Income Investors: Do You Dare to Buy This 13%-Yield Dividend Stock in 2020?

Description

Vermilion Energy (TSX:VET)(NYSE:VET) is a dividend king stock in the oil and gas industry. Amazingly, it has increased or kept its dividend steady since 2003!

During this period, it has offered yields from as low as 4% to as high as 15% primarily due to the large fluctuations of its stock price and secondarily helped by a growing dividend over time.

Geographic and commodity diversification

Vermilion is an international oil and gas producer with operations in North America (66% of production), Europe (29%), and Australia (5%). Therefore, it enjoys a global pricing advantage. For instance, Brent oil tends to be priced at a premium to WTI oil.

In any case, Vermilion should benefit from recent higher oil prices: about 40% of its production is WTI oil and 16% is Brent oil. As of this writing, the WTI and Brent prices, respectively, trade at US$63 and US$68 per barrel, which are at the high end of their range in the last 12 months.

The company's remaining production is 26% in North American gas and 18% in European gas.

Improving the business

Vermilion's operations strive for high margins, low decline rates, and strong capital efficiencies. Since 2011, the oil and gas producer has significantly improved its capital efficiency by 76%.

This was a necessary effort to reduce costs across the entire company from operating spending to transportation costs to general and administrative costs.

The 2014 oil price collapse was a wake-up call for every company in the industry! If you can't control the price you sell your products at, you must make the best effort to control the cost to produce the product.

In fact, each of its major business units generates free cash flow, while maintaining stable or growing production.

Is the 13% yield sustainable?

Vermilion dividend appears to be in better shape for 2020 than it has been for the past decade.

Vermilion estimates its payout ratio in 2020 will improve meaningfully to fall under 100%, which is better than the greater-than-100% payout ratio it had experienced in 13 of the past 17 years (including in the past 11 years) during which it never cut its dividend.

Additionally, the payout ratio encompasses capital spending, including growth capex that management can tweak to protect the dividend.

Investor takeaway

It's all right to be attracted to Vermilion's mesmerizing yield of 13%. At the same time, the high yield suggests that it is indeed a riskier stock than most. Therefore, interested investors must size their positions in the stock accordingly.

Moreover, it's best to view Vermilion Energy (and any investment in that matter) for its total returns versus its income potential alone. This means investors need to account for risk and downside as well.

Currently, the average 12-month price target on VET stock is $24 per share, which suggests total returns of more than 25% are possible over the near term.

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