Will MEG Energy Corp. Triple?

Description

With oil nearing US$50 a barrel, many energy stocks are skyrocketing, especially those with weak balance sheets.

For example, **Encana Corp.** was almost a bankruptcy candidate earlier this year. Today, shares have rallied over 300% as the company has swung to a profit. Many other companies have experienced similar conditions.

Still, it appears as if **MEG Energy Corp.** (TSX:MEG) remains in the doghouse. Despite a major boost for oil prices, shares remain around $5–a decrease since March when oil prices were below US$40.

Will MEG Energy be the next energy company to triple?

Let's take a look

Back in March (when shares were $6), MEG's market cap was $1.6 billion compared to a crushing debt load of $5.2 billion. For 2016, analysts were expecting it to lose $1.82 per share.

The dire predictions came with good cause.

According to MEG's management team, it breaks even at US$53 a barrel after sustaining capital expenditures are factored in. There hasn't been much room left for improvement given just 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.

But there is a silver lining.

If it weren't paying so much interest on its debt, MEG would be able to break even at just US$42 per barrel. Unfortunately, however, it faces a difficult test in repaying its outsized debt load.

MEG doesn't face any debt obligations until 2020, but 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. Over the next four years, it faces another $2.5 billion at an average cost of 5.8%.

How does MEG expect to meet these bills? The company currently only has $150 million in cash. But, it also has access to $3.3 billion in undrawn credit facilities. Unfortunately, that matures in the fourth quarter of 2019, just before the major debt is due.

Should you take a gamble?

Today, an investment in MEG Energy is simple.

If oil prices don't materially improve by 2019, the company has very little chance of meeting its outsized obligations. 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.

While MEG Energy looks enticing for patient investors looking to play a long-term rebound in oil, you have to be a major bull to profit from shares. If you are reasonably confident about the upwards trajectory of oil prices, MEG Energy offers massive upside that few other stocks can match.

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