FINAL TRANSCRIPT

MEG Energy Corp.

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PRESENTATION

Operator

Good morning. My name is Sharon (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the MEG Energy Fourth Quarter 2017 Financial and Operating Results 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'd 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.

Mr. John Rogers, you may begin your conference.

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

Thank you, Sharon, and good morning, everyone, and thanks for listening in to our fourth quarter earnings announcement; also the announcement around the sale of the Access Pipeline and the Stonefell Terminal.

I have in the room with me today, Bill McCaffrey, our CEO; Eric Toews, our CFO; and Helen Kelly, our Director of Investor Relations.

We'll follow the usual format. I'll spend a couple of minutes highlighting for you, some of the things we think are particularly interesting and important from the two announcements, and then after that brief introduction, we'll turn it over to Q&A.

So I'll start with a brief summary of those things we think are particularly interesting and important. The announcement of our fourth quarter earnings and the sale of the Access Pipeline and the Stonefell Terminal really brings to an end a chapter for this company and starts a new one also. Back in 2015, following the collapse of oil prices, management and the board put in place key objectives which will enable us to make the business more resilient, more sustainable, and more profitable at each point of the energy cycle.

To that end, we put in place three initiatives. Number one, to reduce the overall costs of the business. Number two, to reduce the capital investment required to grow. And number three, to decrease the overall impact of our debt. I think—or we think the fourth quarter reports and the sale press releases that were put out earlier this morning are good benchmarks or good measures on how we're doing in each of those initiatives.

So in terms of reducing the day-to-day costs of the business. When we look at non-energy costs in the fourth quarter of 2017 at $4.53, it's now 44 percent lower than it was in 2014. When we look at administrative costs, full year 2017 at $2.94, it's down 31 percent from 2014 levels. So clearly, what we've been able to do is reduce those costs significantly from 2014 levels, when we put the key objective in place. And as we bring more barrels on, we will continue to drive those costs lower.

On the second initiative, in terms of how we're doing in terms of improving our capital efficiency. We have a couple of things we'd like to point out: eMSAGP is adding about 25 percent to the production base. It's obviously a major project, adding about 20,000 barrels or 25 percent to the production base. And given the exit rate at about 94,000 barrels per day in December of 2017, it's obviously right on track, and we're very pleased with the progress.

Now we revised the estimate for that project, down to 350 million from 400 million, in October or late in 2017. At 350 million, it's coming in at about $17,500 per barrel, which is a 60 percent reduction in the capital required to grow.

If we were to look at the brownfield expansion, which is part of the initiative to get to 113,000 barrels a day. We're expecting and anticipating a capital intensity in the range of about $21,000 per barrel. So clearly, we're able to now execute our capital program, our capital investments, at a much lower level than we've been able to do in the past.

The final piece refers directly to the press release on the sale of the Access Pipeline and the Stonefell Terminal. We had to structure a deal that paid us fair value, retained the strategic advantages of these assets, did not have a significant impact on our cost structure, and as it was going to be a long-term partnership, was done with the right organization. Through patience, and I must say, through persistence, we think we have been able to do that.

For us, Wolf is the right long-term partner and has shown this over the past two years since buying Devon's 50 percent of the Access Pipeline. Also, we've been able to retain the advantages that we so required of those assets—will continue to support us as we grow this business out. And finally, at 13.4 EBITDA, the deal by all accounts ranks right up there with some of the better midstream asset sales that have taken place over the last few years.

The incremental cost for the deal will be quickly absorbed by the cost savings which come from our growth. In addition, the 1.225 billion that we anticipate reducing our bank term loan will bring our overall debt down to somewhere in the neighbourhood of approximately CAD 3.4 billion at today's exchange rates. And with the amount we're setting aside for the transaction, we now believe we have sufficient funding to complete the brownfield expansion, achieving a production level of 113,000 barrels a day in 2020.

At that production level and current pricing, we anticipate our debt to EBITDA will drop to the 2 to 3 range. So that is in the context of today's pricing with differentials at about $20. So clearly it's been a journey with a defined set of action plans. Together, each of these critical steps has put the company on a strong foundation where it can grow and be profitable, even in a lower price environment.

So that's all I was going to say—we were going to say—in terms of those things we'd like to highlight from this quarter and from the Access and Stonefell announcement.

Sharon, what we'd like to do now is we'd like to open it up to questions that anybody on the line may have. So if we can do that?

Q&A

Operator

At this time, I would like to remind everyone, in order to ask a question, press *, then the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from Greg Pardy from RBC Capital Markets. Your line is open.

Greg Pardy — RBC Capital Markets

Good morning, John and team. I guess a couple of questions, and this one is jumping ahead, but it's just more how to think about things conceptually. But in 2019 then, you'll have what, 30 percent of the carryover funding from the 13,000 barrels a day that you're now going to move forward with. But in terms of that overall CapEx program, should we sort of think about it as, look, sustaining capital plus that completion? Or do you think—or will there be other new initiatives should we bring on? And should we sort of think about spending as very similar in '19 to '18? I know it's early. I'm just trying to get a sense.

Bill McCaffrey — CEO, MEG Energy Corp.

Yeah. Greg, it's Bill. Thanks for the question there. It is early, so we haven't actually put the plans in place yet on it. But I think you should think about it in similar type of levels of spending. You think of what we're doing right now, we're completing the eMSAGP component. That'll take us to 100,000 by early 2019. And then we'll be completing the second part of our brownfield expansion in that time period, plus the sustaining, so it's reasonable.

I think the other piece of it, though, is we have to make some decisions in terms of how we continue to advance our eMVAPEX at the time. So we're very excited by the results that we're seeing on that, and we'll continue to look at that in our plans going forward.

Greg Pardy

Okay. Bill, so I'm glad you brought up eMVAPEX, because that's where I wanted to go next. But so with 100 million, you've got the recycling plant for propane, you've got I think another seven-well pad. You're boosting overall steam capacities as part of this 13,000-barrel-a-day expansion. And then in addition to that, are you—the line then on access, that will bring up NGLs then. Is that essentially going to be dedicated to propane that you're going to be bringing up?

Bill McCaffrey

Yes. It's all part of an overall package. So yeah, we have seven well pairs that we would add on the eMVAPEX. The pipeline, the 16-inch pipeline that was in addition to the other blend in the diluent line are key, because it allows us to bring up propane to our site, and these technologies need a supply of propane. You recycle, but you do need a supply. And so we're really proud of accomplishing a low-cost supply method of bringing solvents to the oil sands, because that hasn't been an infrastructure that exists to date, yet the technologies are advancing very quickly.

Greg Pardy

Okay. And then is your sense still that you'll be able to declare a victory, which it certainly sounds like, on the eMVAPEX by about mid '18?

Bill McCaffrey

I don't want to put a date on that part of it. We're really just starting the next set of seven well pairs in there, and we just want to continue to grow it. So obviously we're very confident in what we're seeing on the technology, but we also are protective of it and don't want to overstate it at any given point until we get more track record on it. But you can see through our actions that we are very confident in what we're doing.

Greg Pardy

Okay. Understood. Thanks very much.

Bill McCaffrey

Yep.

John Rogers

Thanks, Greg.

Operator

Your next question comes from Benny Wong from Morgan Stanley. Your line is open.

Benny Wong — Morgan Stanley

Hi. Thanks. Hey, Bill, it looks like you guys reduced your capital cost estimate for Phase 2B expansion. I apologize if you already touched on this on your prepared remarks. But can you talk about what's driving that? And does that incorporate eMVAPEX contributing to that?

Bill McCaffrey

Yeah. You're referring to our eMSAGP? Or the ...

Benny Wong

The Phase 2B expansion. I think it's quoted to be 270 now.

Bill McCaffrey

Yeah. No problem. Yeah. It's an example of the capital efficiency improvements that we're seeing, and one of the key pieces of that actual improvement is coming from well and pad designs. So, for example, just in the space of about just over a year, we've been able to drop our well pair costs by about 1.25 million per well pair.

So when you think about our business, our business has morphed away from being large, big projects like facilities to more of a continuous growth type of model. And that involves drilling and tying and wells, and then utilizing the technologies to save on the capital that are required at our plant. So when we get—when we get a significant drop in the actual well pair cost, like I say 1.25 million per well pair, that has a huge implication on reducing our overall future capital costs. And you're seeing some of that in the brownfield expansion.

Benny Wong

Mm-hmm. Thanks. So just to clarify. Any kind of benefit from eMVAPEX is not in that cost assumption for now?

Bill McCaffrey

No, that's right. That's a separate project, so that would be additive to the things we're seeing. But eMVAPEX will benefit because as it frees up steam, and we redeploy it to new well pairs, our new pad designs will be that much cheaper too. So these things tend to complement each other.

Benny Wong

Mm-hmm. Okay. I guess that also leads into my second question, was about the 10 to 15 percent growth beyond the 113,000 barrels per day. I think previously, you kind of dimensioned it to be 10,000 to 20,000 barrels per day of brownfield expansion, at a cost of 20,000 to 30,000 per flowing. Is that kind of still the case? Or could that potentially be in flux, if eMVAPEX becomes commercially successful?

Bill McCaffrey

Yeah. Every next phase takes—you have to look at what the cost is. But I would say that it'll probably be on the lower end of that. It's probably around the 20,000, and you couldn't use a hard, fast rule because it depends on what the scope of the design is. But you can see from two examples of what's there right now, that it's not unreasonable to think 20,000 is a respectable estimate at this stage. But again, just to caution, each next phase depends on what the scope is. But we do see a lot more of what we're doing going forward.

Benny Wong

Great. Thanks for the colour.

Bill McCaffrey

Yep.

Operator

Your next question comes from Mike Dunn from GMP FirstEnergy. Your line is open.

Mike Dunn — GMP FirstEnergy

Good morning, folks, and apologies if you addressed it. I was a bit late getting on the call here, but—

John Rogers

Mike, could you get a little closer to your phone, please?

Mike Dunn

Sure. Is that better, John?

John Rogers

That's a little better. Thank you.

Mike Dunn

Yeah. Just apologies if I missed it earlier; I was a bit late coming on. But could you guys just run through us again, your access options to the Gulf Coast? I believe you have 50,000 on Flanagan South. But on the railing and barging initiatives, just remind us how we should be thinking about that here with these water differentials? Thank you.

Bill McCaffrey

Sure. Yes. We have 50,000 going to the Gulf Coast at the present time. That goes up to 100,000 in 2020. We do have flexible rail that we could use and don't have to use if we don't want to. We have been railing since December, and we'll continue to do more of it. We aren't doing any barges at this stage. Flanagan has substantially replaced the need for the barges.

But we do also have large amounts of storage at Stonefell and other storage that's key to this, and so it's a total package that we use to mitigate the differentials. But we're very excited because if you look at the Gulf Coast right now and you see the strength of those—of the prices, there is a big prize in getting down to the Gulf Coast, and we feel we're well positioned to do that.

Mike Dunn

Okay. And Bill, no—you're not able to share, roughly, the volumes that you're railing?

Bill McCaffrey

No. Strategically, it wouldn't be a good idea to do that.

Mike Dunn

Okay.

Bill McCaffrey

I apologize. But we have ability to move rail, and we are increasing that amount on rail right now.

Mike Dunn

Okay. Thanks. That's all from me.

Bill McCaffrey

Yep. Thank you.

Operator

Your next question comes from Joe Gemino from Morningstar. Your line is open.

John Rogers

Hi, Joe.

Joe Gemino — Morningstar

Hi, guys. Congrats on the quarter.

Bill McCaffrey

Thank you.

Joe Gemino

Your bitumen netbacks fared pretty well this quarter. How do you see that playing out as you bring on more production from Christina Lake?

Bill McCaffrey

I think it's a good question. I take it more as a package kind of look to it. So if you think about it, we'll have increased tolls, we'll have decreased debt, the growth will improve our netbacks as we go. So if you thought of it as a package, you'd actually have a net lower cash cost of about $3 a barrel by 2020, just based on that combined package, so that's pro forma the transaction and the debt repayment.

We think we'll be improving our cash costs—net cash costs by about $3 a barrel, and that's independent of oil prices. And really, what it's doing is it's the brownfield expansion coming on, taking us to that 113,000. And keep in mind, that's fully funded. I don't know if I answered your question, but I—was that your question? Are you—

Joe Gemino

Yeah. Yeah. That's great. That's what I was interested in. Thanks, guys.

Operator

Once again, if you would like to ask a question, please press *, 1 on your telephone keypad.

Your next question comes from Jacob Gomolinski-Ekel from Morgan Stanley. Your line is open.

Jacob Gomolinski-Ekel — Morgan Stanley

That's a new pronunciation. Jacob Gomolinski-Ekel here. Thanks for taking the question, and congratulations on the transaction and the strong quarter. Just I guess given sort of differentials, where they are now, could you just sort of expand upon your decision to accelerate the Phase 2B brownfield expansion? And maybe what your plans are for that production growth in terms of realizations and getting it out of basin?

Bill McCaffrey

Yes. Sure. It's part of what I was just saying actually. As a total package, if you take the tolls that we'll see on access, the debt reduction, and the growth that occurs, the growth is that expansion that we're talking about here. So it's that third leg of the stool, and it's a very important leg because that is a key piece, in addition to actually reducing the absolute debt.

The growth is actually very important to reducing our cash cost by about $3 a barrel by 2020. And then we—and we have added capacity on Flanagan by 2020, to move that down to the Gulf Coast, and before that, we're well positioned with rail and a number of other initiatives that we work on, that will continue to lower our cash cost and mitigate the differentials.

And it's important when we talk about differentials that we don't think of them just as sort of a number. We have a strong—a good percentage of our portfolio, and it'll increase—that allow us to actually move to the Gulf Coast which has very tight differentials. So differentials are largely a Pad 2 phenomenon, so we just move barrels away from that as much as we can. We will be moving barrels to Pad 2, but as much as we can, we'll move them away from that while that—until those differentials come back down.

And then the other piece of it I'd like to highlight is that the brownfield expansion is a very attractive—a good project and with very good returns. It's around 30 percent in current prices, so it's extremely attractive as from an investment perspective, even in today's pricing.

Jacob Gomolinski-Ekel

Got it. No, I appreciate the concept of sort of decreasing of costs when you spread fixed costs over a larger production base. I guess I was—I'm more just thinking is it—for the incremental barrel. What kind of pricing is that incremental barrel getting? And is it the fact that it's maybe just the production growth has synced up with the increase on Flanagan South? Or is there something else going on?

Bill McCaffrey

Yeah. If you think about that incremental barrel, there aren't a lot of additional costs associated with it. So it has some of the highest netbacks that we will see for that barrel, because we don't have to add a lot of people, and we don't—our interest payments don't go up in that part of it, and neither does the G&A. So then as you bring on those barrels, you don't have a lot of extra costs, so they're extremely attractive. And as I said, it does have a 30 percent return on it.

Jacob Gomolinski-Ekel

Okay. And then just maybe—I think you mentioned that on the current differentials base, I think you—I didn't catch the number you said, but just I think you said using current strip pricing on differentials, you'd hit to 2 to 3 times leverage by 2020. Is that sort of the target for leverage and the right level for this kind of business? And then also maybe, is that what—or is that how you think—like does that mean that you think differentials will stay where they are over the next few years?

Bill McCaffrey

Yeah. That is the target, but our target is actually just to continue to improve. We'd be very happy with that, where that would be at that time; our resource supports it. But at the same time, we have a number of things we'll continue to do to improve it. As far as differentials go, pipelines are obviously the topic of the day as it relates to differentials, and we do believe there will be pipelines.

But the key point on it is the rail will put a ceiling on the differential price once it kicks in. And we think it'll start kicking in in the second quarter, and into the third quarter it'll be ramping up even more. And really, what happened was there's always been a plan for rail to come back to mitigate differentials as the remaining volumes came on from some of the larger projects, but the Keystone pipeline caused that to have to move forward in time. And it caused maybe a little bit of a planning exercise for the rail companies, but there is a need to actually accelerate those plans just because of the backup of crude associated with the Keystone pipeline being down.

Jacob Gomolinski-Ekel

Got it. Thanks very much, and congratulations again.

Bill McCaffrey

Yeah. Thank you.

Operator

Once again, if you'd like to ask a question, please press *, then the number 1 on your telephone keypad.

Your next question comes from Jeff Jones with Globe and Mail. Your line is open.

Jeff Jones — Globe and Mail

Thanks very much. And related to the last question, this is kind of a larger one having to do with the overall federal, provincial regulatory issues surrounding Trans Mountain. And wondering if, as a shipper, your patience with regard to delays is endless? And second, are these trade moves by the government—do you think they will work in achieving their objective? Thanks.

Bill McCaffrey

Thank you. Yeah. As far as the patience goes, we have a diversified strategy for moving to several different markets. I think this is—I think the pipeline is a very important pipeline to Canada, and it becomes a Canadian conversation of how we're going to get our energy products to market. The world is looking for those products. And so the trade aspects that are occurring between BC and Alberta right now are really about a confederation and the importance of a country working together on that. And so I think the federal government has to play a role in this part of it too, and that's for the betterment of all Canadians.

Operator

Once again, if you would like to ask a question, please press *, 1 on your telephone keypad.

Your next question comes from Jason Homler from DoubleLine. Your line is open. Jason Homler?

Jason Homler — DoubleLine Capital

Hey, guys. Sorry about that.

Bill McCaffrey

That's okay.

Jason Homler

Just going back to rail. I just wanted to get your comments on some of the chatter out there, in terms of crop demand impacting your ability to ramp up rail on the oil side. If you guys could give some colour on that, that'd be helpful.

Bill McCaffrey

I'm sorry. Could you repeat that again?

Jason Homler

There's been some talk out there about crop demand weighing in on rail being used for oil as they try and ramp up, and maybe pushing out some of the capacity for rail for the oil guys. I was wondering if you comment on what's going on in the market a little more?

Bill McCaffrey

For sure. Yeah. Yeah. Sure. I mean there has been policy to help the farmers to move their grain and everything, but I think it's a planning exercise. In fairness on it, the oil industry hadn't really committed to increase the rail that would be needed over the last few years. And so as we see where we are right now, I think there's a lot of more discussion going on between CN, CP, and the producers, and it's a matter of making room for both of them really.

Jason Homler

So you guys see no issue with the ramp, I mean in the 2Q period, because of that?

Bill McCaffrey

Right now we're hearing that it's probably towards the end of the second quarter and ramping in the third quarter. And what it is, is really just getting enough people to work on it and railcars and the engines and everything. And so we think that—

Jason Homler

Thank you.

Bill McCaffrey

—will ramp up considerably as we go through 2018. And that will have a direct impact on where differentials could go, because as the rail comes on, that creates another alternative for producers that may not have as strong a position as we do on it from the pipe and everything. And then that will govern the actual discussions and negotiations associated with differentials because that's all they really are is a negotiation of somebody buying a product and somebody selling it, and what your alternatives are.

Operator

Once again, if you would like to ask a question, please press *, then the number 1 on your telephone keypad.

Your next question comes from Cindy Treska from Goldman Sachs. Your line is open.

Cindy Treska — Goldman Sachs

Good morning. Thanks for taking my question. We've heard that the rail companies, CN, CP, are looking for longer-term, two- to three-year contracts for crude. Have you been seeing that? Have you been locking any contracts? Or are you open to locking in longer-term contracts?

Bill McCaffrey

Yeah. Those are really conversations that company by company on it. But I mean what the rail companies are looking at is investments, and they want to see that there's a runway there for an investment that they would make to add to their cars. And so that's a little bit arc'd (phon) to their fleet and their people and everything. And so there is a lot of conversation going on in that area right now, but it's a company-by-company—on a company-by- company basis really.

Cindy Treska

And what sort of prices are they asking for, for the longer-term contracts?

Bill McCaffrey

Well, we couldn't talk about that on here. The people would be under confidentiality agreements on it really.

Cindy Treska

Okay. Thanks.

Bill McCaffrey

Yep.

Operator

Once again, if you would like to ask a question, please press *, then the number 1 on your telephone keypad.

We do not have any questions over the phone line at this time. I will turn the call over to the presenters.

John Rogers

Great. Thanks, Sharon. And once again thanks, everyone, for listening in to our call. Helen Kelly and myself of course will be available after, to answer any subsequent question that may come to mind. Apart from that, thank you—

Operator

Pardon me. Pardon me. We do have a question from Tarek Hamid from J.P. Morgan. Your line is open.

Bill McCaffrey

Okay. Please.

Tarek Hamid — J.P. Morgan

Hey. Thank you for taking the questions. I guess last quarter differentials—I think you highlighted in the release were a little over $7. Can you maybe just talk a little bit about what you expect in 1Q, just to help us kind of just sharpen up our models a little bit? I know it's been asked a little bit already here, but I'm just trying to get a little bit tighter on it.

Bill McCaffrey

Yeah. I think if you're talking about the differentials as it relates to crude in the Pad 2 area, I think the market right now has—there's a market strip on there—I don't have it handy right now. But I think you'll see levels start to come down or tighten a little more, but it really is going to be driven by the addition of the rail. So as—and that's not a switch, it just starts to build. So as that builds over Q2 and that, you should start to see those differentials come in.

Tarek Hamid

Okay.

Bill McCaffrey

Did I get all of it? Or—

Tarek Hamid

And I guess—

Bill McCaffrey

Sorry?

Tarek Hamid

I appreciate that. Could you just—just to follow up, I mean, how do you think about sort of the cap on price—on differentials that sort of rail provides? And generically, obviously not to your own specific capacity, but sort of how do we think about that for the market, as being—what's the sort of cap right now?

Bill McCaffrey

I think you'll see a differentials somewhere in the $18 range as a guess on it. I think market is thinking about that that way, so it's not really our number only. But there's logic in it too, and if you think about where that crude would go, it'd go to the Gulf Coast or other markets that are extremely attractive.

So it would really be important, if you're modelling, to take the whole picture into it and think of what I'm describing as a differential as it relates to Pad 2, but—because that's the conversation. That's the alternative in the discussions associated with differentials, when people are selling to Pad 2. But somebody that can move it down to the Gulf Coast is going to realize a much stronger price, and so it's really about putting that whole thought process together of where it's going versus what the cost of that is.

Tarek Hamid

All right. A hundred percent—that's a good—it's a good reminder to think about it on a net revenue basis.

Bill McCaffrey

Yep. Thank you for your questions.

Tarek Hamid

Appreciate it. That's all I had. Thank you.

Bill McCaffrey

Okay. Thank you. Yep.

Operator

And at this time, I will turn the call over to the presenters.

John Rogers

Okay. Well, once again, thanks, everyone, for listening in to our fourth quarter conference call and the sale of the Access and Stonefell Terminal. We really appreciate your interest. Helen and I will be around subsequent to the call, should you have any follow-up questions.

Other than that, again, thanks for your interest and everybody have a good day.

Helen Kelly — Director, Investor Relations, MEG Energy Corp.

Thank you.

John Rogers

Bye now.

Operator

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

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