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Vermilion Energy could slash dividend in half, analyst warns

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Market Call

The sustainability of Vermilion Energy Inc.'s payout to investors has long been a hot topic on Bay Street, and now one analyst says the oil and gas producer could be forced to slash it in half.

"The company has never reduced its monthly payout, a unique feat amongst Canadian [explorers and producers]," wrote ***Veritas Research*** Analyst ***Jeffrey Craig*** Wednesday in his report titled The First Cut May Be The Deepest. "Despite its impressive history, we calculate that Vermilion will be unable to fund its annual dividend from cash flow in the current commodity price environment."

Vermilion pays out a monthly dividend of $0.23 per share, and has held the payout at that level since May 2018. As Vermilion's share price has come under pressure over the last couple of years, however, its yield has run higher and flashed warning signs for some investors. As of Wednesday morning, the company's dividend yield was sitting at 16.7 per cent.

In his analysis, ***Craig*** estimated Vermilion could face a cash shortfall of as much as $205 million this year and has limited flexibility because of high debt levels and few assets that could be shopped around.

"To close the pre-hedging gap, we calculate that Vermilion would need to reduce its annual dividend to $1.44 per share -- a decrease of ~50 per cent," he wrote.

Vermilion Energy wasn't immediately available for comment on ***Craig's*** commentary, but its CEO, Anthony Marino, has consistently defended his company's payout strategy in interviews with BNN Bloomberg.

"Actually, as of a week ago, we've updated our funding estimate, our cash flow generation as compared to our uses for capex and for the dividend. We show ourselves overfunded – meaningfully overfunded at the current pricing level," Marino said in a Jan. 21 interview. "So we think it's completely economically-warranted. It's actually our lowest total payout ratio that we've had since 2008 - since before even the financial crisis. We continue to pay the dividend because it is funded and economically-warranted for the company to do that."

As a result of ***Craig's*** doubt about Vermilion's current capital plan, he downgraded the company's shares to a Sell recommendation with an intrinsic value of $16.50 per share.