Can MEG Energy Corp. Survive?

Description

Since its IPO in 2010, shares of **MEG Energy Corp.** (TSX:MEG) have steadily drifted downward from over $30 to an all-time low of $2.60. Now languishing at just $6, things haven't improved much. The company's market cap is still just $1.6 billion compared to a crushing debt load of $5.2 billion. This year, analysts expect it to lose $1.82 per share.

In a world of sub-$40 oil, can MEG continue to survive?

A tough price to break even

According to MEG's management team, it breaks even at US$52.81 a barrel after sustaining capital expenditures are factored in. There isn't much room left for improvement. Only 12% of capital expenditures are considered discretionary, so any further cuts would hit production. General operating costs are down nearly 40% since 2011 and are already near industry lows.

If it weren't paying so much interest on its debt, MEG would be able to break even at just US$42 per barrel. Fortunately, MEG doesn't face any debt obligations until 2020. If that weren't the case, the company may have already filed for bankruptcy. In 2020 alone, MEG faces $1.2 billion in debt maturities. If oil prices don't sustain a rebound above $50 a barrel soon, the company could have serious issues repaying its outsized debt load.

Riskier every year

MEG will likely survive until at least 2020 even without a rebound in oil. It has US$2.5 billion in undrawn revolving credit facilities with no financial maintenance covenants. That line of credit expires in 2019, however, just before the biggest financial headwinds hit. MEG also has $408 million in cash to keep itself afloat, though it will continue to add debt every day until oil spikes.

And because management has focused spending on the lowest-cost production wells to conservecash, expenses are likely to increase in future years as the company's production normalizes. Forexample, sustaining capital expenditures today are just $5 a barrel, which is down from a historicalaverage of $7-8 a barrel.

All of these factors mean that MEG's breakeven price will likely rise in future years. It's very possible it will need $60 or more a barrel to turn a profit by 2020. That would represent a 50% rise from today's oil price. More concerning is that prices would need to be much higher to turn a reasonable profit, let alone pay off its $5.2 billion in debt.

Better options are out there

MEG is in a difficult position. While its stock will surely benefit from rising energy prices, it's far from guaranteed that it will ultimately be able to profit from improved conditions. Unless we see a return to +$100 oil soon, MEG will face a material restructuring in just a few years. If you're a long-term oil bull, stick with companies such as **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG), which is set to become a dividend machine once prices improve.

CATEGORY

1. Energy Stocks
2. Investing

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1. NYSE:VRN (Veren)
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