Can MEG Energy Stock Double in 2023 Like Last Year?

Description

Canadian small- and mid-cap energy space has been more appealing than their larger counterparts. This has been proven in their market performances since the pandemic. One such name, **MEG Energy** (TSX:MEG) stock, doubled in the first half of 2022, notably beating its peers. It lost steam in the second half of last year, as the entire sector was on the downtrend amid weaker oil prices. MEG Energy stock soared 50% in 2022 and 1,000% since the pandemic.

What's so special about MEG Energy?

MEG Energy is a $6 billion crude oil producer with some of the longest reserve life index of around 55 years. In layman's terms, it would take 55 years to exhaust its reserves with its current daily production pace. It is one of the few energy producers with unhedged production profiles in 2023. So, it will have a full upside to the rising crude oil prices. But at the same time, this also exposes it to the potential lower oil prices, even if that currently seems like a remote possibility. For 2023, it aims to produce 100,000 barrels of oil per day.

It wasn't just MEG Energy; the entire energy sector saw stellar financial growth last year amid high oil prices. A large chunk of that cash went to debt repayments, notably strengthening the balance sheets. As a result, the energy sector as a whole has achieved much better financial shape since the pandemic.

MEG Energy: Financial growth and balance sheet

MEG Energy reported free cash flows of $1.23 billion in the first nine months of 2022, nearly three times higher than in 2021. Interestingly, almost a billion dollars of them went to debt repayments. So, at the end of Q3 2022, MEG had net debt of $1.4 billion, almost half of what it had in 2020.

As the debt has come down significantly, its interest expense will also fall, notably improving the company's profits. It also makes it less vulnerable to rapidly increasing interest rates.

Note that MEG had enough cash flow for shareholder returns after aggressive debt repayments last year. So, it bought back 20.6 million shares last year, worth $380 million. Share repurchases are expected to continue this year as well, with attractive free cash flows. This will likely drive MEG stock higher in the short term. While dividend payments are a preferred route by investors, buybacks provide more flexibility to the company management.

Valuation and conclusion

MEG stock is currently trading at a 2023 free cash flow yield of 15% and looks attractive. That's largely in line with the industry average. As oil prices rally, it will likely boost the financials of these energy companies. Its strengthening balance sheet makes MEG a more appealing bet.

So, based on MEG's free cash flow growth potential and appealing valuation, the stock will likely outperform in 2023. Doubling from here looks like a steep target for MEG now. However, Last year's steep fall in MEG was also a result of a widened differential between Western Canadian Select and West Texas Intermediate oil prices. As the differential will relatively narrow this year and as oil prices turn higher, MEG will likely create meaningful value like last year.

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