



Vermilion Energy Inc. (VET)

Updated August 26th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	\$14	5 Year CAGR Estimate:	12.9%	Volatility Percentile:	85.7%
Fair Value Price:	\$8	5 Year Growth Estimate:	8.4%	Momentum Percentile:	4.0%
% Fair Value:	175%	5 Year Valuation Multiple Estimate:	-10.6%	Growth Percentile:	86.9%
Dividend Yield:	15.1%	5 Year Price Target	\$12	Valuation Percentile:	2.5%
Dividend Risk Score:	F	Retirement Suitability Score:	C	Total Return Percentile:	64.9%

Overview & Current Events

Vermilion Energy was founded in 1994. Today, the \$2.2 billion market cap company is based in Canada and is engaged in the exploration and production of oil and natural gas. The company has operations in Canada, the U.S., Australia, France, Ireland, Germany, and the Netherlands. Vermilion primarily focuses on light oil and liquids-rich natural gas resource plays in Canada and the U.S., natural gas opportunities in the Netherlands and Germany, and oil drilling in France and Australia. In the most recent quarter, Vermilion generated 59% of its output from Canada.

In late July, Vermilion reported (7/29/19) financial results for the second quarter of fiscal 2019. Production fell marginally over the previous quarter, as production growth in the U.S. and Australia was offset by reduced production in France due to a refinery outage in Paris Basin. Fund flows from operations decreased 12% sequentially due to lower output and lower natural gas prices. Even worse, in the first half of the year, Vermillion boosted its capital expenses by 41% and hence it is poised to post much lower free cash flows this year. We have thus reduced our expected free cash flow-per-share for this year from \$2.50 to \$1.00. Investors should note that free cash flows are extremely volatile for oil and gas producers due to the dramatic swings of commodity prices and capital expenses.

Management reiterated its guidance for this year's production of between 101,000 and 106,000 barrels per day. At the mid-point, this guidance implies 19% annual production growth.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
FCF/S	---	---	-\$1.09	\$0.61	\$1.09	\$1.09	-\$0.62	\$2.20	\$2.23	\$2.48	\$1.00	\$1.50
DPS	\$1.73	\$1.73	\$1.73	\$1.73	\$1.82	\$1.96	\$1.96	\$1.96	\$1.96	\$2.09	\$2.12	\$2.12
Shares¹	80.6	83.2	92.3	99.3	102.5	107.2	109.6	115.7	123.5	153.9	158.0	170.0

Vermilion's free cash flow-per-share has fluctuated wildly over the past decade. This should not come as a surprise, as oil and gas producers are highly exposed to the price of oil and natural gas. Future growth will be fueled by production growth and higher commodity prices, which are very difficult to predict. In addition to higher expected future commodity prices, Vermilion's acquisition of Spartan is a major growth catalyst. This was the largest acquisition in the history of the company and gives Vermilion greater exposure to the high-quality properties of southeast Saskatchewan. Given the strong production growth and higher expected commodity prices but also the wild fluctuation of free cash flow-per-share, we find it prudent to expect Vermillion to post free cash flow-per-share around \$1.50 in 2024.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/FCF	---	---	---	76.6	48.4	55.0	---	15.3	15.9	13.0	14.0	8.0
Avg. Yld.	7.0%	4.9%	5.0%	4.4%	3.8%	4.5%	6.9%	4.6%	5.6%	6.5%	15.1%	17.7%

Vermilion's valuation multiple has fluctuated over the past 10 years, which is not surprising for a cyclical oil and gas production company. We see fair value at 8 times free cash flow, which compares unfavorably to the current valuation of 14.0 times free cash flow. As a result of the volatility of Vermilion's earnings and cash flow, we believe it is best to

1. In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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conservatively estimate fair value. If the stock returned to 8 times free cash flow, the corresponding move down would cause a -10.6% decline in Vermilion’s annual returns.

While the price-to-FCF ratio of the stock may seem too low to most investors, they should note that this is a small-scale oil and gas company (its output is less than 3% of the output of Exxon Mobil). As such it has a much higher inherent risk than the well-known oil majors, which are much more diversified and integrated.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	284%	167%	180%	---	89%	88%	84%	212%	141%

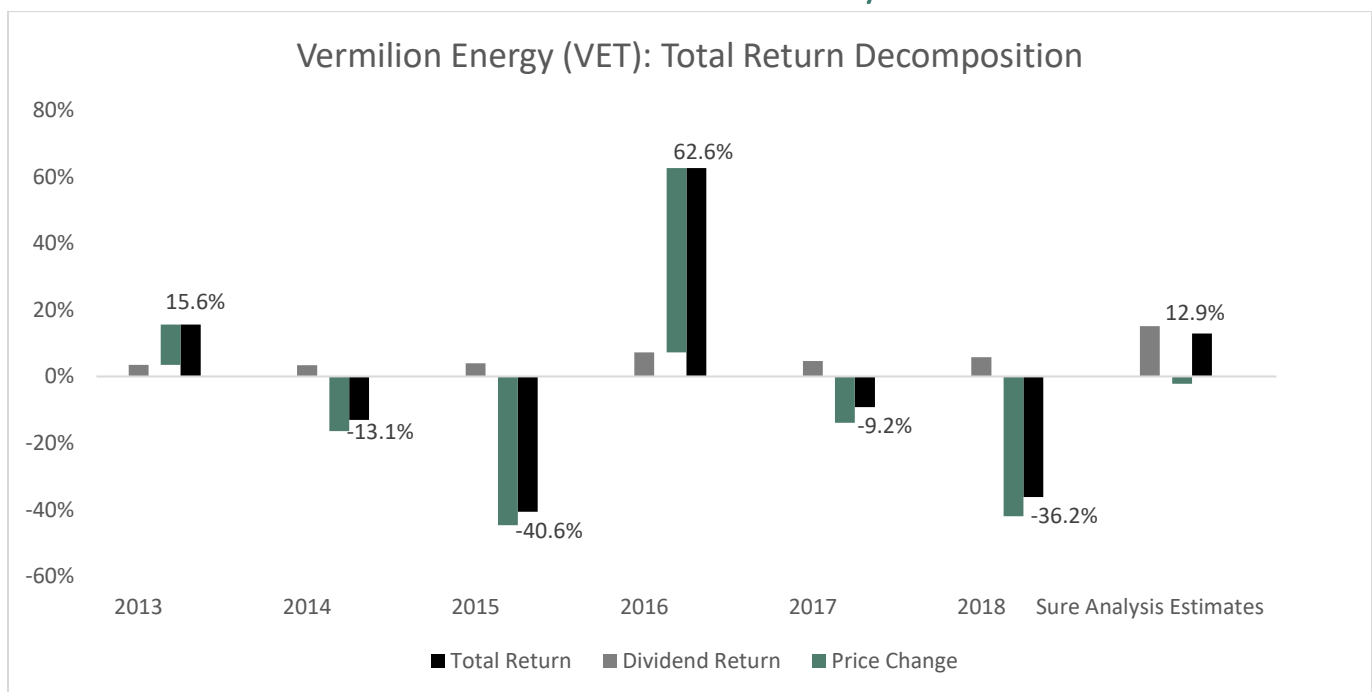
Vermilion may not be the best stock selection for investors primarily concerned with safety and quality, due to the company’s highly volatile fundamentals. The company’s interest coverage and payout ratio will fluctuate a great deal, depending on whether commodity prices are high or low. No oil and gas company can control the direction of commodity prices, which means investors cannot rely on Vermilion as a safe investment.

With that said, the company does have competitive advantages, mainly its oil and gas properties, which have low rates of decline and significant amounts of reserves. This allowed the company to grow production by 15% per year from 2013 to 2019. The company performed surprisingly well during the Great Recession, by remaining profitable in 2008 and 2009. If oil and gas prices remain at a decent level, the company could perform well during the next recession.

Final Thoughts & Recommendation

Vermilion is not a suitable choice for risk-averse investors looking for stability and consistency, as the company’s fortunes will rise and fall based largely on the price of oil and gas. With that said, investors interested in a high dividend yield and growth potential could be interested in Vermilion, particularly if oil and gas prices rise in the upcoming years. In the absence of a downturn, Vermillion could offer a 12.9% average annual return over the next five years. In a stable operating climate, we view the stock as undervalued, with a high yield and FCF growth. We rate it as a cautious buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	563	706	988	1031	1171	1188	685	626	790	1178
SG&A Exp.	43	75	110	115	136	156	134	122	123	127
Operating Profit	75	226	451	410	509	414	21	-79	80	281
Operating Margin	13.4%	32.1%	45.7%	39.8%	43.4%	34.8%	3.0%	-12.6%	10.2%	23.9%
Net Profit	163	43	144	191	318	244	-170	-121	48	210
Net Margin	29.0%	6.1%	14.6%	18.5%	27.2%	20.5%	-24.9%	-19.3%	6.1%	17.8%
Free Cash Flow	-109	391	-96	-62	140	-105	-56	127	190	17
Income Tax	-1	78	175	163	246	166	3	-48	48	64

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	1978	2325	2679	3092	3483	3778	3033	3031	3161	4604
Cash & Equivalents	94	146	230	103	366	104	30	47	37	20
Accounts Receivable	111	147	173	181	157	148	116	98	132	191
Inventories	5	11	14	26	16	8	9	11	14	20
Total Liabilities	992	1280	1375	1666	1871	2037	1694	1861	1934	2536
Accounts Payable	188	252	292	302	252	257	179	135	174	330
Long-Term Debt	152	303	366	645	930	1067	1000	1010	1010	1319
Shareholder's Equity	986	1046	1304	1426	1612	1741	1339	1171	1227	2068
D/E Ratio	0.15	0.29	0.28	0.45	0.58	0.61	0.75	0.86	0.82	0.64

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	9.5%	2.0%	5.8%	6.6%	9.7%	6.7%	-5.0%	-4.0%	1.6%	5.4%
Return on Equity	20.4%	4.2%	12.3%	14.0%	20.9%	14.6%	-11.1%	-9.6%	4.0%	12.7%
ROIC	16.5%	3.5%	9.6%	10.2%	13.8%	9.1%	-6.6%	-5.3%	2.2%	7.5%
Shares Out.	80.6	83.2	92.3	99.3	102.5	107.2	109.6	115.7	123.5	153.9
Revenue/Share	6.99	8.49	10.71	10.39	11.43	11.08	6.24	5.41	6.46	8.27
FCF/Share	-1.35	4.70	-1.04	-0.63	1.37	-0.98	-0.51	1.10	1.55	0.12

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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