



Why Vermilion Energy (TSX:VET) Stock Jumped 18% Last Week

Description

It's no surprise that TSX energy stocks are flying high again. Thanks to solid Q2 2022 earnings and stabilizing oil prices, energy names have changed their course in late July. While broader markets have lost 8% this year, energy stocks have returned nearly 50%, outperforming by a wide margin.

Even that outperformance is dwarfed when we compare it to some top-performing oil and gas names. For example, **Vermilion Energy** ([TSX:VET](#))([NYSE:VET](#)) stock has returned 110% this year and is currently trading at its multi-year highs. The company is set to release its second-quarter earnings on August 11. Like its peers, Vermilion could also report record quarterly performance and a significant balance sheet improvement during the quarter. On the back of rallying oil prices and expectations of a strong Q2, VET stock soared 18% last week.

VET stock outperforms peers

Interestingly, VET stock's solid upward momentum ahead of its earnings is quite welcoming for its investors. After weeks of weakness, [oil and gas prices](#) have also started moving back up. Moreover, peers have already set a strong ground in terms of solid free cash flow growth for the quarter.

So, a strong earnings growth should be at the bottom of the expectations. What will be more interesting to watch is its debt reduction and a potential dividend hike. Management commentary and guidance about its future free cash flow will also be important to watch.

Vermilion Energy is a \$5.5 billion oil and gas production company that has operations in North America, Europe, and Australia. The stock has been riding higher of late largely due to its exposure to the strong pricing environment in Europe. It generates around 30% of its total revenues from Europe.

In addition, natural gas prices in Europe are sitting at a 14-year high due to supply constraints caused by the Russia-Ukraine war. Notably, very few Canadian energy companies have such a large exposure to Europe. Thus, Vermilion will likely see a more compelling impact in its Q2 earnings.

What to expect from Vermilion in Q2 2022

Vermilion Energy reported a free cash flow of \$305 million in Q1 2022, which was an increase of 73% sequentially. Perhaps that was when WTI crude oil prices averaged around US\$95 a barrel during the first quarter. So, Vermilion will likely see much steeper growth when oil prices averaged US\$120 a barrel during the second quarter.

Like its industry peers, Vermilion will deploy a large chunk of its cash flows to debt repayments. So, investors should see lower leverage and a much stronger balance sheet at the end of Q2 2022.

Vermilion reinstated its dividend after seeing windfall gains in its Q1 cash flows. It will pay \$0.24 per share this year, implying a trivial yield of 0.7%. However, there is a large scope of dividend growth in the next few quarters. As the company repays debt and leverage turns lower, the management will allocate a larger portion of its cash flows towards shareholder dividends.

Conclusion

Despite such a steep rally, VET stock is currently trading at a free cash flow yield of 37%. That's lower than peers and indicates a handsome growth potential ahead.

So, considering the strong earnings-growth prospects, its exposure to Europe, and undervalued stock, VET stock could continue to reward its shareholders.

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Date

2025/08/14

Date Created

2022/08/01

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