

VANGUARD NATURAL RESOURCES LLC

Reduces Distribution and Provides 2015 and 2016 Guidance; Adjusting Estimates

VNR (NASDAQ)

Company & Market Data

Closing Price (as of 02/20/2015):	\$17.28
Rating:	BUY
Price Target:	\$20.00
52 Week Range:	\$11.90 - \$33.04
Market Capitalization (MM):	\$1,452
Units Outstanding (MM):	83.6
Avg Daily Volume (M):	1,287.3
Fiscal Year End:	Dec

Balance Sheet

Enterprise Value (MM):	\$3,666
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Forecast Returns %

Forecast Price Appreciation:	15.7%
Forecast Distribution Yield:	8.2%
Forecast Total 12 Month Return:	23.9%

Estimates

EPU	2014E	2015E	2016E
1Q	\$0.31	\$(0.09)	—
<i>Prior</i>		\$0.06	
2Q	\$0.27	\$(0.07)	—
<i>Prior</i>		\$0.08	
3Q	\$0.34	\$(0.02)	—
<i>Prior</i>		\$0.12	
4Q	\$0.19	\$0.03	—
<i>Prior</i>	\$0.15	\$0.14	
Full Year	\$1.10	\$(0.15)	\$0.20
<i>Prior</i>	\$1.06	\$0.40	
EBITDA (MM)	\$421.8	\$384.2	\$401.9
<i>Prior</i>	\$413.3	\$455.7	
DCFP	\$2.61	\$1.85	\$1.95
<i>Prior</i>	\$2.48	\$2.20	

Ratios

P/E	15.7x	NA	86.4x
EV/EBITDA	8.7x	9.5x	9.1x
P/DCFP	6.6x	9.3x	8.9x

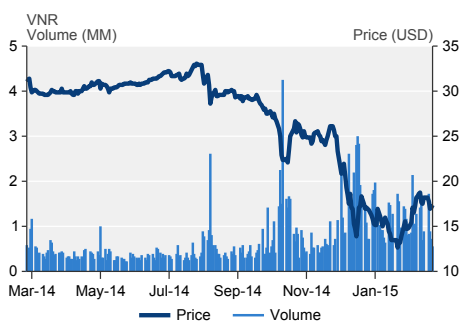


Chart data: Bloomberg

Highlights

VNR (on 2/17) reduced its common unit distribution and provided preliminary unaudited financial and operating information for 2014, along with full year 2015 and 2016 budgets and guidance.

VNR reduced its monthly common unit distribution to \$0.1175 (\$1.41 per unit on an annualized basis) from \$0.21 (\$2.52 per unit on an annualized basis) to position the company to live within cash flow and to preserve liquidity for potential future acquisition opportunities in this low commodity price environment.

VNR also reported preliminary unaudited financial and operating Q4 '14 results for Adjusted EBITDA of ~\$126 million (vs. our \$117 million estimate), distributable cash flow of \$74 million (vs. our \$63 million estimate), distribution coverage ratio (based on its prior \$0.63 per unit quarterly distribution) of 1.40x (vs. our estimate of 1.18x) and production of 402 MMcfe/d (vs. our estimate of 399 MMcfe/d). The better results (relative to our estimates) were primarily due to higher commodity price realizations. VNR plans to provide final Q4 and full-year 2014 results when it files its 10K on March 2.

VNR has set initial 2015 and 2016 capital budgets of \$114 million and \$117 million, respectively, compared with an estimated \$142 million (including \$26 million of growth capital) last year. Roughly 50% of the 2015 capital budget is allocated to non-operated vertical wells in the Pinedale Anticline, 25% to the newly acquired East Haynesville assets (both vertical and horizontal wells and several recompletions) with the remainder for maintenance activities in its other operating areas.

Based on this budget, VNR provided production guidance for 2015 of 360-398 MMcfe/d and for 2016 of 353-393 MMcfe/d compared with estimated 402 MMcfe/d in Q4 '14. VNR's production guidance is adjusted for ethane rejection at Pinedale, which started at the beginning of this year and is expected to reduce its production by ~10-12 MMcfe/d. VNR estimates its current PDP annual decline rate is ~15%.

VNR has restructured its hedge portfolio in an attempt to limit further downside and volatility in the current commodity price environment by converting a significant portion of its three-way collars in 2015 to fixed price swaps or lowered the pricing on existing short puts. VNR has now hedged 77% and 45% of its estimated 2015 and 2016 oil production at average prices of \$76/Bbl and \$83/Bbl, respectively. VNR has hedged ~82% and 67% of its estimated natural gas production in 2015 and 2016 at average prices of \$4.32/MMBtu and \$4.37/MMBtu, respectively. VNR's current production is ~15% oil, ~10% NGLs and ~75% natural gas.

Based on its reduced common unit distribution and current strip commodity prices, VNR estimates its distribution coverage ratio for 2015 will be ~1.24x and for 2016 will be ~1.20x.

VNR currently has \$600+ million of availability under its reserve-based credit facility with its next scheduled borrowing base redetermination in April.

Adjusting our 2015 Adjusted EBITDA/distributable cash flow per unit estimates to \$384 million/\$1.85/unit from \$456 million/\$2.20/unit. Introducing 2016 Adjusted EBITDA/distributable cash flow per unit estimates of \$402 million/\$1.95/unit.

Reiterate Buy rating and \$20 price target based on it trading at ~11x our 2015 distributable cash flow estimate.

Disclosures and Analyst Certifications can be found in Appendix A.

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Earnings Model

Table 1: VNR Earnings Model

VANGUARD NATURAL RESOURCES	2016E	2015E	Q4E	Q3E	Q2E	Q1E	2014E
WTI Crude Oil	\$80.00	\$59.00	\$71.00	\$60.00	\$55.00	\$50.00	\$92.54
Natural Gas	\$4.00	\$3.50	\$3.75	\$3.50	\$3.25	\$3.50	\$4.30
Production: Oil (Bbls/Day)	9,450	9,450	9,450	9,450	9,450	9,450	9,043
NGLs (Bbls/Day)	6,500	7,085	6,750	6,900	7,200	7,500	7,559
Gas (Mcf/Day)	260,000	275,204	268,500	272,500	277,500	282,500	227,498
Equivalent (BOE/Day)	59,283	62,402	60,950	61,767	62,900	64,033	54,518
Breakdown: Liquids	26.9%	26.5%	26.6%	26.5%	26.5%	26.5%	30.5%
Gas	73.1%	73.5%	73.4%	73.5%	73.5%	73.5%	69.5%
INCOME STATEMENT (\$,000)							
Oil, Natural Gas and NGL Sales	604,134	503,106	144,398	127,371	115,078	116,260	615,898
Gains (Losses) on Oil & Gas Derivatives	37,964	113,289	15,318	27,936	36,114	33,921	20,843
Marketing	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0
Total Operating Revenue	642,098	616,395	159,716	155,307	151,191	150,181	636,741
Lease Operating	149,305	150,327	37,009	37,505	37,778	38,036	132,702
Production and Other Taxes	61,924	52,826	15,162	13,374	12,083	12,207	61,124
DD&A	255,333	268,776	65,887	66,770	67,828	68,292	223,828
Impairment	0	0	0	0	0	0	0
General & Administrative	34,000	34,000	8,500	8,500	8,500	8,500	31,292
Other	0	0	0	0	0	0	0
Total Operating Expenses	500,562	505,930	126,558	126,148	126,189	127,035	448,947
OPERATING INCOME	141,536	110,466	33,158	29,159	25,002	23,147	187,794
Interest Expense	90,656	89,246	22,034	22,368	22,478	22,366	72,437
Other Expenses (Income)	0	0	0	0	0	0	(33,508)
Income Before Income Taxes	50,881	21,219	11,124	6,791	2,524	780	148,866
Income Taxes (Benefit)	0	0	0	0	0	0	0
Effective Tax Rate (Net of Credits)	0%	0%	0%	0%	0%	0%	0%
Income Before Extraordinary Items	50,881	21,219	11,124	6,791	2,524	780	148,866
Preferred Dividend	33,900	33,900	8,475	8,475	8,475	8,475	19,982
Reported Earnings	16,981	(12,681)	2,649	(1,684)	(5,951)	(7,695)	128,884
Reported Earnings Per Unit	0.20	(0.15)	0.03	(0.02)	(0.07)	(0.09)	1.57
Recurring Earnings	16,981	(12,681)	2,649	(1,684)	(5,951)	(7,695)	90,428
Recurring Earnings Per Unit	0.20	(0.15)	0.03	(0.02)	(0.07)	(0.09)	1.10
Wtg. Avg. Units Outstanding (,000)	84,800	84,300	84,300	84,300	84,300	84,300	82,177
Diluted Units Outstanding (,000)	84,800	84,300	84,300	84,300	84,300	84,300	82,305
Adjusted EBITDA (\$000's)	401,870	384,242	100,295	97,179	94,080	92,688	421,819
Less: Interest Expense	(92,656)	(88,246)	(21,534)	(21,868)	(22,478)	(22,366)	(73,840)
Less: Maintenance Cap Ex	(117,000)	(113,500)	(25,500)	(25,500)	(31,250)	(31,250)	(116,528)
Plus: Proceeds from Sale of Leasehold Interest	0	0	0	0	0	0	1,950
Less: Preferred Distribution	(26,750)	(26,750)	(6,688)	(6,688)	(6,688)	(6,688)	(18,197)
Distributable Cash Flow	165,464	155,746	46,574	43,123	33,665	32,384	215,204
Distributable Cash Flow Per Unit	1.95	1.85	0.55	0.51	0.40	0.38	2.61
Distribution Per Unit						0.353	2.52
Distribution Coverage Ratio (projections based on current distribution)	1.38x	1.31x	1.57x	1.45x	1.13x	1.09x	1.04x
COMPONENT ANALYSIS (\$/BOE Prod.)							
O&G Operating Revenues	27.92	22.09	25.75	22.41	20.10	20.17	30.95
Lease Operating	6.90	6.60	6.60	6.60	6.60	6.60	6.67
Production and Other Taxes	2.86	2.32	2.70	2.35	2.11	2.12	3.07
Production Taxes as a % of Oil & Gas Revenue	10.3%	10.5%	10.5%	10.5%	10.5%	10.5%	9.9%
D.D. & A.	11.80	11.80	11.75	11.75	11.85	11.85	11.25
General & Administrative	1.57	1.49	1.52	1.50	1.49	1.47	1.57
Interest Expense	4.19	3.92	3.93	3.94	3.93	3.88	3.64
Adjusted EBITDA	18.57	16.87	17.89	17.10	16.44	16.08	21.20

Source: Ladenburg Thalmann & Co. Inc., Company Reports

Risks include, but are not limited to:

Declines in commodity prices (including regional pricing) could result in the company not being able to generate sufficient cash flow to fund its budget, which could result in it not being able to make its production growth forecast.

Difficulty in predicting production performance of new wells, production, operational or permit delays; weather delays that negatively impact drilling activities and difficulty in accessing needed pipeline infrastructure or applying well completion methods could negatively impact the company's operations.

Because of the natural decline in its production, VNR's ability to maintain or grow production depends on successful drilling results and/or making and integrating additional acquisitions on economically acceptable terms.

The inadequate performance by its partners, particularly in its non-operated properties, for its current and planned projects could negatively impact reserve and production growth.

Acquisitions may be delayed or may not be completed. The delay or lack of completion of an acquisition may materially affect the company's results. In addition, acquisitions may include execution and integration risk. VNR operates in a highly competitive industry and participants compete for acquisitions that are accretive to distributable cash flow.

Unexpected negative outcomes from pending or potential lawsuits could negatively impact VNR. Unfavorable regulatory or environmental rulings may hamper VNR's ability to develop its properties as planned.

The number of viable drilling locations may prove to be lower than company's current identified locations and reserves are subject to negative revisions.

The issuance of equity could significantly dilute existing unit holders. Disruption or volatility in the credit and capital markets may make it difficult to obtain funding through new borrowings or the issuance of equity on an accretive basis.

VNR's borrowings are subject to interest rate fluctuations, which we believe could limit its ability to grow and cash available for distribution. Also, MLP unit prices can react negatively to increases in interest rates.

VNR may issue additional units without unitholder approval, which would dilute their existing ownership interests.

VNR's limited liability company agreement restricts the voting rights of unitholders owning 20% or more of its units. VNR's limited liability company agreement provides for a limited call right that may require unitholders to sell their units at an undesirable time or price.

Unitholder's should analyze the federal, state, local and non-U.S. tax consequences particular to that unitholder resulting from its ownership or disposition of its units.

VNR expects to be treated as a partnership for federal income tax purposes and, therefore, generally will not be liable for federal income taxes. Instead, each of VNR's unitholders will take into account its respective share of its items of income, gain, loss and deduction in computing its federal income tax liability as if the unitholder had earned such income directly, even if no cash distributions are made to the unitholder. Distributions by VNR to a unitholder generally will not give rise to income or gain taxable to such

unitholder, unless the amount of cash distributed to a unitholder exceeds the unitholder's adjusted tax basis in its units.

Changes in tax legislation could negatively impact VNR.

Unit holders may be required to file taxes in states where the partnership conducts business and should consult a tax advisor for further counsel.

APPENDIX A: IMPORTANT RESEARCH DISCLOSURES

ANALYST CERTIFICATION

I, Michael C. Schmitz, attest that the views expressed in this research report accurately reflect my personal views about the subject security and issuer. Furthermore, no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation or views expressed in this research report, provided, however, that:

The research analyst primarily responsible for the preparation of this research report has or will receive compensation based upon various factors, including the volume of trading at the firm in the subject security, as well as the firm's total revenues, a portion of which is generated by investment banking activities.

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COMPANY BACKGROUND

Vanguard Natural Resources, which is limited liability company with partnership tax status, is a Texas-based E&P company with a primary goal to provide stability and growth of distributions by acquiring, developing and maximizing cash flow from a growing portfolio of long-life oil and natural gas assets, while at the same time, reducing cash flow volatility via hedging commodity prices.

VALUATION METHODOLOGY

We primarily value E&P Master Limited Partnerships (MLPs) and Limited Liability Companies (LLCs) utilizing a multiple of projected distributable cash flow.

RISKS

In addition to normal economic and market risk factors that impact most all equities, Vanguard Natural Resources is at risk to changes to commodity prices (including regional pricing), operational risks, disappointing drilling results, production shortfalls, concentration risks, government regulations, weather-related delays/shut-ins, difficulty in obtaining oilfield services, midstream constraints/issues. The delay or lack of completion of an acquisition may materially affect the company's results. In addition, acquisitions may include execution and integration risk. The issuance of equity could significantly dilute existing unit holders. Disruption or volatility in the credit and capital markets may make it difficult to obtain funding through new borrowings or the issuance of equity on an accretive basis. MLP unit prices can react negatively to increases in interest rates. Unitholder's should analyze the federal, state, local and non-U.S. tax consequences particular to that unitholder resulting from its ownership or disposition of its units. Changes in tax legislation could negatively impact VNR. Unit holders may be required to file taxes in states where the partnership conducts business and should consult a tax advisor for further counsel.

The above-mentioned risk factors do not constitute all the potential risks of investing in the subject company's shares. Investors should refer to the company's SEC filings including the most recent forms 10-K and 10-Q for further details on the risks associated with an investment in the subject company's shares.

STOCK RATING DEFINITIONS

Buy: The stock's return is expected to exceed 12.5% over the next twelve months.

Neutral: The stock's return is expected to be plus or minus 12.5% over the next twelve months.

Sell: The stock's return is expected to be negative 12.5% or more over the next twelve months.

Investment Ratings are determined by the ranges described above at the time of initiation of coverage, a change in risk, or a change in target price. At other times, the expected returns may fall outside of these ranges because of price movement and/or volatility. Such interim deviations from specified ranges will be permitted but will become subject to review.

RATINGS DISPERSION AND BANKING RELATIONSHIPS AS OF (February 23, 2015)

Rating	%	IB %
BUY	74.0	59.1
NEUTRAL	26.0	36.7
SELL	0.0	0.0

COMPANIES UNDER MICHAEL'S COVERAGE

Bill Barrett Corp. (BBG)

Chesapeake Energy (CHK)

Cabot Oil & Gas Corporation (COG)
 Concho Resources (CXO)
 EV Energy Partners LP (EVEP)
 Legacy Reserves LP (LGCY)
 LRR Energy, LP (LRE)
 Range Resources (RRC)
 Stone Energy (SGY)
 Vanguard Natural Resources LLC (VNR)

Comstock Resources (CRK)
 EQT Corporation (EQT)
 Energy XXI (Bermuda) Ltd. (EXXI)
 LINN Energy LLC (LINE)
 Memorial Production Partners LP (MEMP)
 SandRidge Energy (SD)
 Southwestern Energy (SWN)
 Whiting Petroleum (WLL)

COMPANY SPECIFIC DISCLOSURES

Ladenburg Thalmann & Co. Inc. has managed or co-managed a public offering for Vanguard Natural Resources LLC within the past 12 months. Ladenburg Thalmann & Co. Inc received compensation for investment banking services from Vanguard Natural Resources LLC within the past 12 months.

Ladenburg Thalmann & Co. Inc had an investment banking relationship with the Vanguard Natural Resources LLC within the last 12 months.

INVESTMENT RATING AND PRICE TARGET HISTORY

Vanguard Natural Resources LLC Rating History as of 02/20/2015

powered by: BlueMatrix



B=Buy N=Neutral S=Sell D=Drop Coverage I=Initiate NR=Not Rated

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Additional Information Available Upon Request

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