



Vermilion Energy Inc. (VET)

Updated March 22nd, 2020 by Samuel Smith

Key Metrics

Current Price:	\$2.16	5 Year CAGR Estimate:	21.8%	Market Cap:	\$337M
Fair Value Price:	\$2.55	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	3/31/20
% Fair Value:	85%	5 Year Valuation Multiple Estimate:	3.6%	Dividend Payment Date:	4/15/20
Dividend Yield:	23.6%	5 Year Price Target	\$3.25	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	B	Last Dividend Increase:	N/A

Overview & Current Events

Vermilion Energy was founded in 1994. Today, the \$337 million market capitalization 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 early March, Vermilion reported (3/6/20) financial results for the fourth quarter of fiscal 2019. The company had to slash its monthly dividend down to C\$0.02, from its original C\$0.23 that it had already paid out in the first two months of the year. The forces driving this drastic cut were the double black swan events involving dramatically reduced demand from the coronavirus outbreak and the oil price war between Saudi Arabia and Russia, which have combined to send oil prices to roughly one-third of their pre-crisis levels. The company also slashed its capital expenditure guidance for the year to roughly C\$360 million, down 25% from original guidance. Combining its reduced dividend and capital expenditures, management expects to be able to retain an additional C\$270 million this year to help it meet its debt obligations. In Q4, the company took in \$216 million in fund flows from operations and full year fund flows from operations increased 8% year-over-year to a record \$908 million.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
FCF/S	---	-\$1.09	\$0.61	\$1.09	\$1.09	-\$0.62	\$2.20	\$2.23	\$2.48	\$2.14	\$0.51	\$0.65
DPS	\$1.73	\$1.73	\$1.73	\$1.82	\$1.96	\$1.96	\$1.96	\$1.96	\$2.09	\$2.12	\$0.51	\$0.51
Shares¹	83.2	92.3	99.3	102.5	107.2	109.6	115.7	123.5	153.9	158.0	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 massive headwinds facing the company from the oil price war and the economic disruption from the coronavirus outbreak, we expect the company's free cash flow to plummet this year, though CapEx reductions will help considerably. However, these reductions will also lead to significantly lower growth moving forward. We also think that the dividend will grow slower than free cash flow per share moving forward as management will need to retain a lot of cash to shore up the balance sheet and catch up on CapEx programs.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/FCF	---	---	76.6	48.4	55.0	---	15.3	15.9	13.0	7.6	4.2	5.0
Avg. Yld.	4.9%	5.0%	4.4%	3.8%	4.5%	6.9%	4.6%	5.6%	6.5%	13.1%	23.6%	15.7%

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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Vermilion’s valuation multiple has fluctuated over the past 10 years, which is not surprising for a cyclical oil and gas production company. Given the immense current pricing challenges in the oil and natural gas segments and Vermilion’s considerable leverage, we see fair value at 5 times free cash flow (down from 10 times free cash flow prior to the crash), which compares favorably to the current valuation of 4.2 times free cash flow. If the stock returned to 5 times free cash flow, the corresponding move would produce a sizable tailwind to Vermilion’s annual returns. While the price-to-FCF ratio of the stock may seem 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. The company also has a weaker balance sheet, bringing with it greater risk.

Safety, Quality, Competitive Advantage, & Recession Resiliency

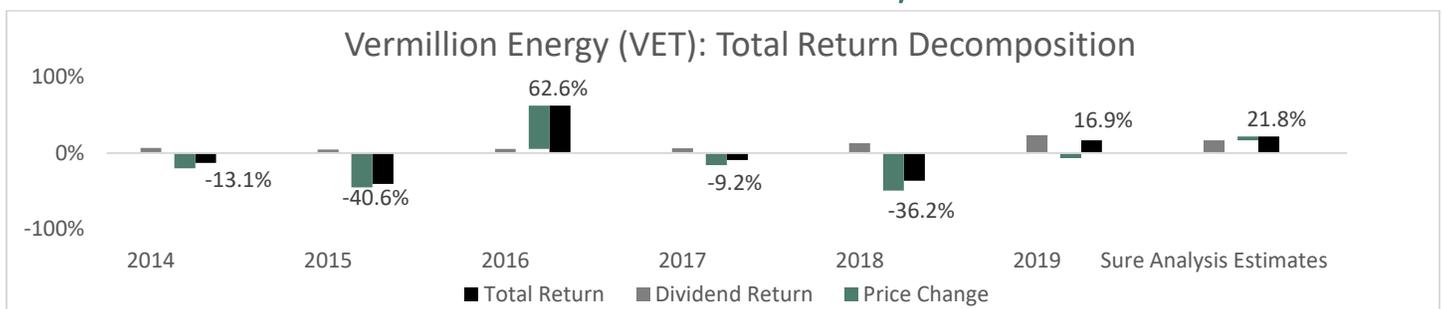
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	284%	167%	180%	---	89%	88%	84%	99%	100%	78%

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, remaining profitable in 2008 and 2009. If oil and gas prices can return at a decent level, the company could perform well during the next recession. However, we may already be there, and oil prices are at extremely low levels. As a result, we think that the company will be much more hesitant to raise its dividend moving forward until they have plenty of coverage with free cash flows and their balance sheet leverage is reduced considerably.

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 recover rapidly in the coming years. Assuming that prices recover to between \$40 and \$50 a barrel, we think that Vermilion will provide investors a compelling total return of 21.8% and the dividend will recover somewhat, though not even close to where it was before the recent crash as management will need to focus on repairing the balance sheet instead. If oil and gas prices remain subdued for a lengthy period of time, the company will likely fall far short of this guidance and may suffer further capital destruction. As a result, we rate this stock a speculative buy for aggressive investors only.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	706	988	1,031	1,171	1,188	685	626	790	1,178	1,317
SG&A Exp.	75	110	115	136	156	134	122	123	127	147
Operating Profit	226	453	419	509	415	(4)	(82)	80	281	138
Operating Margin	32.1%	45.8%	40.6%	43.5%	34.9%	-0.6%	-13.0%	10.2%	23.9%	10.5%
Net Profit	43	144	191	318	244	(170)	(121)	48	210	25
Net Margin	6.1%	14.6%	18.5%	27.2%	20.5%	-24.9%	-19.3%	6.1%	17.8%	1.9%
Free Cash Flow	391	(96)	(62)	140	(105)	(56)	127	190	230	226
Income Tax	78	175	163	246	166	3	(48)	48	64	82

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,325	2,679	3,092	3,483	3,778	3,033	3,031	3,161	4,604	4,491
Cash & Equivalents	146	230	103	366	104	30	47	37	20	22
Accounts Receivable	147	173	181	157	148	116	98	132	191	162
Inventories	11	14	26	16	8	9	11	14	20	22
Total Liabilities	1,280	1,375	1,666	1,871	2,037	1,694	1,861	1,934	2,536	2,613
Accounts Payable	252	292	302	252	257	179	135	174	330	239
Long-Term Debt	303	366	645	930	1,067	1,000	1,010	1,010	1,319	1,473
Shareholder's Equity	1,046	1,304	1,426	1,612	1,741	1,339	1,171	1,227	2,068	1,878
D/E Ratio	0.29	0.28	0.45	0.58	0.61	0.75	0.86	0.82	0.64	0.78

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.0%	5.8%	6.6%	9.7%	6.7%	-5.0%	-4.0%	1.6%	5.4%	0.5%
Return on Equity	4.2%	12.3%	14.0%	20.9%	14.6%	-11.1%	-9.6%	4.0%	12.7%	1.3%
ROIC	3.5%	9.6%	10.2%	13.8%	9.1%	-6.6%	-5.3%	2.2%	7.5%	0.7%
Shares Out.	83.2	92.3	99.3	102.5	107.2	109.6	115.7	123.5	153.9	158.0
Revenue/Share	8.49	10.71	10.39	11.43	11.08	6.24	5.41	6.46	8.27	8.43
FCF/Share	4.70	(1.04)	(0.63)	1.37	(0.98)	(0.51)	1.10	1.55	1.61	1.45

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

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