The Stock Picker's Guide to MEG Energy for 2014

Description

MEG Energy (TSX:MEG) is well known as the "go-to, pure-play oil sands stock", as put recently by RBC analyst Mark Friesen. And for good reason. The company's entire operations are devoted to producing heavy oil in Alberta, with zero downstream (i.e. refining or retailing) operations.

MEG also does not have any production of light oil, meaning its entire output is subject to the steep discount that applies to Western Canadian Select (WCS). For anyone who thinks the spread will narrow, and is looking for a way to bet on that happening, MEG is often cited as a great way to do so.

All of MEG's production, currently 35,000 barrels per day, comes from Steam Assisted Gravity Drainage (SAGD). The key to any SAGD operation is the Steam-Oil Ratio (SOR), or the barrels of steam required to produce a barrel of oil. A lower SOR means lower capital costs, operating costs, and even a lower environmental footprint. MEG's SOR is already one of the best in the industry at 2.4 (YTD 2013).

As a result, MEG's operating costs are also among the lowest in the industry, at about $10 per barrel. By comparison, **Suncor** (TSX:SU), Canada's largest energy producer, has cash operating costs of over $30 per barrel. MEG is thus able to remain profitable in practically any environment. Despite realizing only $53 per barrel of bitumen in 2013, the company netted $40 per barrel after operating costs, transportation costs, and royalties. Further investment only requires about a $40 oil price in order to earn a 10% rate of return.

MEG is expanding rapidly, with a goal of reaching 80,000 barrels per day by early 2015. This will not come cheap; the company has a capital budget of $1.8 billion ($8 per share) for next year alone. The company also hopes to lower its SOR further, down to 2.0. If MEG is able to reach these goals, then the company stands to benefit immensely from tightening differentials.

MEG's share price does not seem to reflect that scenario playing out. The net asset value of MEG's reserves, based on 2012 numbers, is $52 per share. Even after subtracting out MEG's debt of $10 per share, it is clear that MEG still trades at a discount. And this doesn't even account for MEG's additional resources or the progress the company made in 2013.

Foolish bottom line

Only two and a half years ago, MEG shares traded above $50 per barrel, and despite all the progress the company has made, have since fallen by about 40%. Clearly the headlines about pipelines, differentials, and the explosion in U.S. oil production have not helped the company nor its share price.

But at $30 per share, MEG offers plenty of upside for those willing to place a bet on Canadian energy. Time will tell if it's a bet worth making.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

Category

1. Investing

Date
2025/07/27
Date Created
2014/01/31
Author
bensinclair