Vermilion Energy Inc. (VET)

Updated November 19th, 2020 by Samuel Smith

Key Metrics

Current Price:	$3.1	**5 Year CAGR Estimate:**	6.4%	**Market Cap:**	$495M
Fair Value Price:	$5.4	**5 Year Growth Estimate:**	-9.5%	**Ex-Dividend Date:**	N/A
% Fair Value:	58%	**5 Year Valuation Multiple Estimate:**	11.5%	**Dividend Payment Date:**	N/A
Dividend Yield:	13.9%	**5 Year Price Target**	$3.3	**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 $495 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 November, Vermilion reported (11/09/20) financial results for the third quarter of fiscal 2020. The company saw FFO grow by 40% sequentially to $0.73 per share but still down significantly year-over-year due to lower commodity prices stemming from the OPEC+ price war and COVID-19 reductions in demand. FCF in Q3 came in at $83M, more than double from the prior quarter as a result of increased FFO and limited capital investment. Meanwhile, the company's annual production guidance has been tightened to a range of 94,000 to 96,000 boe/d. Management also reported that they have been taking a careful and thoughtful approach to preparing their capital budget for 2021 in order to ensure prudent balance sheet management in light of ongoing uncertainty.

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	***$1.07***	***$0.65***
DPS	$1.73	$1.73	$1.73	$1.82	$1.96	$1.96	$1.96	$1.96	$2.09	$2.12	***$0.43***	***$0.10***
Shares[1]	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 declining production 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	***2.9***	***5.0***
Avg. Yld.	4.9%	5.0%	4.4%	3.8%	4.5%	6.9%	4.6%	5.6%	6.5%	13.1%	***13.9%***	***3.1%***

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

1. In millions.

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considerable leverage, we see fair value at 5 times free cash flow (down from 10 times free cash flow prior to the crash), which makes shares undervalued at present. While the fair value estimated 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

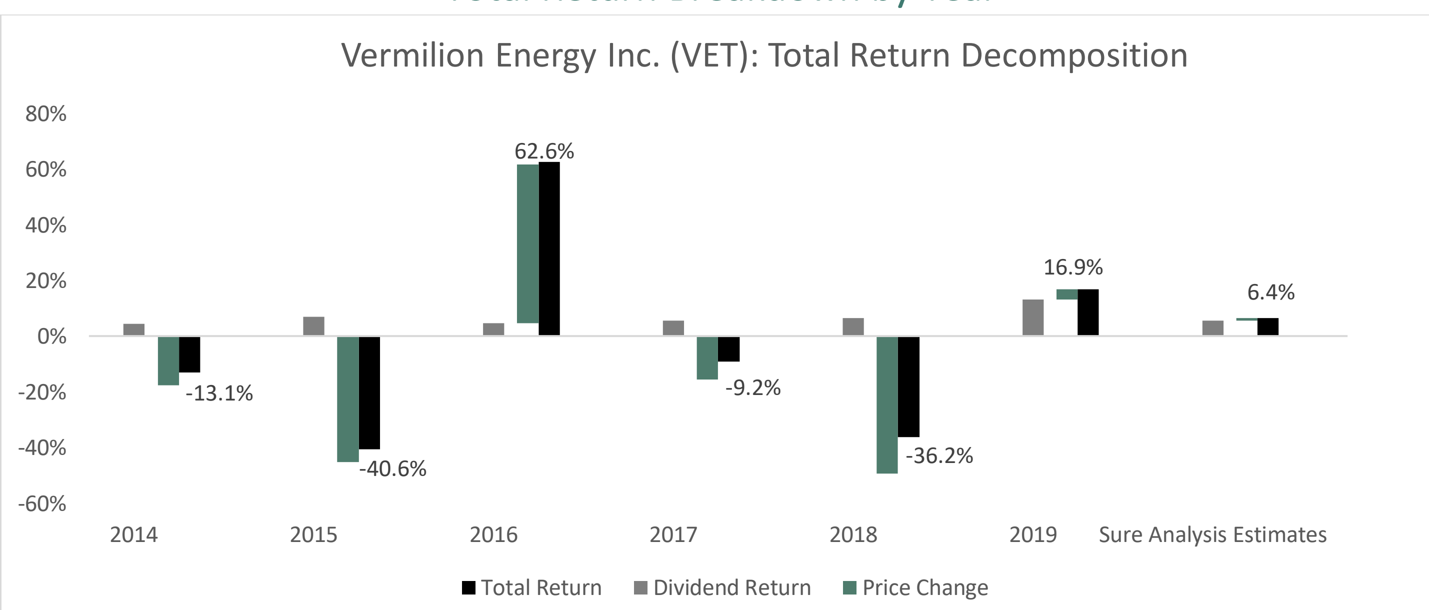
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	284%	167%	180%	---	89%	88%	84%	99%	***40%***	***16%***

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 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, and the balance sheet has a lot of leverage at present. Given the headwinds facing the company the annualized total return potential of 6.4% over the next five years are not very appealing. As a result, we rate the stock a hold.

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.