

This High-Risk, High-Reward Energy Stock Has Doubled in Just 3 Months! Time to Buy?

Description

With the price of oil climbing and the discount Canadian oil producers receive relative to their U.S. and global counterparts subsiding somewhat, investing in oil sands operations at current levels is something I've been selectively bullish about. I see significant improvement in this sector overall. However, I also should be very clear that not all companies are created equal, and investors willing to accept the risk associated with oil sands operators ought to be very selective with the companies they choose.

One company I have [not traditionally been fond](#) of is **MEG Energy Corp. (TSX:MEG)**. MEG is closest to what could be called a pure-play oil sands operator in Western Canada, a reality that has led to a significant decline in the company's stock price in recent years due to declining oil prices and widening discounts for heavy Western Canadian oil. MEG has also traditionally held [significant amounts of debt](#), leading to a high debt relative to its cash flow. This has made MEG a much more risky play relative to peers with better balance sheets given that interest rates continue to be on the rise and higher debt loads are increasingly loathed by investors.

MEG, along with other heavy oil operators, have looked for ways to improve their balance sheets in a way that makes sense to long-term investors. As such, MEG has recently announced that will be selling its 50% ownership in its Access Pipeline as well as a 900,000 barrel oil storage facility to Wolf Midstream Inc. for just over \$1.6 billion. MEG will retain a 30-year capacity agreement with the pipeline (presumably negotiated at a favorable rate, as per the sale), although this sale will increase the company's operating costs, as it won't be able to take advantage of the vertically integrated synergies it had previously held.

The conundrum many firms find themselves in is a situation in which assets on the market are relatively cheap and therefore attractive to buy; selling such assets at current prices, however, may be viewed as imprudent given the rising value of such assets in an increasing commodity price environment. That said, given MEG's current balance sheet situation, this move was viewed positively by the market, with the company's share price trading significantly higher on the news.

Bottom line

While MEG is certainly a very interesting deep-value play for investors looking to buy risk in the oil sands sector, I believe the risk profile of this operator remains too high relative to its current operating margin to justify its current share price. In my view, the price of oil remains too volatile to justify long-term projections of \$60-\$80 a barrel (which is what many models have factored in).

My view with respect to oil sands companies is to only invest in such firms that can potentially withstand five to 10 years of \$30-\$40 oil. At those prices, MEG would be hard-pressed to keep its current valuation.

That said, if oil continues to climb, MEG could turn out to be another double-up in 3 months' time.

Stay Foolish, my friends.

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