
# MEG Energy Corp (TSX:MEG) Can Double its Free Cash Flow if This Happens

## Description

**MEG Energy** (TSX:MEG) has fallen by roughly 80% over the past five years. Judging by the company's operating record, it's not hard to see why.

From 2014 through 2017, MEG Energy lost a cumulative $1 billion, or 60% of its current market cap. While management has been promoting its $90.4 million profit last quarter, that came off the heels of a $138.3 million *loss* the quarter before.



Unsurprisingly, the company has had to plug its losses with share dilution. Since 2014, its share count has increased by 75 million shares, or around 33%. Most of this dilution occurred during historically low prices, meaning shareholders have had to bear the brunt of MEG Energy's financial mismanagement.

You may be surprised to learn that the company's management team believes it can produce around $800 million in excess cash this year, which it calculates by combining free cash flow with its year-end cash on hand. By 2023, the company anticipates this figure to double to around $1.6 billion.

With a current market cap of exactly $1.6 billion, shares would have massive upside of management's targets are achieved. How can MEG Energy hit these targets, and should you trust their lofty expectations?

## Understand these numbers

In its forecast, MEG Energy assumes production of around 100,000 barrels per day. Management ran a sensitivity analysis to forecast what its excess cash flow would be at various selling prices. Notably, it used three prices: US$50 per barrel, US$60 per barrel, and US$70 per barrel.

These assumptions are notable for two reasons.

First, current oil prices are around US$60 per barrel, making US$50 and US$70 price marks seem like reasonable upper and lower bounds. But historically, these are aggressive prices. From the start of 2015 through the end of 2017 — a three-year period — oil prices averaged *under* US$50 per barrel.

Only the last 12-18 months have brought prices within the US$50-70 range.

Assuming US$50 per barrel prices — roughly the average selling price over the past five years — MEG Energy would produce just $300 million in excess cash this year — a far cry from its aggressive $800 million forecast. By 2023, excess cash would amount to $700 million versus its more bullish target of $1.6 billion.

Second, it's not clear that MEG Energy can even fetch the average selling price of other North American oil companies due to its exposure to lower quality Canadian oil. In late 2018, U.S. oil producers were fetching prices of US$50 per barrel or more, while West Canadian Sweet prices tumbled to as low as $20 per barrel. As I wrote in January, "Surging regional production hit transportation bottlenecks, forcing producers to bid aggressively against each other to move its output."

In an emergency move, the Albertan government mandated 8.7% production cuts across the board. While this corrected some of the discount, it's clear that companies are still reeling from the impact. For example, 35% MEG Energy's Edmonton exposure for 2019 is hedged at a price of just US$43.80 per barrel — well below its financial forecast.

## Buy this stock for one reason



In summary, don't trust management's forecast, which calls for a massive cash flow ramp. Many things need to go right for this to happen, most of which are outside the company's control.

Today, you should only buy MEG Energy shares if you're a massive oil bull. If that's the case, you should be able to profit buying nearly any oil stock. MEG Energy is just one way to play that thesis.

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