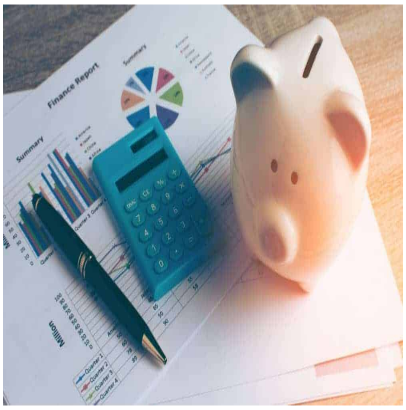


# Latest Results Confirm That MEG Energy Corp. (TSX:MEG) Is an Attractive Investment

## Description

Canada's smaller oil sands companies such as **MEG Energy Corp.** (TSX:MEG) were among the hardest hit when the precipitous collapse in crude began in late 2014, as many were built around the concept of US$100 a barrel oil on the assumption that crude would not weaken. The reason for this is the considerable upfront costs associated with developing oil sands projects, which are typically significantly higher than other sources of unconventional oil such as shale.



For this reason, MEG, like its peers, had amassed a considerable amount of debt as it pushed to develop its flagship Christina Lake steam-assisted gravity drainage project. Because of oil's prolonged slump, MEG was forced to cut back sharply on expenditures and restructure its business so as to optimize its balance sheet and ensure its survival in a world in which US$50 a barrel appeared to be the new norm.

**Now what?**

The sudden and unexpected rally in crude that sees the North American benchmark West Texas Intermediate (WTI) trading at almost US$70 a barrel, while unanticipated, has been a boon for energy companies such as MEG. The additional cash flow that higher oil prices generate will allow MEG to ramp up development activities at Christina Lake.

The strength of MEG's operations become quite clear after reviewing its second quarter 2018 results despite it reporting a $179 million loss compared to a $104 million profit a year earlier. That loss can be attributed in part to lower revenue because of oil production falling by 2% year over year to 71,325 barrels daily. The reason for this reduced output was the planned maintenance at Christina Lake, which has since been completed.

MEG also reported a cash operating netback — a key measure of profitability — of $19.43 per barrel, which was 14% lower than the $ 22.66 from a year earlier. The decline in the company's netback however was not due to cost blowouts or operational issues, but rather the impact of risk management contracts on operating costs.

You see, because of oil's sustained weakness, MEG, like many other energy companies, implemented a strategy aimed at managing the risks posed by lower prices through instituting a series of price hedges. Because of crude's unanticipated recovery, the cost of those derivative contracts has risen sharply, thereby triggering a loss that has to be accounted for in MEG's operating costs.

Prior to the loss on those contracts being factored into MEG's netback, it came to $30.50 per barrel, a considerable improvement over the netback reported for the same period in 2017, thereby underscoring the profitability of MEG's Christina Lake operations, particularly in an operating environment where oil is rising.

The costs associated with MEG's currency and oil price hedging contracts came to $64.2 million and $150 million, respectively. These costs were responsible for the company's net loss. The majority of MEG's commodity price contracts will unwind by the end of 2018, leaving it well positioned to benefit from firmer oil prices and higher production in 2019, where oil output is expected to reach 100,000 barrels daily. That should see MEG experience a significant lift in profitability and earnings.



**So what?**

The strength of MEG's operations coupled with higher oil, growing production, falling costs and a stronger balance sheet leave the company well positioned to unlock value for investors. It isn't difficult to see MEG doubling in value once the market is convinced that higher oil is here to stay.

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