2019

Press Release | MEG ENERGY

MEG Energy reports strong adjusted funds flow in first quarter 2019

All financial figures in Canadian dollars ($ or C$) unless otherwise noted

CALGARY, ALBERTA (May 6, 2019) – MEG Energy Corp. ("MEG") reported its first quarter 2019 operational and financial results. Highlights include:

- Bitumen production volumes of 87,113 barrels per day (bbls/d) at a steam-oil-ratio (SOR) of 2.2, reflecting continued Alberta-wide mandated curtailments on MEG's production capacity of 100,000 bbls/d;
- Delivery of 31% of sales volumes to the U.S. Gulf Coast ("USGC") market where, net of transportation costs, realized pricing represents a US$3 premium to those sold in Western Canada;
- Average Access Western Blend ("AWB") sales price of $59.02 (US$44.40) per barrel, representing a US$1.79 per barrel premium to the Western Canadian Select benchmark in Hardisty and a 56% improvement from the prior quarter;
- Bitumen realization of $50.21 per barrel is the highest achieved in the last four years;
- Net operating costs of $6.17 per barrel, including non-energy operating costs of $5.22 per barrel;
- General and administrative ("G&A") expense of $2.27 per barrel of production in the quarter continue to decline, reflecting reduced staffing levels and increased focus on cost structure. 2019 G&A expense is anticipated to average $1.95 - $2.05 per barrel;
- Adjusted funds flow of $151 million ($0.50 per share), compared to negative adjusted funds flow of $38 million in the fourth quarter of 2018, largely due to the significant narrowing of light to heavy differentials in the Corporation's North American markets;
- Total cash capital investment of $53 million, primarily consisting of sustaining and maintenance capital; and
- Strong free cash flow of $98 million in the first quarter of 2019 with cash and cash equivalents on the balance sheet of $154 million on March 31, 2019.

"MEG generated approximately $100 million of free cash flow during the first quarter of 2019 as realized pricing improved from the fourth quarter of 2018. Our diversified marketing strategy with growing access to world-priced markets, along with disciplined cost management and low levels of sustaining capital, supports material free cash flow generation going forward," says Derek Evans, President and Chief Executive Officer. "The strengthening of our balance sheet remains a top priority. Based on current strip pricing, we expect our net debt to EBITDA to be in the range of 2.75x to 3.00x by the end of 2019."

Bitumen production averaged 87,113 bbls/d in the first quarter of 2019, 7% lower than the same period in 2018 due to the Alberta Government's mandated production curtailment program which came into effect January 1, 2019. Bitumen sales of 89,822 bbls/d exceeded production during the first quarter, as MEG took advantage of stronger pricing to draw down on its inventory in storage.

First quarter 2019 per barrel non-energy operating costs of $5.22 and net operating costs of $6.17 compares to first quarter 2018 per barrel non-energy and net operating costs of $4.55 and $5.98 respectively. First quarter 2019 per barrel costs were impacted by lower production volumes and a higher portion of staff costs ascribed to operations, primarily as a result of lower levels of capital spending. Energy operating costs of $3.36 per barrel in the first quarter of 2019 reflect higher natural gas prices, compared to $2.64 per barrel for the same period in 2018.

G&A expense of $2.27 per barrel of production in the first quarter of 2019 represent a 12% reduction from the same period in 2018. To align with lower levels of capital spending and to further optimize operational efficiencies, MEG reduced its staffing levels in February 2019. While cost reductions are not fully reflected in the quarter, the Corporation anticipates G&A expense to average $1.95 - $2.05 per barrel in 2019.

Pricing and Market Access

MEG's AWB sales price averaged $59.02 (US$44.40) per barrel in the first quarter of 2019, compared to $37.76 (US$28.57) per barrel in the fourth quarter of 2018 as WTI:WCS differentials at Hardisty narrowed to US$12.29 from US$39.43 per barrel and WTI:AWB differentials in the Gulf Coast narrowed to US$0.89 from US$6.25 per barrel. Taking into account Enbridge's Mainline apportionment, MEG sold 31% of its sales volumes to the USGC market in the first quarter of 2019 compared to 25% during the same period in 2018, where MEG's AWB barrels receive premium pricing due to strong, continued demand for heavy oil.

During the first quarter of 2019, MEG's bitumen realization averaged $50.21 per barrel, compared to $15.31 per barrel in the fourth quarter of 2018 and $35.46 per barrel in the first quarter of 2018. The significant narrowing of the WTI:WCS differential positively impacted the blend sales price. In addition, the Corporation's cost of diluent during the first quarter of 2019 was lower than the same period in 2018 due to lower average condensate pricing.

Transportation costs averaged $11.27 (US$8.48) per barrel in the first quarter of 2019 compared to $5.99 (US$4.73) per barrel for the same period in 2018. The increase on a per barrel basis is primarily the result of incremental costs associated with the Transportation Service Agreement for the Access Pipeline put in place during March 2018, as well as additional costs related to increased volumes transported by rail.

MEG increased its rail volumes to 18,649 bbls/d in the first quarter of 2019, 46% of which were delivered to the USGC. Although WTI:WCS differentials at Hardisty tightened significantly during the quarter primarily due to Alberta curtailment, MEG continues to use rail as a mechanism to clear barrels due to continued high Enbridge Mainline apportionment which ran at 41% in the quarter and reduce exposure to the post-apportionment market. Delivered rail costs of US$23 per barrel during the quarter were impacted by fixed costs associated with the Corporation's currently underutilized capacity at the Bruderheim Terminal as well as one-time costs associated with the change out of its leased rail car fleet in the first and second quarters of 2019. MEG anticipates to fully utilize its 30,000 bbls/d of contracted capacity at Bruderheim by the third quarter of 2019, at which time the Corporation expects normalized delivered rail costs from Edmonton to the Gulf Coast in the range of US$17-19 per barrel on a go-forward basis.

"MEG's strategic access to the USGC continues to deliver strong realized pricing for our blended barrels. Net of transportation costs, our Gulf Coast barrels realized a US$3 premium to those sold in Western Canada, even as WCS differentials narrowed in Alberta," says Evans. "There is an increasingly favourable outlook for Canadian heavy crude demand at the USGC as traditional import sources remain challenged. MEG is well-positioned to significantly increase our exposure to this premium market with our growing commitment on Flanagan South/Seaway to 100,000 barrels per day mid-2020 and continuing access to rail capacity. Subject to Mainline apportionment, MEG has contracted egress capacity in place for up to 90 per cent of our production to high-value markets by the end of next year."

Capital Investment

Total cash capital investment in the first quarter of 2019 totaled $53 million relative to MEG's 2019 base capital budget of $200 million. Capital investment in the period was primarily directed towards sustaining and maintenance capital, in addition to advancing eMVAPEX and completing work already underway on the Phase 2B Brownfield expansion.

Adjusted Funds Flow and Net Earnings

MEG's cash operating netback averaged $29.80 per barrel in the first quarter of 2019, compared to $7.14 per barrel in fourth quarter of 2018 and $20.31 per barrel in first quarter of 2018. The strong netbacks in the quarter were primarily the result of the stronger realized blend sales prices, partially offset by higher transportation expenses.

Adjusted funds flow was impacted by the same primary factor as cash operating netback, resulting in realized adjusted funds flow of $151 million in the first quarter of 2019, compared to negative $38 million in the fourth quarter of 2018 and $83 million in the first quarter of 2018.

MEG recognized a net loss of $48 million in the first quarter of 2019, compared to net earnings of $141 million in the first quarter of 2018. Net loss in the first quarter of 2019 included a gain on asset disposition of $12 million related to the sale of earned Emission Performance Credits, a net foreign exchange gain of $78 million, and a loss on commodity risk management contracts of $230 million, comprised of $209 million of unrealized losses and $21 million of realized losses. Comparatively, net earnings in the first quarter of 2018 included a gain on asset dispositions of $318 million related to the sale of MEG's 50% interest in the Access Pipeline, a net foreign exchange loss of $108 million, and a loss on commodity risk management contracts of $76 million, comprised of $58 million of unrealized losses and $18 million of realized losses.

Outlook

MEG reiterates its 2019 base capital investment plan of $200 million, designed to sustain production capability at 100,000 bbls/d and advance growth projects beyond 2019. While MEG has the ability to average 100,000 bbls/d of production, the current 2019 production guidance of 90,000 to 92,000 bbls/d reflects the impact of the Alberta Government's mandated production curtailment program, with the assumption that it eases throughout the year. To enhance the Corporation's profitability in the quarter given the current strong pricing environment, MEG has strategically purchased production credits from other upstream producers which chose to sell some of their allocations under the current Alberta-wide curtailment. Further, subject to market conditions, MEG will evaluate utilizing a portion of its previously announced discretionary capital spend of $75 million in the second half of 2019 to advance the highly economic Phase 2B expansion that will support production growth to 113,000 bbls/d, once facility and well capital has been fully invested.

MEG continues to progress the Board renewal process and will be announcing three new candidates, representing a broad range of skills and experience, to stand for election at the Corporation's upcoming annual general meeting in June 2019.

“The MEG of today is a very different company than the one in the recent past as we focus on what creates sustainable value in the current business environment. While debt reduction remains our number one priority, we continue to make significant progress towards other pressing objectives which I laid out earlier this year on capital discipline, cost reductions and Board renewal,” continues Evans. “Our proprietary technologies enable us to produce some of the lowest carbon-intensity barrels in the basin, and we are focused on maximizing the value for our products as we continue to diversify markets while maintaining cost discipline. With existing production capacity of 100,000 barrels per day, our projected free cash flow provides visibility for substantial debt reduction. As market access improves, we will thoughtfully deploy capital to initiatives that drive the most shareholder value while living within our means.”

Conference Call

A conference call will be held to review MEG’s first quarter 2019 operating and financial results at 7:30 a.m. Mountain Time (9:30 a.m. Eastern Time) on Tuesday, May 7, 2019. To participate, please dial the North American toll-free number 1-888-390-0546, or the international call number 1-587-880-2171.

A recording of the call will be available by 12 noon Mountain Time (2 p.m. Eastern Time) the same day at www.megenergy.com/investors/presentations-and-events.

Operational and Financial Highlights

	2019	2018				2017		
($ millions, except as indicated)	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**
Bitumen production - bbls/d	**87,113**	87,582	98,751	71,325	93,207	90,228	83,008	72,448
Bitumen sales - bbls/d	**89,822**	88,283	93,856	74,418	91,608	94,541	76,813	74,116
Bitumen realization - $/bbl	**50.21**	15.31	49.63	47.33	35.46	48.01	39.93	39.74
Net operating costs - $/bbl[1]	**6.17**	4.55	4.34	5.64	5.98	5.86	6.00	7.42
Non-energy operating costs - $/bbl	**5.22**	4.25	4.38	5.47	4.55	4.53	4.57	4.23
Cash operating netback - $/bbl[2]	**29.80**	7.14	24.01	18.66	20.31	33.54	26.88	23.04
Adjusted funds flow[3]	**151**	(38)	116	18	83	192	83	55
Per share, diluted[3]	**0.50**	(0.13)	0.39	0.06	0.28	0.65	0.28	0.19
Revenue[4]	**919**	520	803	689	721	755	576	584
Net earnings (loss)	**(48)**	(199)	118	(179)	141	(24)	84	104
Per share, basic	**(0.16)**	(0.67)	0.40	(0.61)	0.48	(0.08)	0.29	0.36
Per share, diluted	**(0.16)**	(0.67)	0.39	(0.61)	0.47	(0.08)	0.28	0.35
Total cash capital investment	**53**	144	145	183	148	163	103	158
Cash and cash equivalents	**154**	318	373	564	675	464	398	512
Long-term debt - C$	**3,660**	3,740	3,544	3,607	3,543	4,668	4,636	4,813
Long-term debt - US$	**2,740**	2,741	2,742	2,745	2,746	3,729	3,706	3,709

(1) *Net operating costs include energy and non-energy operating costs, reduced by power revenue.*

(2) *Cash operating netback is a non-GAAP measure and is calculated by deducting the related diluent expense, transportation, net operating costs, royalties and realized commodity risk management gains (losses) from petroleum revenue, net of purchased product, on a per barrel of bitumen sales volume basis.*

(3) *Adjusted funds flow and the related per share amounts are non-GAAP measures and do not have standardized meanings prescribed by IFRS and therefore may not be comparable to similar measures used by other companies. Adjusted funds flow is reconciled to net cash provided by (used in) operating activities and is discussed further under the heading "NON-GAAP MEASURES" in the "ADVISORY" section.*

(4) *The total of petroleum revenue, net of royalties and other revenue as presented on the consolidated statement of earnings and comprehensive income. Effective January 1, 2018, petroleum revenues are presented on a gross basis as they represent separate performance obligations, as discussed in the "NEW ACCOUNTING STANDARDS" section of the Corporation's Management's Discussion and Analysis. The comparative prior period amounts have been revised to reflect the new presentation.*

ADVISORY

Basis of Presentation

MEG prepares its financial statements in accordance with International Financial Reporting Standards ("IFRS") and presents financial results in Canadian dollars ($ or C$), which is the Corporation's functional currency.

Non-GAAP Measures

Certain financial measures in this news release including: funds flow from (used in) operations, adjusted funds flow, operating cash flow, cash operating netback, free cash flow and net debt to EBITDA are non-GAAP measures. These terms are not defined by IFRS and, therefore, may not be comparable to similar measures provided by other companies. These non-GAAP financial measures should not be considered in isolation or as an alternative for measures of performance prepared in accordance with IFRS.

Funds Flow From (Used in) Operations, Adjusted Funds Flow and Free Cash Flow

Funds flow from (used in) operations and adjusted funds flow are non-GAAP measures utilized by the Corporation to analyze operating performance and liquidity. Funds flow from (used in) operations excludes the net change in non-cash operating working capital while the IFRS measurement "net cash provided by (used in) operating activities" includes these items. Adjusted funds flow excludes the net change in non-cash operating working capital, realized gain on foreign exchange derivatives not considered part of ordinary continuing operating results, defense costs related to unsolicited bid, contract cancellation expense, net change in other liabilities, payments on onerous contracts and decommissioning expenditures, while the IFRS measurement "net cash provided by (used in) operating activities" includes these items. Funds flow from (used in) operations and adjusted funds flow are not intended to represent net cash provided by (used in) operating activities calculated in accordance with IFRS. Free cash flow is presented to assist management and investors in analyzing performance by the Corporation as a measure of the capacity of the business to repay debt, incur discretionary capital or increase returns to shareholders. Free cash flow is calculated as adjusted funds flow less total cash capital investment. Funds flow from (used in) operations, adjusted funds flow and free cash flow are reconciled to net cash provided by (used in) operating activities in the table below.

	Three months ended March 31	
($000)	2019	2018
Net cash provided by (used in) operating activities	**$(69,729)**	$118,026
Net change in non-cash operating working capital items	**220,287**	(8,136)
Funds flow from (used in) operations	**150,558**	109,890
Adjustments:		
Realized gain on foreign exchange derivatives[(1)]	**—**	(35,362)
Payments on onerous contracts	**—**	6,008
Decommissioning expenditures	**340**	2,621
Adjusted funds flow	**$150,898**	$83,157
Total cash capital investment	**($53,293)**	($147,739)
Free cash flow	**$97,605**	($64,582)

(1) A gain related to the settlement of forward currency contracts to manage the foreign exchange risk on Canadian dollar denominated proceeds related to the sale of assets designated for U.S. dollar denominated long-term debt repayment.

Operating Cash Flow and Cash Operating Netback

Operating cash flow is a non-GAAP measure widely used in the oil and gas industry as a supplemental measure of a company's efficiency and its ability to fund future capital investments. The Corporation's operating cash flow is calculated by deducting the related diluent expense, blend purchases, transportation, operating expenses, royalties and realized commodity risk management gains or losses from proprietary blend sales revenue and power revenue. The per-unit calculation of operating cash flow, defined as cash operating netback, is calculated by deducting the related diluent expense, blend purchases, transportation, operating expenses, royalties and realized commodity risk management gains or losses from proprietary blend revenue and power revenue, on a per barrel of bitumen sales volume basis.

Net Debt to EBITDA

Net Debt to EBITDA is a non-GAAP measure used to monitor the Corporation's capital structure and financial position. Net debt is calculated as current and long-term portions of long-term debt, net of cash and cash equivalents. EBITDA is defined as net earnings (loss) before net finance expense, income tax expense (recovery), depletion and depreciation, gain on asset dispositions, unrealized loss (gain) on commodity risk management, unrealized net loss (gain) on foreign exchange and stock-based compensation calculated on a trailing twelve-month basis. The ratio of Net Debt to EBITDA is used to measure the Corporation's financial strength.

Forward-Looking Information

Certain statements contained in this news release may constitute forward-looking statements within the meaning of applicable Canadian securities laws. These statements relate to future events or MEG's future performance. All statements other than statements of historical fact may be forward-looking statements. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe", "plan", "intend", "target", "potential" and similar expressions are intended to identify forward-looking statements. Forward-looking statements are often, but not always, identified by such words. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. In particular, and without limiting the foregoing, this press release contains forward looking statements with respect to our forecast base capital budget, allocation and funding, expected 2019 funds flow, free cash flow, adjusted funds flow, target production, non-energy operating costs, focus and strategy, market access and diversification plans.

Forward-looking information contained in this press release is based on management's expectations and assumptions regarding, among other things: future crude oil, bitumen blend, natural gas, electricity, condensate and other diluent prices, foreign exchange rates and interest rates; the recoverability of MEG's reserves and contingent resources; MEG's ability to produce and market production of bitumen blend successfully to customers; impact of the Alberta Government's mandatory production curtailment program; future growth, results of operations and production levels; future capital and other expenditures; revenues, expenses and cash flow; operating costs; reliability; anticipated reductions in operating costs as a result of optimization and scalability of certain operations; anticipated sources of funding for operations and capital investments; plans for and results of drilling activity; the regulatory framework governing royalties, land use, taxes and environmental matters, including the timing and level of government apportionment easing, in which MEG conducts and will conduct its business; and business prospects and opportunities. By its nature, such forward-looking information involves significant known and unknown risks and uncertainties, which could cause actual results to differ materially from those anticipated.

These risks include, but are not limited to: risks associated with the oil and gas industry, for example, the securing of adequate access to markets and transportation infrastructure; the availability of capacity on the electricity transmission grid; the uncertainty of reserve and resource estimates; the uncertainty of estimates and projections relating to production, costs and revenues; health, safety and environmental risks; risks of legislative and regulatory changes to, amongst other things, tax, land use, royalty and environmental laws and curtailment of production; assumptions regarding and the volatility of commodity prices, interest rates and foreign exchange rates, and, risks and uncertainties related to commodity price, interest rate and foreign exchange rate swap contracts and/or derivative financial instruments that MEG may enter into from time to time to manage its risk related to such prices and rates; risks and uncertainties associated with securing and maintaining the necessary regulatory approvals and financing to proceed with MEG's future phases and the expansion and/or operation of MEG's projects; risks and uncertainties related to the timing of completion, commissioning, and start-up, of MEG's turnarounds, and of future phases, expansions and projects; the operational risks and delays in the development, exploration, production, and the capacities and performance associated with MEG's projects; and uncertainties arising in connection with any future disposition of assets.

Although MEG believes that the assumptions used in such forward-looking information are reasonable, there can be no assurance that such assumptions will be correct. Accordingly, readers are cautioned that the actual results achieved may vary from the forward-looking information provided herein and that the variations may be material. Readers are also cautioned that the foregoing list of assumptions, risks and factors is not exhaustive.

Further information regarding the assumptions and risks inherent in the making of forward-looking statements can be found in MEG's most recently filed Annual Information Form ("AIF"), along with MEG's other public disclosure documents. Copies of the AIF and MEG's other public disclosure documents are available through the Company's website at www.megenergy.com/investors and through the SEDAR website at www.sedar.com.

The forward-looking information included in this news release is expressly qualified in its entirety by the foregoing cautionary statements. Unless otherwise stated, the forward-looking information included in this news release is made as of the date of this news release and MEG assumes no obligation to update or revise any forward-looking information to reflect new events or circumstances, except as required by law.

This news release contains future-oriented financial information and financial outlook information (collectively, "FOFI") about MEG's prospective results of operations including, without limitation, cash flow and various components thereof, all of which are subject to the same assumptions, risk factors, limitations, and qualifications as set forth above. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on FOFI. MEG's actual results, performance or achievement could differ materially from those expressed in, or implied by, these FOFI, or if any of them do so, what benefits MEG will derive therefrom. MEG has included the FOFI in order to provide readers with a more complete perspective on MEG's future operations and such information may not be appropriate for other purposes. MEG disclaims any intention or obligation to update or revise any FOFI statements, whether as a result of new information, future events or otherwise, except as required by law. A full version of MEG's 2019 First Quarter Report to Shareholders, including unaudited financial statements, is available at www.megenergy.com/investors and at www.sedar.com.

About MEG

MEG Energy Corp. is focused on sustainable in situ development and production in the southern Athabasca oil sands region of Alberta, Canada. MEG is actively developing enhanced oil recovery projects that utilize SAGD extraction methods. MEG's common shares are listed on the Toronto Stock Exchange under the symbol "MEG".

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