Interview: Vermilion Energy CEO Lorenzo Donadeo on the Duvernay

Description

American shale plays like the Eagle Ford, the Bakken, and the Permian Basin have been game-changers for the North American energy industry. New techniques like horizontal drilling and hydraulic fracturing have unlocked vast quantities of hydrocarbons. And these developments created fortunes for investors in 2013.

Now the hunt is on for the next big shale play and the Alberta Duvernay holds a lot of promise. According to estimates from Alberta's Geological Survey, the field could rival the high-profile American shale plays listed above. And the industry is buzzing about the Duvernay's potential.

In the final part of my interview with **Vermilion Energy** (TSX:VET, NYSE:VET) Chief Executive Officer Lorenzo Donadeo, we discuss the prospects for the Duvernay and his company's operations in the play. Below is the transcript of our conversation; it has been lightly edited for clarity.

Robert Baillieul: We've seen a number of big operators — Encana, Chevron and Shell — come out with some really good reports out of the Duvernay these past few months. Do you have any colour on Vermilion's operations in the Duvernay?

Lorenzo Donadeo: Well we have a significant position. We have a little over 200,000 acres in the liquids rich window.

We're pretty encouraged by the commitment to this play by Shell, Chevron, and Encana and how they have all indicated that is is really one of their top-tier plays in their portfolios. They have large portfolios. Encana I think they said it's in their top five. At Chevron, I just met with one of their senior guys there and they said that it's a keeper from their perspective.

There're parts of it that are better than others. Shell recently announced the rationalization of their assets. But I think a large percentage of the Duvernay was a keeper. Now, I'm encouraged by all that. These are smart guys who have put hundreds of millions of dollars into this play. Chevron, I think they've invested over a billion dollars when they acquired a Canadian company in the Duvernay.

We think this play is going to be economic. There're going to be parts that work and parts that don't work. You have to find the sweet spots. But I think that as you dig through some of the production and liquids results that we seeing – there has now been over 100 wells that have been drilled in the play – we're quite encouraged. You get into these programed drilling on well pads, things like that where you get the costs down. I think it's going to be a pretty attractive play.

Baillieul: I think on the last conference call I choked when I heard that the typical well is costing up to $15 million to compete. What kind of production numbers do we have to see for this play to be economical?

Donadeo: We have sort of in the $10 to $12 million range. And they're some guys that have gotten that number down as low as $9 million. They've somewhat optimized their operations, but there's still room for more improvement. I think that in the region of $9 million or $10 million and this can be an economical play.

You do have to be in the liquids part of the window. We feel pretty confident that we're in the liquids rich part of the window. In fact there has been some industry data that has come out that has sort of indicated that we have the fourth largest land position in the liquids window behind Chevron, Shell, and Encana.

Baillieul: I mean each one of those guys have come out with some amazing results that past couple of months.

Donadeo: Well I think so. Certainly for us the reason we're excited is that if this works we got a huge huge position. Under a situation where the play actually works, the Duvernay could add anywhere from 15,000 to 45,00 bpd to our production base.

Right now, it's bit of an option in the company. People that buy Vermilion don't have to pay for the Duvernay. But for shareholders it's a pretty significant option. Like I said it could have anywhere between 15,000 to 45,000 bpd of production.

We're pretty excited about it. We're just starting to drill our first two wells there in the first half of this year. As we evaluate them we may drill some more wells from there and bring in partners as well. It's got quite a large opportunity.

Baillieul: I think we're coming up to the 20 minute window of our conversation which is all the time I promised to steal from you today. I really appreciate you taking the time to speak with me and the Motley Fool community today. Just as we wrap things up, is there anything you'd like to tell our readers.

Donadeo: The only thing in terms of our overall strategy. We have a growth and income model. People that buy Vermilion get a reliable dividend. It's about a 4% yield it's never been cut in 10 years and raised about three times in the last six years. And we think there's going to be more room for dividend growth going forward. We're going to be growing our cash flow over the next few years by about 13% to 14%.

People who own Vermilion are going to get a 4% dividend, the potential for dividend growth, cash flow growth and the potential for capital appreciation. And then the Duvernay is a bit of an option.

Baillieul: That answer just jogged my memory. One more question just because you mentioned the dividend. What is your overall capital allocation philosophy?

Donadeo: Well the dividend is a key part in terms of rewarding our shareholders on a regular basis. We’re committed to that. We’re not really interested in share buybacks. With a dividend shareholders get the cash in their jeans. When you look at that dividend growth model it has really outperformed on a long term basis many of the other models.

Basically when we look at capital allocation we look at maintaining our dividend as a minimum and then growing that dividend at a 5% to 7% annual per year. And doing that all within our total cash flow.

CATEGORY

1. Investing

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1. NYSE:VET (Vermilion Energy)
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1. Investing

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