Vermilion Energy

Q2 results

Q2 FFO in line; oil price upgrade drives valuation

Oil & gas

Vermilion Energy (VET) reported Q2 fund flows from operations (FFO) of C$193m, in line with consensus estimates and a 23% increase q-o-q. The acquisition of Spartan drove a 15% q-o-q increase in production to 80.6kboed, c 1% ahead of consensus, which includes volumes from Spartan after close of the C$1.4bn acquisition on 28 May 2018. We increase our expectations for FY18 FFO from C$887m to C$946m (+7%) and FY19 FFO from C$1,104m to C$1,208m (+9%), reflecting higher oil price expectations for H218 and 2019. We use EIA short-term WTI price projections of US$66/bbl in 2018 and US$62/bbl in 2019. Our valuation increases from C$53.8/share to C$57.9/share as a result.

Year end	Revenue (C$m)	EBITDA* (C$m)	Operating cash flow (C$m)	Net (debt)/ cash** (C$m)	Capex ex acquisitions (C$m)	Yield (%)
12/16	828.5	361.7	509.5	(1,298.9)	(242.4)	5.8
12/17	1,024.4	673.0	593.9	(1,223.8)	(320.4)	5.8
12/18e	1,558.0	812.6	850.6	(1,484.0)	(502.3)	6.0
12/19e	1,920.3	1,174.6	1,150.7	(1,205.5)	(563.2)	6.3

Note: *Reported EBITDA includes hedging and FX gains/losses. **Net debt = long-term debt, short-term debt minus cash and equivalents.

Capex and dividend funded from FFO

Vermilion's FY18 production guidance OF 86-90kboed range (Edison 88.4kboed) remains unchanged. Capex guidance has increased from C$430m to C$500m, driven by the acceleration of drilling in Australia, taking advantage of rig availability, and to a lesser extent foreign exchange rates. VET's dividend and capex programme remain fully funded for FY18 and FY19 based on our forecasts. With total debt to EBITDA of 1.7x and more than C$370m in unutilised debt capacity, liquidity is not a concern.

Spartan synergies to be realised over time

Management expects Spartan synergies to evolve over time, driving down unit opex at Vermilion's largest producing business unit, Canada. Operating costs rose 7% to C$9.04/boe in Q218 (including a one-month contribution from Spartan), but management expects to see immediate synergies from items such as marketing, insurance and G&A, with a more material reduction of C$2-3/boe to be realised over time.

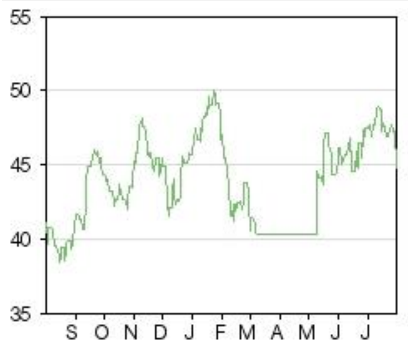
Blended valuation: 8% increase driven by oil price

Our valuation methodology is outlined in further detail in our recent initiation note and uses a combination of P/CF, EV/EBIDAX, Gordon's growth model and SOTP based on sustainable FCF and drilling inventory NPV_{10}. The key driver of an increase in our valuation to C$57.9/share is our revised FY19 WTI price assumption, which rises by 6% from US$58.7/bbl to US$62/bbl. The valuation remains highly sensitive to underlying commodity price assumptions despite hedging.

31 July 2018

Price	**C$44.78**
Market cap	**C$6807m**
	US$/C$1.29
Net debt (C$bn) at 30 June 2018	1.8
Shares in issue	152m
Free float	94%
Code	VET
Primary exchange	TSX
Secondary exchange	NYSE

Share price performance



%	1m	3m	12m
Abs	(5.6)	3.2	7.2
Rel (local)	(5.9)	(1.5)	(0.8)
52-week high/low		C$50.1	C$38.5

Business description

Vermilion Energy is an international E&P with assets in Europe, North America and Australia. Management expects FY18 production to average 86-90kboed after incorporating the acquisition of Spartan.

Next events

Q3 results	24 October 2018

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Edison profile page

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Operational highlights

At group level, production grew 20% y-o-y, largely driven by the acquisition of Spartan, offsetting declines in Germany, Ireland, Australia and the US. Production declines in these regions were driven by natural decline, but also by operational outages and delays. Management remains confident in full year guidance of 86-90kboed, which remains unchanged and targets an exit run rate of 100kboed.

Capex forecasts for FY18 have risen from C$430m to C$500m, reflecting the acceleration (from 2019 into Q418) of drilling in Australia where management is looking to take advantage of available rig slots, and to a lesser extent foreign exchange rate fluctuations.

Exhibit 1: Operational performance review

Country	Production (kboed)	Growth y-o-y	Growth q-o-q	Context
Canada	43.8	53%	37%	Acquisition of Spartan and benefited from drilling activity in Q118.
France	11.7	3%	6%	Production additions from the Neocomian and Champotran drilling programme, as well as reduced downtime.
Netherlands	7.3	37%	-3%	Shut-in of Eesveen-02 well following production test. Well expected back on stream in August 2018 after permitting.
Germany	3.4	-21%	-9%	Downtime at non-op sour gas plant. Two-thirds of volumes not expected back online until late in Q3.
Ireland	9.4	-11%	-7%	Natural declines and minor plant downtime.
Australia	4.1	-32%	-17%	Higher than normal downtime to perform workovers.
US	0.8	-13%	27%	Natural declines and production delays led to a y-o-y decline. Net wells and resumption of gas sales following restart of third-party gas facility drove growth q-o-q.
Total	**80.6**	**20%**	**15%**	

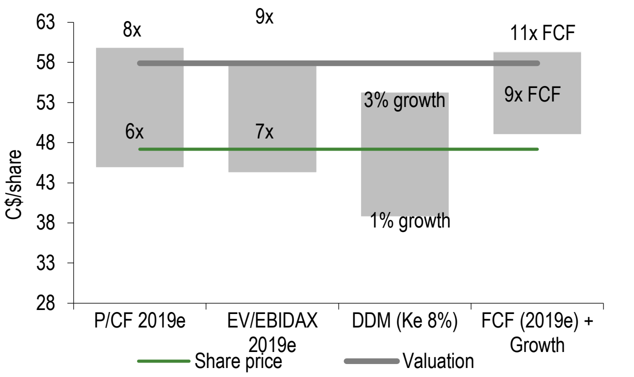
Source: Vermilion Energy, Edison Investment Research

Valuation benefits from higher realisations

Below we provide an update of our blended valuation for Vermilion based on higher short-term crude realisations. Our FY18 and FY19 oil price assumptions are based on EIA projections, which currently stand at US$66/bbl in 2018 and US$62/bbl in 2019.

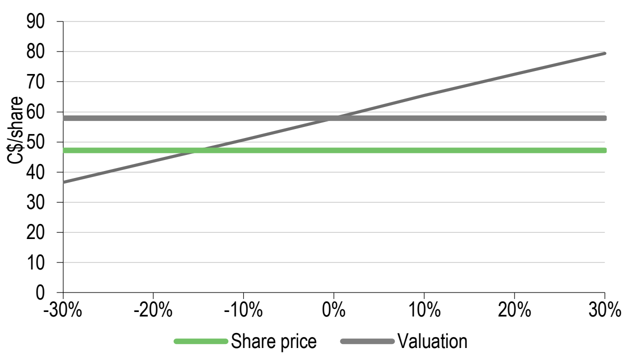
We would expect Vermilion to trade towards the top end of our C$44.3/share to C$57.9/share valuation range based on its track record of reserves and production growth, peer-leading dividend yield, low F&D costs, and commitment to emission disclosure and reduction. We note that valuation sensitivity to underlying commodity price assumptions remains high, despite hedge protection, as shown in Exhibit 3 below.

Exhibit 2: Valuation range C$44.3-57.9/share



Source: Edison Investment Research. Note: Ke = required rate of return.

Exhibit 3: Valuation sensitivity to commodity price FY19e



Source: Edison Investment Research

Commodity price leverage and valuation

Benchmark commodity prices for FY19 are a key sensitivity to our group valuation. Exhibit 4 below indicates this sensitivity by flexing our commodity price inputs for 2019 by ±30%. Our valuation varies from C$36.7/share to C$79.4/share over this range, with the market-implied discount to our commodity price deck for 2019 at c -12%.

Exhibit 4: Midpoint valuation sensitivity to commodity price input for FY19 (base case in bold)

Brent/(US$/bbl)	**48.1**	**55.0**	**61.9**	**68.7**	**75.6**	**82.5**	**89.4**
WTI/(US$/bbl)	43.4	49.6	55.8	62.0	68.2	74.4	80.7
NBP (C$/mmbtu)	4.9	5.6	6.3	7.0	7.7	8.4	9.1
AECO (C$/GJ)	1.2	1.4	1.5	1.7	1.9	2.0	2.2
TTF (C$/GJ)	4.9	5.6	6.3	7	7.7	8.4	9.1
Price change versus base	-30%	-20%	-10%	0%	10%	20%	30%
C$/share	36.7	43.6	50.6	**57.9**	65.4	72.5	79.4

Source: Edison Investment Research

Financials

Edison versus consensus

Our updated forecasts relative to company and Bloomberg consensus are shown in the table below. Key variations include our production expectations for FY19, which are 7% ahead of consensus, reflecting a full year contribution from Spartan and increase in equity at Corrib (Ireland) post the transition of operatorship to Vermilion, an increase in production from the Netherlands on the resolution of permitting issues and the positive impact of two new wells in Australia offsetting production declines. We expect to revisit our production forecasts towards the end of FY18 when we have more information on production from the acquired Spartan asset base.

Exhibit 5: Edison forecast versus Bloomberg consensus

C$m	**Edison**		**Consensus**		**Delta**	
	2018e	**2019e**	**2018e**	**2019e**	**2018e**	**2019e**
Production	88.4	108	86.8	100.9	2%	7%
Revenues	1,558	1,920	1,578	1,881	-1%	2%
Adj EBITDA*	843	1,206	983	1,202	-14%	0%
EBIDAX	805	1,148	N/A	N/A		
FFO	946	1,208	940**	N/A	1%	
CFPS	5.5	7.3	6.5	7.7	-15%	-5%
Capex ex acquisitions	502	563	500***	518	0%	9%

Source: Edison Investment Research, Bloomberg. Note: *Adjusted for non-cash items. **Company consensus. ***Company guidance.

Exhibit 6: Financial summary

C$m	2016	2017	2018e	2019e	2020e
Dec	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	829	1,024	1,558	1,920	2,064
Cost of Sales	(262)	(286)	(454)	(594)	(625)
Gross Profit	567	739	1,104	1,327	1,439
EBITDA	362	673	813	1,175	1,287
Operating Profit (before amort. and except.)	(166)	182	166	364	457
Intangible Amortisation	0	0	0	0	0
Exceptionals	0	0	0	0	0
Other	0	0	0	0	0
Operating Profit	(166)	182	166	364	457
Net Interest	(57)	(57)	(62)	(58)	(44)
Profit Before Tax (norm)	(223)	124	103	306	413
Profit Before Tax (FRS 3)	(223)	124	103	306	413
Tax	63	(62)	(39)	(58)	(65)
Profit After Tax (norm)	(243)	104	80	248	348
Profit After Tax (FRS 3)	(160)	62	65	248	348
Average Number of Shares Outstanding (m)	116	121	141	156	158
EPS - normalised (C$/share)	(2.1)	0.9	0.6	1.6	2.2
Dividend per share (C$/share)	2.6	2.6	2.7	2.8	2.8
Gross Margin (%)	68	72	71	69	70
EBITDA Margin (%)	44	66	52	61	62
Operating Margin (before GW and except.) (%)	(20)	18	11	19	22
BALANCE SHEET					
Fixed Assets	3,861	3,713	5,271	5,024	4,733
Intangible Assets	275	293	297	323	323
Tangible Assets	3,433	3,338	4,733	4,460	4,169
Investments	153	82	241	241	241
Current Assets	226	262	380	412	442
Stocks	15	17	22	22	22
Debtors	132	166	230	230	230
Cash	63	47	99	132	161
Other	17	32	29	29	29
Current Liabilities	(291)	(363)	(502)	(502)	(502)
Creditors	(218)	(258)	(333)	(333)	(333)
Other short term liabilities	(73)	(105)	(169)	(169)	(169)
Long Term Liabilities	(2,218)	(2,069)	(2,519)	(2,301)	(1,941)
Long term borrowings	(1,362)	(1,270)	(1,583)	(1,338)	(950)
Other long term liabilities	(856)	(798)	(937)	(963)	(991)
Net Assets	1,578	1,543	2,630	2,634	2,732
CASH FLOW					
Operating Cash Flow	510	594	851	1,151	1,271
Capex	(242)	(320)	(502)	(563)	(539)
Acquisitions/disposals	(99)	(28)	(114)*	0	0
Financing	(17)	(4)	(5)	(6)	(6)
Dividends	(105)	(200)	(279)	(303)	(309)
Net Cash Flow	47	41	(49)	278	417
Opening net debt/(cash)	1,346	1,299	1,224	1,484	1,205
HP finance leases initiated	0	0	0	0	0
Other	0	34	(211)	0	0
Closing net debt/(cash)	1,299	1,224	1,484	1,205	789

Source: Company accounts, Edison Investment Research. Note: *Spartan acquisition consideration consisted of 27.9m VET shares valued at C$1.2bn. Edison calculates net debt as long-term debt, plus short-term debt minus cash and cash equivalents.

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