FINAL TRANSCRIPT

MEG Energy Corp.

Third Quarter Conference Call

Event Date/Time: October 26, 2017 — 10:30 a.m. E.T.

Length: 23 minutes

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David Silverstein
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PRESENTATION

Operator

Good morning. My name is Mike, and I will be your conference Operator today. At this time, I would like to welcome everyone to the MEG Energy Third Quarter Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press the # key.

Thank you. I will now turn the call over to John Rogers, Vice President of Investor Relations and External Communications. You may begin your conference.

John Rogers — Vice President, Investor Relations and External Communications, MEG Energy Corp.

Great. Thank you, Mike, and thanks, everyone, for your interest and listening in to the call today. We have with us today Bill McCaffrey, who's our President and CEO; Eric Toews, our CFO; Helen Kelly, our Director of Investor Relations; and myself.

We're going to start the call by really highlighting, I think from our perspective, about three things that we think were particularly noteworthy during the quarter, and then we'll turn it over to Q&A. So let me start by highlighting those things which we think are particularly noteworthy this quarter and we're particularly proud of.

The first thing of note, of course, is the implementation of eMSAGP is proceeding on time and under budget. I think that is particularly noteworthy when you think the size and the impact that this project is having on our business and on our company. It is adding about 25 percent to our production base. And being able to bring it in on time and under budget, which I'll speak about a little more in a minute, is particularly good for us and I think bodes well for the future implementation of this project.

Of course, technology is driving this growth, as we've mentioned many times in the past, and it will continue to drive our future growth as we go forward as our unfolding technologies take hold.

You did see production during the third quarter begin to reflect that implementation of eMSAGP, and we are seeing—I can tell you, we are seeing in October, our production to date is in the 85,000 barrel-a-day range. And we are particularly confident that exiting the year, we should be in that 86,000 to 89,000 barrel-a-day range, which is what we had predicted. And it really does tell you that the implementation is going very well and is right on track.

On top of that, the capital efficiency continues to improve. We're now seeing the capital efficiency around eMSAGP to be in the $17,500 range. We've been able to reduce the capital spending that's associated with the eMSAGP project to $350 million, which is down from the $400 million. So it's 17,500 per barrel. The returns on that particular project are going to be particularly good. So we're obviously very pleased with the progress, the results from the application of our technology and feeling very good about going forward.

The second thing, a key takeaway from the overall quarter is the overall reduction in our capital program from 590 million down to 510 million. This directly results from efficiency gains and spending optimization, which we have seen associated with our capital program, and it certainly bodes well for our ending cash balance to the end of the year. It was pretty strong at the end of the third quarter and should remain strong right through to the end of the year. So that optimization of that capital program, the reduction of that capital program, certainly is going to help in this regard.

The third piece is reduction in our non-energy operating cost guidance. Now this is the second time we've been able to do this, this year, and we continue to see positive trends in this area. Our new guidance is in the range of $4.75 to $5, as we have noted in the press release, and our net operating cost is an unbelievable $6. And I said that in terms of unbelievable because it wasn't that long ago that if you could actually produce a barrel for under $10 you were doing really, really well. So the fact that we now have our net operating cost in the $6 range we're particularly proud of, and we'll continue to see strength in that area.

Now the final point I was going to make, which is not really a highlight in the quarter but something I would like to note to people is that we did have 6,000 barrels a day, which were in transit, as we were transiting and sending the product down to the

Gulf Coast to pursue higher priced markets, and that will be recognized in the fourth quarter.

Now for those analysts that have difficulty with their estimates this quarter meeting our estimates, that equated to about $0.04 a share in terms of cash flow and that should help bridge your estimate versus ours, our actual results.

So those were the three highlights, which I was actually going to point out and the other noteworthy item. So, Mike, I think at this point in time what we'd like to do is open it up to questions. So, Mike, if we could do that?

Q&A

Operator

At this time, I'd like to remind everyone in order to ask a question, press *, 1 on your telephone keypad. We'll pause for a moment to compile the Q&A roster. And your first question is from Greg Pardy from RBC Capital Markets.

Greg Pardy — RBC Capital Markets

Yeah. Thanks. Good morning. John, I joined a second couple minutes late. So if I missed this, sorry about that, but did you say anything just about the performance on eMVAPEX at this stage?

Bill McCaffrey — President, Chief Executive Officer and Director, MEG Energy Corp.

I'll take it on there, Greg. Thanks for the question there. We didn't actually say anything, but what we're doing is obviously we have an eMVAPEX pilot underway. This is Bill, by the way. We have an eMVAPEX pilot that's underway right now, and we're continuing with that. The results so far are looking quite encouraging, and so we're analyzing the data. We need to make sure we're comfortable before we come out and talk too much about it. But I would just say we're very encouraged by what we see so far.

Greg Pardy

Okay. Fantastic. And is your thinking, Bill, that's probably like mid next year when you'll have a sufficient test drive on it? Or could that occur sooner?

Bill McCaffrey

It's a good question. It's one we're asking ourself right now, Greg. I think the way we're looking at it is we'll look at ways we would expand it. We're just doing our 2018 budget plans right now. And we're thinking what do we know at this stage? How comfortable are we at this stage? And so there's a lot of work underway assessing that.

I guess I'd add to it a little bit is we think of eMSAGP and eMVAPEX these days as really highly economic energy processes as opposed to defined projects. And what that means is that we're actually starting to think of our business a little different where we think we could have a continuous highly economic growth plan that just implements the process along the way. And when we think of it that way it's because the energy efficiencies are so good on this that it causes us to think through the development plan.

And so if we can free up steam, for example, using a process, we can redeploy it to new wells temporarily and then get those in position to put that eMSAGP or eMVAPEX technology into play and then reuse that somewhere else.

So what that does is it tears down large amounts of capital that we would have needed before for our growth; takes it away on that. And that's quite exciting.

Greg Pardy

Very good. Thanks very much.

John Rogers

Thanks, Greg.

Bill McCaffrey

Thanks, Greg.

Operator

The next question is from Paul Chambers from Barclays.

Paul Chambers — Barclays

Yeah. Thanks, and commendable job on the cost for sure. Guys, it looks like you've hedged about—you put financial hedges about a third of your 2018 WCF diff exposure. We've seen that diff widen from the summer levels. Just kind of curious your thoughts, particularly as we've seen the Myan (phon) diff strengthen a bit. Kind of your thoughts as we go into '18 on that and where you'd like to be on that hedge.

Bill McCaffrey

Sure. Well, I think I'll answer it in a couple of ways. First of all on differentials for the Gulf Coast, we're seeing very tight differentials, if you'd like. That's largely driven off of Venezuela and issues in Mexico, as well as Saudi is reducing its heavy barrels as it cuts back on its production, which means there's tremendous increase in demand for the heavy at the Gulf Coast. And so having Flanagan is real key to our strategy, and it's really helping our strategy. So John mentioned earlier that we have barrels that are between quarters, if you'd like, where they're going down to the Gulf Coast, and that's because we see tremendous advantage in doing that.

Then, what we're doing is thinking through 2018. We see that as a continuous story down there. We're thinking about how we best move our barrels and what's the most cost-effective way to do that in order to improve the netbacks. And so we have a physical activity that's underway as it relates to the differentials.

Then on the financial aspect of the differential, to answer your question, we are increasing the hedging on those differentials to mitigate any apportionment that might occur in the second half of next year, probably towards the end of the year, but we're also putting physical plans in place. So we will increase our hedging as we see opportunities to do, whether it's in terms of fixed barrels that we're pursuing or fixed contracts that we're pursuing with refiners, or whether it's on the actual financial hedging. And we look for those opportunities.

Paul Chambers

Okay. Great. Thanks. And then maybe a follow-up. Can you add a little clarity? In the release, you talk about during the quarter, you recognized a contract cancellation expense of 18.8 million on a long-term marketing contract. Can you add clarity? Was that entire 18.8 million expensed in the quarter?

Bill McCaffrey

Sure. It's a onetime expense that's related to cancellation of a marketing arrangement. And what we – I should spend a minute just talking about – where I can't give you exact details because of confidentiality, I would like to spend a minute and try and put some clarity to what our thinking is. And what I would say first of all, I think what we're doing here is not unique to MEG. It's probably the industry is thinking this way as well.

In 2014, when we had heavy apportionment before, we were–industry was looking for any way it could to move its barrels so it didn't have to shut in. Over the last few years the infrastructure has improved quite significantly, and so I think you see today that industry is now looking for—or is chasing opportunities where it can find cheaper ways to move barrels to market and hence improve the netbacks. So this is a product of it, and essentially what it is it's more cost advent. We have a better position to cancel this contract and improve the netbacks by moving barrels in a different manner. And I think, as I say, that's an industry opportunity to pursue right now.

Paul Chambers

Okay. Great. Thanks for that colour.

Bill McCaffrey

It is a onetime run and it won't all be realized, to answer the other part of your question. Eric, how do you want to describe that, or?

Eric Toews — Chief Financial Officer, MEG Energy Corp.

It's recognized in the quarter, although it's paid out over multiple periods, multiple years, four years basically. So from a cash perspective, it'll be a much-smaller-than-that number over the next four years.

Paul Chambers

Ah. Got it. Great.

Operator

The next question is from Jason Bouvier from Scotiabank.

Jason Bouvier — Scotiabank

Hi, guys. You just answered the question I had. Thank you.

Bill McCaffrey

Yeah.

Eric Toews

Thanks, Jason.

Operator

The next question is from Joe Gemino from Morningstar.

Joe Gemino — Morningstar

Great. Thank you. Do you guys see any further room of improvement on your non-energy operating costs? Or is that 450 range kind of the best that you can see happening?

Bill McCaffrey

Thanks. I'll answer that one. It's Bill. We actually think we will see it improve over the next few years. And let me just take a minute on the non-energy operating costs to try and give some insight as to what we've seen and where we're headed.

Over, just to put it into a macro look, since 2011 we've reduced our non-energy costs by about 55 percent, and since 2014, 42 percent. And the savings have come in the areas of headcount reductions, as well as much of it's from continued reductions associated with efficiency gains with our technology. And then the other part is just really rigorous cost containment.

And to get to your question, what we're doing is we are finding a large number of ways to reduce the numerator, the cost side of the equation, just through efficiency processes. When it comes to the–and that's what's been driving a lot of it plus the barrel, the increase in barrels on the denominator side of that $1 per barrel started to have an effect on it too.

Going forward, as the barrels increase, again we're on pace for hitting 100,000 by the early part of 2019, then we would spread our fixed costs, in non-energy it's about 70 percent, 70, 75 percent, over more barrels. So that's how those costs will come down in addition to further, as I say, cost containment on it there.

Joe Gemino

Great. I appreciate the insights. Thank you.

Bill McCaffrey

Yeah. You're welcome.

Operator

The next question is from David Silverstein from Kildonan.

David Silverstein — Kildonan

Hi. Thanks for taking my question. A couple of items. Can you give us an idea as to what you expect your 2018 CapEx levels to be relative to this year, especially given some of the changes to your capital budget this year, and an update on the sustaining CapEx number? In the past, you used a number around $5.

Bill McCaffrey

Sure. We're just in the process of building our budget for next year. So it would be premature for me to comment too much, but let me give you what I can at this stage. Clearly, the base level of the plan's going to be focused on the sustaining and maintenance costs, as well as the ongoing implementation of the eMSAGP process. And then from there, we're assessing how much energy is freed up and where we should deploy additional capital. So that work's all underway still.

When it comes to your question on sustaining and maintenance, we, for budgeting purposes, typically use about a 6 to $7 range. Sometimes it's less than that. Sometimes it might be on the higher side of that. But it's just as a rough number. And it's dependent on what you're replacing your barrels with; whether they're infill wells or whether they're SAGD well pairs.

David Silverstein

Great. Thank you. And just a follow-up. In terms of gas costs, obviously we've seen a massive step- change in the value of gas marked out of AECO. And I was wondering how much of that you were able to capture during the third quarter. Was it something that really you're going to capture more so in the fourth quarter? And I realize there's give and take with power sales.

And then are you considering doing anything in terms of locking in this enormous basis because the curve has really shifted dramatically for AECO?

Bill McCaffrey

Yeah. So a lot of the changes occurred over the last little bit of time here, and we are very active in it, and we do look for opportunities to lock it in where it makes sense to. So what I could say is we're very active in that market right now. And you're right. The gas costs have come down a lot, and there is restrictions in the province associated with gas getting out. And that's very favourable for businesses like ours.

David Silverstein

Were you able to capture any of that in Q3? Or was it (unintelligible) there?

Bill McCaffrey

We did capture a bit in the–I mean we–it's a tough question that way when you say capture. We're capturing it through the market pricing that's available as we buy it on an ongoing basis.

David Silverstein

Mm-hmm.

Bill McCaffrey

But we do look to lock in gas when we think we can get a favourable position on that as well.

David Silverstein

Great. Thanks very much.

Bill McCaffrey

Yeah.

Operator

And as a reminder, to ask a question, press *, 1 on your telephone keypad. The next question is from Cindy Treska from Goldman Sachs.

Cindy Treska — Goldman Sachs

Good morning. Thank you for taking my question. I was wondering how much of the 50 million decline in the eMSAGP capital program is part of the 2017 capital guidance reduction.

Bill McCaffrey

Well, the 50 million–you want to take that one, Eric? Or try to start that one and I'll add to it directly (phon)?

Eric Toews

Of that 50 million, about 60 percent of that is efficiency gains, and 40 percent of that is capital optimization, so the profile of our capital. So about 40 percent of the $80 million would be going into 2018.

Bill McCaffrey

And maybe what I could do is, if it's helpful, I can add a little colour in that area as well. When we think about the efficiency gains that we're seeing, sometimes people ask us, what is that? What is efficiency gain on it? And so the answer is it's largely in the area of lower construction costs and improved well and pad designs. So, for example, that 50 million is obviously a 13 percent reduction there.

But where it comes from is that MEG has moved its project management people in-house into the operation where we're focused on actually improving the contractor productivity but also reducing the number of contractors at site. And that's making a big difference in the sense of efficiency of implementation of the process. Plus the actual work we do these days is much simpler than we would have done before because we're basically drilling and tying in wells. And so that's created tremendous reduction in the number of contractors, a tremendous reduction in the complexity of our business, and hence, we are able to drive that efficiency really hard by having our own people in place.

And the other piece of that is that we do have–we have improved–changed, if you want–the pad designs, and that's saving large dollars as well. And that's a very important component because going forward, much of our costs are those pad designs. And so if we can reduce those costs and then multiply it by the number of pads, that's a big deal for continued reduction in our capital requirements going forward.

Cindy Treska

Thank you. That's helpful. And then one on asset sales. Where do you stand on the Access Pipeline or any other asset sales you may be considering?

Bill McCaffrey

Sure. Well we've got our program underway on deleveraging, and that's the–remember we did the refinancing earlier in the year, and we're growing our barrels, and that's going to reduce our costs over the next few years by 4 to $5. That improves our cash flows and that helps to improve our debt metrics.

That said, we are still focused on asset sales at the right time. So for example, the pipeline is clearly an opportunity, but we have to get the right price, and then we have to look at the long-term cash impacts to the company on it because that's a very important part. And you can imagine that in low oil prices, that's not the best time to monetize an asset. But we are very focused. We're disciplined, but we're very focused on that very aspect right now.

Cindy Treska

Okay. Thank you.

Operator

That was our last question at this time. I will turn the call back over to the presenters.

John Rogers

Great. Thanks, Mike. And once again, thanks, everyone, for listening in to our third quarter conference call. Again, if there's any more questions that you may have, Bill and I will be available later for any calls you may have. Otherwise, everybody have a good day.

Bill McCaffrey

Thanks.

Operator

This concludes today's conference call. You may now disconnect.

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