Vermilion Energy Inc.: Is it a Buy or Sell?

Description

From a 2014 high of about $71, **Vermilion Energy Inc.** (TSX:VET)(NYSE:VET) has fallen about 44% to under $40. Instead of yielding 3.6%, the mid-cap energy company now yields 6.5%. Is it finally time to buy Vermilion Energy or should you stay away?

About Vermilion Energy

Vermilion Energy has leading positions in high netback businesses in North America, Europe, and Australia. These global assets offer commodity diversification and premium pricing compared to a portfolio based only in North America. For example, the European natural gas price is about three times that of the North American gas price. Vermilion Energy also enjoys a premium price for its Brent crude compared to its WTI crude.

For its production profile in 2016, the company estimates that it will consist of 30% of Brent oil (19% from France and 11% from Australia), 29% of European gas (13% from Netherlands, 12% from Ireland, and 4% from Germany), and 21% of gas, 8% of natural gas liquids, and 11% of WTI oil from Canada.

This production profile would produce estimated funds from operations (FFO) diversification as follows: 42% from Brent oil, 41% from European gas, 11% from WTI oil, 4% from natural gas liquids, and 2% of Canadian gas.

Navigating the negative environment

Other than its pricing advantage from Brent oil and European gas, Vermilion Energy also employs a hedging strategy. However, only 5% of its oil production is hedged for 2016. Additionally, 43% of its gas production is hedged. In total, 25% of its production is hedged. Depending on where commodity prices go from here, we'll be able to tell if the company made the right move by hedging the percentage that it did.

Cash flows and dividends

From 2011 to 2014, Vermilion Energy's FFO per share increased by 9-16% per year. However, in 2015 its FFO per share fell by 38%, and the company expects it to fall another 36% this year. If commodity prices don't improve, which can very well materialize, its shares will likely fall further.

That said, Vermilion Energy focuses on a long-term dividend-growth model. Since 2003, Vermilion Energy hasn't cut its dividend and has increased it three times.

If Vermilion Energy's FFO per share does end up falling another 36% this year, it would result in a payout of almost 86% of its FFO to maintain its monthly dividend of 21.5 cents per share ($2.58 per share annually).

Conclusion

Within a 15-year period, Vermilion Energy has outperformed five energy indices over different time frames. The company seems to be a safer mid-cap energy investment than many others, especially those that have cut their dividends.

However, Vermilion Energy anticipates that FFO per share will fall another 36% this year, so there's no rush to buy its shares. If you hold the company's shares already, there's no rush to sell them either because Vermilion's 6.5% yield doesn't seem to be in any immediate danger.

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