Company Name: MEG Energy Corp
Company Ticker: MEG CN
Date: 2017-05-11
Event Description: Q1 2017 Earnings Call

Market Cap: 1,762.63
Current PX: 6.01
YTD Change($): -3.22
YTD Change(%): -34.886

Bloomberg Estimates - EPS
Current Quarter: -0.162
Current Year: -0.593
Bloomberg Estimates - Sales
Current Quarter: 496.000
Current Year: 2176.167

Q1 2017 Earnings Call

Company Participants

- John M. Rogers
- William J. McCaffrey
- Eric L. Toews

Other Participants

- Greg Pardy
- Dan Healing
- Nia Williams
- Benny Wong
- Jeff Lewis

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to MEG Energy Corp. Q1 Results Conference Call. Please be advised that this call is being recorded.

I would now like to turn the meeting over to John Rogers, VP Investor Relations and External Communications. Please go ahead, Mr. Rogers.

John M. Rogers

Thanks, Elena, and good morning, everyone, and welcome to our first quarter conference call. For our conversation today, we have with us our CEO, Bill McCaffrey; and our CFO, Eric Toews. To start off, Bill will discuss our vision and priorities for 2019 supported by the financial transactions we announced back in January. Eric will review our results for the first quarter of 2017.

I'll remind you that today's call contains forward-looking information. Please refer to our quarterly report and other documents on SEDAR and our website for further information.

And, with that, I'll turn it over to Bill.

William J. McCaffrey

Thanks, John, and good morning, everyone. As we look back at our first quarter results, I'd like to put them into context with our goals and objectives through 2019. Over the next two years, we will implement our proprietary eMSAGP technology on our Phase 2B assets, which will begin to increase our production in the third quarter and add an incremental 20,000 barrels per day over our current production base by 2019. We plan to complement this eMSAGP growth with the brownfield expansion on Phase 2B, which will add an incremental 13,000 barrels a day. And in 2020, we expect our production to reach 113,000 barrels a day, which is 40% higher than our current levels. With our eMSAGP implementation underway in the first quarter of 2017, we have now commenced the first step of this journey.

Our objectives for 2017 are as follows. We will continue the strong production performance demonstrated by our operations to-date while working towards further efficiency improvement. We will execute on our highly economic growth projects. These projects will significantly increase production, decrease our steam-oil ratio, further reduce costs, improve sustainability of the business, and move the company towards a more normalized balance sheet. Our third objective is to maintain the strength of our financial liquidity.

So, let's take a moment to discuss the first quarter. Production for the first quarter of 2017 was higher than our production for the same period last year. It was also within the range we set for the quarter of 77,000 barrels a day to 79,000 barrels a day. Q1 was the first quarter since reinitiating our growth and we've been very pleased with the drilling results that have been seen to-date.

Our focus so far has been on infill wells. In Q1, we drilled 14 of the total 39 infill wells planned for 2017. We also plan to drill up to 28 SAGD well pairs this year, which will be brought on stream in the latter part of 2017 and into 2018. Now, these well pairs enable us to take advantage of the freed-up steam associated with the efficiency gains from the eMSAGP process.

As anticipated, the infill drilling program resulted in adjacent SAGD well pairs being temporarily shut in and correspondingly lowered production in the first quarter of 2017 compared to the fourth quarter of 2016.

With our drilling now underway, we've set the stage for our growth program to begin yielding benefits. As wells are tied in, we will begin seeing an increase in our production rates, which will commence in the third quarter. We remain on track to meet our annual production guidance of 80,000 barrels a day to 82,000 barrels a day and to exit the year producing 86,000 barrels a day to 89,000 barrels a day.

At the end of the first quarter, we had CAD 549 million of cash in the bank, which is significant, given how far we have progressed with our growth initiatives. Additionally, in the first quarter, we completed a comprehensive refinancing, which positioned us well to continue to strengthen our balance sheet.

Our first outstanding debt is not due until 2023, and we maintain a strong liquidity position. Along with our cash on hand, this provides MEG with significant liquidity as we move forward on our journey to 113,000 barrels per day and beyond. And we're well positioned with respect to the three corporate priorities I set out at the beginning of my comments.

With that, I'll turn it over to Eric.

Eric L. Toews

Thanks, Bill, and good morning, everyone. As John indicated, I'll start with our financial performance over the past quarter.

A combination of technological advancements and an absolute focus on cost control has enabled us to reduce our per-barrel non-energy operating costs by 50% since 2011 and 35% since 2014 to CAD 5.20 per barrel in the first quarter, well within our guidance of CAD 4.75 to CAD 5.75 per barrel. We also achieved net operating cost of CAD 8.43 per barrel in the first quarter. With WTI prices averaging $51.91 per barrel, we were able to generate adjusted funds flow of CAD 43 million in the first quarter.

Let me take a moment to talk about MEG's financial position. The company undertook capital investments of CAD 78 million during the first quarter of 2017. Our cash balance of CAD 549 million and projected 2017 cash flow is expected to fund the remainder of our 2017 capital budget of approximately CAD 510 million. Our $1.4 billion five-year covenant-lite revolver remains undrawn.

We continue to apply our hedging strategy, which is focused on protecting our capital program against downward oil price movements and helping us mitigate the volatility we are seeing in the marketplace. We have hedges in place for approximately half of our blend sales for the rest of the year. We have also hedged more than 40% of our condensate purchases through the remainder of 2017.

We're targeting production for the second quarter of 69,000 barrels per day to 73,000 barrels per day due to our 35-day major maintenance turnaround planned at Phase 2. As Bill mentioned earlier, we remain on track to meet our annual production guidance.

With that, I'll pass it back to Bill.

William J. McCaffrey

Thanks, Eric. So, to conclude, I'd like to highlight the significant changes which have taken place in our business. As mentioned, the debt restructuring and the capital raise have enabled the execution of a very visible path for MEG to 113,000 barrels a day. This has been made possible by the success of our proprietary eMSAGP technology. And I'd like to quickly list the benefits of this proven technology that is transforming our company.

First, along with our brownfield expansions, eMSAGP is enabling us to lower our capital cost by 25% to 50%, with further opportunities for savings still ahead. Our prior greenfield costs were over CAD 41,000 per flowing barrel. Our future cost at Christina Lake will average between CAD 20,000 and CAD 30,000 per flowing barrel.

Second, eMSAGP is allowing us to reduce our development times for projects to 12 to 18 months from the three to four years we would have had to spend when we're constructing greenfield projects.

Third, when we spread our fixed costs over the incremental barrels from our eMSAGP and brownfield expansion, we will reduce our overall corporate cash costs by CAD 6 to CAD 7 a barrel.

Fourth, on the production that we have applied eMSAGP to, we have cut the steam-oil ratios in half and reduced our energy costs and greenhouse gas intensities. Our overall net GHG emission intensities are currently 22% below the industry average and has potential to be reduced even further as we continue to expand eMSAGP.

Lastly, the returns on the first two expansions are exceptional, ranging between 30% and 40% at $55 WTI and approximately 20% to 30% at $45 WTI.

As these expansions are rolled out, the benefits will be very apparent. Starting in the third quarter, we expect to begin seeing production increases and a corresponding decrease in our cost per barrel and steam-oil ratio over time. And we expect to see production continue to go up and our cost per barrel and steam-oil ratios to keep going down as we further our growth.

After we've reached 113,000 barrels a day in 2020 with a 12% compound annual growth rate, we envision a business that can continue to reduce cost and be even more sustainable and resilient to commodity price swings. We plan to follow the first two expansions with a series of high-return short-cycle projects that can take us all the way to our current regulatory approved limit of 210,000 barrels per day. Now, our teams put a lot of work into the planning and development of the strategy. Our focus now is on its continued implementation as we create value for our shareholders.

And, with that, I'll turn it back to John.

John M. Rogers

Thank you, Bill and Eric, for your comments on the quarter. What we'll do now is open up the – all lines to questions. So, Elena, if you want to see the callers and I will mention again that if you can keep your questions at the strategic level. Helen and I will be around later on to answer your specific modeling questions. So, Elena, if we can go ahead?

Q&A

Operator

Thank you. [Operator Instructions] The first question is from Greg Pardy with RBC Capital Markets. Please go ahead.

<Q - Greg Pardy>: Thanks. Good morning. Bill, could you elaborate a little bit on what the 13,000 barrel a day expansion will entail?

<A - William J. McCaffrey>: Sure, Greg. No problem. It involves just adding additional steam to the existing plant. So it is a – what we see happening over time is that as we grow our volumes, we'll look for where the next bottleneck would be. We don't have to do that on the first eMSAGP because what we're doing is freeing up steam that we can redeploy to new wells. So the second part will be adding additional steam that can be deployed to additional wells beyond that.

<Q - Greg Pardy>: Okay. Great. And then just you're spending obviously limited in the first quarter as you're gearing up to do things, but could you give us just an idea of what the shape of the program will be for the balance of 2017? And is it possible that you'll under-spend the CAD 590 million?

<A - William J. McCaffrey>: Sure. Yeah. As a general description of the capital spend [indiscernible] (12:37) start off drill – so we're drilling with three rigs right now. As that continues, we get into continued drilling as well as the actual tie-in of those wells so that that has an increase at that time of the spend of capital.

To look at our total budget in perspective, I would say we're very, very pleased with the success of the drilling to-date and that we are seeing efficiency gains and cost savings in the drilling program. And we believe that will continue throughout the year. This time, we're not revising anything. We're comfortable with our budget, but we are very comfortable where we sit.

<Q - Greg Pardy>: Okay. Great. Thanks very much.

<A - John M. Rogers>: Thanks, Greg.

Operator

Thank you. The next question is from Dan Healing with The Canadian Press. Please go ahead.

<Q - Dan Healing>: Good morning. Thanks for taking my question. I just had a question about transportation marketing in view of the election results from BC, which could possibly create a barrier to building a Trans Mountain Expansion. Is this going to affect MEG particularly and do you think that it could result in more use of, say, crude by rail?

<A - William J. McCaffrey>: Thanks, Dan. Well, MEG has a very diversified strategy on the marketing and so no particular market [ph] with Access (14:06) would hurt MEG because of its diversification. Our largest volumes currently go to the Gulf Coast and PADD II. We do have barrels available to go out to the West Coast in the event that TMX gets built. I don't want to comment on the election results or anything, but it's not a major impact on our performance or anything.

<Q - Dan Healing>: Do you think that the federal government should step in and make clear that TMX is going to be built?

<A - William J. McCaffrey>: I think that's going to be a question for the government to decide. I can't. Canadian government has to decide its position on if they've approved it. And so there will be very important questions that they have to ask themselves, but I don't want to form an opinion on their behalf.

<Q - Dan Healing>: Okay. Thank you.

Operator

Thank you. The next question is from Nia Williams with Reuters. Please go ahead.

<Q - Nia Williams>: Hi, there. I just want to ask about the additional phases of Christina Lake. When are you likely to make investment decisions on those? And sort of up to what capacity have you made final investment decision so far?

<A - William J. McCaffrey>: Thank you. Yeah. What we do is that we have a series of expansions. The guidance we've given is that they'll be in the 20,000 to 30,000 barrel a day on a flowing barrel basis as we go forward. We are mapping out those future ones. The general comment I could make is that the future phases are very well-delineated, giving us a high comfort on the resource quality in those areas and that they would be very similar in scope and nature to the brownfield expansion that we're doing. So, we think of them as a little bit more of the same.

We sanction them one at a time. And so, right now, we have sanctioned the first one, which is the eMSAGP component. But we've also done a lot of the work and engineering is complete on the second one. And we just keep going down the line as a continuum as we go forward towards our regulatory approved 210,000 barrels a day.

<Q - Nia Williams>: Okay. Thanks. And is there a certain oil price at which these expansions will break even with a good return on capital? Do you have any price in mind?

<A - Eric L. Toews>: The way we look at it, I think the two ex project that Bill referenced with a range of return – it's Eric Toews speaking – range of returns on two ex is somewhat representative of how we see the rest of the phases. So, from an oil price perspective, we don't see in the future an oil price where we'd be hindered in moving forward. But it will depend on the ultimate decisions that we make around capital budgets at the time that they come out.

<A - William J. McCaffrey>: Yeah. And I would add to that that we mentioned that even at $45, these are very economic. And so, Eric's comment is very good that we feel comfortable with the price range that we think.

<Q - Nia Williams>: Okay. Thanks.

Operator

Thank you. [Operator Instructions] The next question is from Benny Wong with Morgan Stanley. Please go ahead.

<Q - Benny Wong>: Hey. Good morning, guys. Apologies if you've already addressed this question as I missed the beginning of the call. You mentioned in your press release thinking about moving forward – anticipating moving forward with the brownfield expansion in 2018 budget. Anything else in 2018 that you guys are thinking about on a preliminary basis that you guys might look at maybe in terms of spend on technology side or marketing or any levers or guidelines you guys are kind of looking at in terms of crude prices or whatever in terms of how you guys are thinking about that budget?

<A - William J. McCaffrey>: Sure. Well, 2018 budget is actually done in December, so it is a ways away for us to comment too much on it. But [ph] one (18:22) comment I would put is that we are very much focused on the implementation execution of the eMSAGP at this point as well as positioning up the brownfield expansion. And so, that will be the most meaningful focus of any capital investments for 2018.

<Q - Benny Wong>: Got it. Okay. Thanks. And just wanted to get a sense of do you have an outlook or you'd share or what your views on where heavy oil differentials are now even before this recent outage. I understand crude differentials were relatively tight before. Do you see this dynamic persisting with OPEC cuts or how are you thinking about that?

<A - William J. McCaffrey>: Yeah. We think on a general statement that we would probably see tight differentials in the second quarter and probably returning to more normal differentials in the remainder of the year. But I will say that OPEC has been reducing its production and it is reducing its heavier barrels and that's reducing the amount of barrels available to the Gulf Coast. And so, I see that as something that we'll continue and with declines in Venezuela and Mexico, I think it does position the Canadian heavy barrel very well if you can get access to the Gulf and makes well positioned with that access.

<Q - Benny Wong>: Great. And I've just got a final question. How are you thinking about Surmont these days and how are they going to fit in with your longer-term plans? And I'll leave it there. Thanks.

<A - William J. McCaffrey>: Okay. Thanks. We're still in the regulatory process with the Surmont Project. We do see with our development plans at Christina Lake, those will continue with that series. Later on in time, we do see significant free cash flow in that area and I think that complements the development of Surmont very well. Our focus right now, though, is and will continue to be on Christina Lake.

<A - John M. Rogers>: Thanks, Benny.

Operator

Thank you. The next question is from Jeff Lewis with The Globe & Mail. Please go ahead.

<Q - Jeff Lewis>: Hi. Thanks for taking my question. Bill, can you just clarify how much space you recently took on the Trans Mountain Pipeline and what that brings your commitment to in total?

<A - William J. McCaffrey>: Yeah. Thanks, Jeff. We haven't actually released that number. It's not large relative to the rest of what we're doing on the Gulf from that, but it's a little commercially sensitive at this time, so I prefer not to say. I will say, though, that it's not meaningful in our portfolio.

<Q - Jeff Lewis>: Okay. Thanks.

<A - William J. McCaffrey>: Yeah.

Operator

Thank you. The next question is from [ph] Sheila Tobin with Bloomberg 365 (21:39). Please go ahead.

<Q>: Hi. Good morning. This is [ph] Sheila (21:44). So I just wanted to drill back to the information that was provided on the second quarter maintenance. I'm trying to get a little more detail from this. This is on Christina Lake, I take it. And can you say when it will start and end? And had it started actually? And do you have any other plans – do you have maintenance plans for the Surmont site as well? Thank you.

<A - William J. McCaffrey>: Sure. Thanks. Well, Surmont, first of all, is not under development yet. So, that would not have any maintenance. Now on Christina Lake, this year, we have maintenance programs to do on our Phase 2B, which has already been done, and Phase 1 and 2, which is currently underway. On our Phase 2B, that went very well and there were no surprises in the turnaround. And then on Phases 1 and 2, that's currently underway right now. And at this stage, we haven't seen anything meaningful – any meaningful surprises. And I'd like to make sure it's clear that these are planned maintenance programs just to ensure that we maintain our equipment over time.

<Q>: Okay. And I do have one other question. Is this on pricing, like – I know the other caller had asked about pricing for Canadian heavy crudes. Do you have any targets for where you see it like WCS differentials trending towards the end of the year in light of OpEx, all their cuts and so on and so forth?

<A - William J. McCaffrey>: Well, yeah, as I mentioned earlier that we see them narrow in this next quarter and then returning to normal in the second half of this year. That would be related to the PADD II area. We do see if [indiscernible] (23:44) continues with its program of restricting supply, we do believe that that would continue to be the heavier barrel and that will keep the differentials and the pricing – differentials narrow and the pricing strong at the Gulf Coast. And that is a target that we are focused on right now.

<Q>: Did you have any figures, like where you see it going, like where do you see it trading from – like, at the end of the year what kind of pricing that you're seeing?

<A - William J. McCaffrey>: No, that's going to be based on the supply and demand at the time. So I do think that we will see narrow differentials at the Gulf. We're seeing it now. But that's all a function of what OPEC decides to do in the second half of the year and they obviously haven't announced their plans yet.

<Q>: Okay. Thank you so much. I appreciate it.

<A - William J. McCaffrey>: Thank you.

Operator

Thank you. The next question is from [ph] Jacob Egmelinski (24:50) with Morgan Stanley. Please go ahead.

<Q>: Hey, guys. Thanks for taking the question. With the terming out of the portion of your revolver and refinancing of your term loan, is the balance sheet where you want it to be now or is there more you'd like to do on that front?

<A - William J. McCaffrey>: Well, no. The refinancing was very helpful. It extended the life, so the first outstanding debt is not due till 2023. It did allow us to do a couple things. It allowed us to commence because there was an equity raise, which has allowed us to commence our growth plan, which will deleverage our balance sheet to growth over the next few years, and we talked a little bit about that in the script there.

And then the other thing is we do remained focused on absolute debt reduction. And in this area, what we do is we want to make sure anything that we would look at in terms of absolute debt reduction actually takes a look at the meaningfulness of an absolute debt reduction coupled with the impact that that would have on the long-term impact of our business.

So, both are a focus. It's the deleveraging organically through the growth and assessing and looking for opportunities that would make sense to our shareholders in the long run to reduce the absolute amount of debt.

<Q>: Just in terms of reducing the absolute amount of debt, obviously, for the growth of EBITDA, you're naturally deleveraging. But from an absolute perspective, any potential thoughts around accelerating that through – I don't know if you have any baskets for open market repurchases or anything of that sort.

<A - William J. McCaffrey>: Well, we look at a number of options when we're doing that and so, again, we just want to make sure that whatever option we do execute on, if it makes sense to execute on one, we would do that with the idea of striking that right balance between the proceeds and the long-term impact.

<Q>: Sorry. Can you just – when you say the long-term impact, do you just mean capital allocation between buybacks and investment in that growth CapEx?

<A - William J. McCaffrey>: Well, it depends really what the option is that you would look at. You have to – anytime you make a decision, if it was the sale of an asset or some other thing, you have to look at the outcome in the long term. One part of it is you would look at the amount of debt you could retire if you were on the subject of asset [indiscernible] (27:38). But that you have to look at any outcome or consequence that would be associated with that as it related to your balance sheet. If you're talking about buybacks, right now, we're more focused on deleveraging organically than that. But we don't rule out opportunities. We're very opportunistic and focused. And if there was something that made sense, then we look [ph] at it (28:01).

<Q>: Great. That's very helpful. Thank you very much.

<A - William J. McCaffrey>: Thanks.

Operator

Thank you. The next question is a follow-up question from Benny Wong with Morgan Stanley. Please go ahead.

<**Q - Benny Wong**>: Hey, guys. Sorry about that. Just had one more follow-up. Just want to see if we can get an update in terms of how you're thinking about asset divestitures and how you guys are thinking about potential selling of your Access interest and if [ph] GOR (28:27) makes sense in terms of your strategic plan. Thanks.

<**A - William J. McCaffrey**>: Yeah. Thanks, Benny. Well, consistent with what I was just mentioning there, in addition to the deleveraging through the growth, as I mentioned, absolute debt reduction does remain a focus. Certainly, Access or [ph] GOR (28:48) or those types of things are options that can make sense. But, again, you have to weigh the impact of the reduced leverage versus the effect that any one of those would have on the long-term impact to your business. So, we do look at those types of things. Those are two examples of the things that we do look at. And we are actively thinking through that part of the business.

<**Q - Benny Wong**>: Great. Thanks, guys.

<**A - William J. McCaffrey**>: Yeah.

Operator

Thank you. There are no further questions registered at this time. I would like to turn the meeting back over to Mr. Rogers.

John M. Rogers

Great. Thanks, Elena, and thanks, everyone, for listening into our first quarter conference call. Again, if there's any follow-up questions, Helen and I will be around after the call. Other than that, everybody, have a good day. Thank you. Bye.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time and we thank you for your participation.