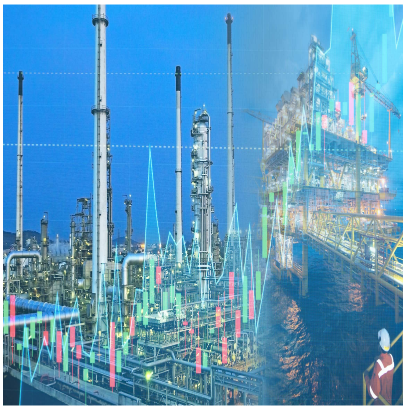

Vermilion Energy Stock Plummeted 40% From the Top – Is It a Buy Today?

Description

The year 2022 has been a rollercoaster ride for energy investors. Even though there was massive volatility, energy names are still sitting on handsome gains for the year. Canadian midcap name **Vermilion Energy** (TSX:VET) stock has dropped 40% from its record highs in August. Despite the fall, it is sitting at a 55% gain in 2022. In comparison, crude oil has declined 40%, and TSX energy stocks, on average, have lost 20% of their value from their respective highs.

So, what's the deal with Vermilion? Why is everybody talking about its recent fall? And is it a buy after such a steep correction?

What's next for VET stock?

First, Vermilion is the only Canadian energy company that has significant exposure to Europe. Its European assets derive nearly 30% of its total earnings. Moreover, higher energy prices in Europe, mainly after the Russia-Ukraine war, have notably boosted Vermilion's cash flows in 2022. As a result, VET stock has been the top performer among TSX energy stocks this year.

To distribute windfall cash flows among shareholders, Vermilion mainly preferred a share buyback route till Q3 2022. However, things soon became grim for Vermilion. Europe's proposed windfall taxes on oil and gas companies hammered the stock and its growth prospects. The company expects around a $300 million hit this year because of the higher taxes. That's more than its quarterly profit.

So, driven by the uncertainties over the windfall taxes, Vermilion chose to pause its buyback plan in Q4 2022. The market evidently did not receive this very well, leading to VET's incessant fall since November. Note that peer energy companies have been aggressively buying back shares in the current markets.

Superior cash flows and strengthened balance sheet

Vermilion attained much sounder financial shape this year, with its net debt-to-EBITDA falling to 0.7x.

EBITDA is earnings before interest, tax, depreciation, and amortization. At the end of Q3 2022, it had net debt of $1.4 billion, declining from $1.8 billion at the end of 2021. Declining debt indicates a lower outflow on debt servicing and higher future profitability.

Energy companies were almost always highly indebted names on the street. However, this has changed since the pandemic. Energy explorers and producers have repaid a massive amount of debt, making them investor favourites.

Interestingly, although Vermilion is likely to take an unwelcome impact on its financials, the stock looks immensely undervalued. It is currently trading at a free cash flow yield of 30%, while peers are at 16%. This indicates a significant discount compared to the industry average. VET stock is trading four times its earnings, again representing a considerable discount compared to its historical average.

Weighing the risk vs reward

Vermilion has a diversified asset base that stands tall among its peers. Huge exposure to Europe amid the super-high pricing scene will likely boost its financials next year as well. However, the windfall taxes indeed add uncertainties to Vermilion's growth prospects for 2023. So, VET is a high-risk bet only for those who can stomach its large price swings. The rewards will likely be equally higher outweighing the uncertainties.

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