This Energy Producer Has Soared 61% and It's Still Cheap

Description

It hasn't been a great year for the oil & gas industry. The widening gap between heavy crude, or Western Canadian Select (WCS), and West Texas Intermediate (WTI), the North American benchmark, has had devastating consequences.

Oil majors have been forced to cut production and the government of Alberta even stepped in to regulate a mandatory 8.7% cut in production effective January 1, 2019. The end result has been significant share price depreciation. Year to date, Canada's **Oil & Gas Index** is down almost 17%.

If you look hard enough however, there are some real gems in Canada's oil & gas sector. Last week, I introduced you to **Gibson Energy**. This week, I present to you **MEG Energy** (TSX:MEG), one of the best-performing producers.

Hostile bid from Husky Energy

MEG and Husky Energy entered into negotiations for a potential merger back in May. At the time, the two energy producers did not come to a deal. Then in early August, Husky took things into their own hands. It offered $11.00 per share for MEG — an offer the Board felt materially undervalued the company and had quickly rejected.

In late September, the company took its offer directly to shareholders. The bid as it stands represents a 30% increase over today's share price, which isn't a bad premium. The merger activity has kept the company's share price from suffering a significant price drop amidst the recent macro environment.

Growing cash flows

One of the secrets to MEG's success is that it's a low cost producer. The company's operating costs per barrel came in at a record low $4.34 per barrel, marking the eighth consecutive quarter of lower costs per barrel. In 2019, the company is expecting to generate significant cash flows.

As it ramps up production, MEG expects to achieve a cash flow yield between 30 and 55% by 2022. This is up from 2019's yield, which is expected to be in the single digits.

Likewise, the company has fared well despite the WCS differential, doubling crude by rail shipments and MEG's diversified strategy enabled it to realize an average bitumen price of $49.58 per barrel in the third quarter.

Growth potential

MEG is currently trading at price-to-book and price-to-sales ratios below one. The company is expected to grow earnings by double-digits in 2019 on the back of increased production from its Christina Lake property. Likewise, the company is waiting on regulatory approval on its Surmont and May River project, which are expected to add an additional 287,000 bopd to the company's production.

The company is targeting a long-term growth rate of 8% over the next decade. Analysts have an average one-year price target of $10.96, which is right inline with Husky's bid.

Foolish takeaway

MEG is a low cost producer that's poised to benefit in a big way once Canada's pipeline glut is resolved. In the meantime, the company's status as a low cost producer is enabling it to navigate these tough times better than most. Its Christina Lake project is a high-quality asset and MEG has two new projects that will support growth for years to come.

It's worth noting that if the Husky deal falls through, MEG's share price may be subject to a price drop. In the meantime, the offer is propping up the company's share price.

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