Why MEG Energy (TSX:MEG) Stock Lost 16% in September

Description

While crude oil has again started to march towards triple-digit levels, TSX energy stocks seem ready to soar higher, too. The recent rally is much along the expected lines after months-long weakness. One of the top gainer TSX stocks, MEG Energy (TSX:MEG), lost 16% last month, in line with its peers. Moreover, it looks well placed to outperform in the next few months.

Why oil and gas stocks fell in September

Crude oil prices have declined for months and lost 30% since June. Since energy producers' earnings are directly impacted by oil and gas prices, they were also weak.

Driven by aggressive interest rate hikes and record-high inflation, there is a strong possibility that we might see a more severe global recession soon. A long-lasting economic downturn significantly dents energy demand—a potential bear signal for crude oil prices. As a result, oil and gas prices were weak for months.

At the same time, there has also been strong rhetoric that energy demand will not be hampered much, even in the case of a severe recession. However, this view seems to have been overlooked by energy market participants.

Fundamentally, there is concern about the supply-demand imbalance at the moment in the global energy markets, which suggests higher crude prices. Higher oil prices mean more free cash flow growth for energy companies and higher shareholder returns.

Despite a steep correction, MEG Energy stock is still sitting on handsome gains of 90% since last year. The stock could gain momentum, given its appealing valuation, solid earnings growth prospects, and buybacks.

Should you buy MEG Energy stock?

MEG Energy produces thermal oil and intends to produce approximately 95,500 barrels of oil per day this year. Its key asset, the Christina Lake project, holds high-quality, low-decline reserves. A strong production growth outlook in a high-price environment suggests solid earnings growth and margin expansion for MEG, at least for the next few quarters.

In the first half of 2022, MEG Energy reported free cash flows of $736 million, representing jaw-dropping growth of 1,300% year over year. Such windfall cash has made way primarily for debt repayments and share repurchases. As a result, the balance sheet has significantly improved, making MEG a less risky investment than it once was.

On the valuations front, MEG stock is trading at an enterprise value-to-cash flow ratio of 2.6x. This is in line with TSX energy stocks. MEG has created massive wealth for shareholders, returning almost 1,000% since the pandemic. Given the company's fundamental strength and fair valuation, it could continue to generate considerable shareholder value.

Valuation

Even though energy stocks have been falling for months, this seems the time when things will reverse. Higher oil prices could push energy stocks closer to their previous highs. Given the relatively appealing valuation and aggressive ongoing buybacks, MEG Energy stock could outperform for the next few quarters.

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