and development capital expenditures, of under 100%. As oil [rises further](#), thereby boosting cash flow and earnings, the payout ratio will fall to an even more sustainable level. It is also worth noting that even when oil plunged to below US\$30 per barrel in early 2016, Vermilion maintained its dividend payment.

Foolish takeaway

Vermilion is a very attractively valued play on higher crude and the improved outlook for petroleum in 2020. Aside from trading at a discount to its NAV, the driller has a solid balance sheet and a history of steadily growing its oil production, allowing it to take advantage of higher prices. While waiting for Vermilion's market value to appreciate, investors will be rewarded by its sustainable dividend and that very tasty 13% yield.

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1. Dividend Stocks
2. Energy Stocks
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