Cenovus Hits New Lows; Is it Time to Invest?

Description

After a recent analyst downgrade, integrated Canadian oil heavy-weight **Cenovus** (TSX:CVE)(NYSE:CVE) has seen its share price plunge 18% over the last year. But it is difficult to understand the negative sentiment surrounding Cenovus with it reporting solid 2013 operational results and a dividend increase.

Fellow Fool Brian Pacampara eloquently stated in an article earlier this year: "(Cenovus)… currently boasting a 3%-plus dividend yield… might be providing energy-savvy Fools with a juicy long-term income opportunity."

And now we will see why Brian may just be right and more, with Cenovus set to continue performing strongly throughout 2014.

Were 2013 results detrimental enough to deserve a downgrade?
Cenovus' full year 2013 operational results saw total crude production grow 8% in comparison to 2012 and more importantly oil sands production – which made up 57% of 2013 production – spiking 14% for the same period.

This is particularly important, first because crude prices continued to rise throughout 2013, with West Texas Intermediate gaining 7% by the end of the year. Second, the price differential between Canadian heavy crude and bitumen – the end products of oil sands mining – continued to narrow against West Texas Intermediate, boosting oil sand revenues.

As a result 2013 revenue popped almost 11% and cash flow grew a tidy 3.5% in comparison to 2012. But net earnings plunged by a third for the same period to $662 million or $0.87 per share.

However, this can be primarily attributed to tax management losses and foreign exchange losses, rather than asset write-downs or significant operational issues. Indicating Cenovus' underlying business continues to perform strongly.

Oil reserves grew in 2013 by 5% in comparison to 2012, to 2.3 billion barrels of crude, boosting production life and Cenovus' underlying asset value. This compares favorably with peer **Husky Energy**

(TSX:HSE), which grew its reserves by 11% for the same period.

Despite the plunge in net earnings, Cenovus' board approved a 10% increase in the quarterly dividend to $0.27 per share, giving Cenovus a juicy yield of 3.7%. This is equivalent to Husky's 3.6% but significantly higher than **Suncor's** (TSX:SU)(NYSE:SU) 2.5% and **Canadian Natural Resources'** (TSX:CNQ)(NYSE:CNQ) paltry 2%.

All of that indicates that Cenovus continues to perform strongly and perhaps the downgrade by TD Securities was premature — particularly with Cenovus continuing to reward patient investors for their loyalty by boosting the dividend.

What are the issues driving the downgrade?
The key issue driving the downgrade was the company's decision to adjust its timeline for completion of the Forster Creek production optimization. Essentially Cenovus made the decision to delay the optimization so as to evaluate and assess its new operating procedures. As such oil production will not increase to the previously projected levels at the start of production of each new phase.

Some analysts are concerned that the outlook for Forster Creek may not be as optimistic as previously announced by the company. There is also concern that capital costs for the project will increase as the company re-evaluates its operating procedures.

But by delaying the optimization program Cenovus is better positioned to evaluate the development and ensure the project delivers the expected increase in production. Interestingly, analyst Menno Hulshof of TD Securities went on the record pointing out these issues are nothing more than short-term growing pains and their long-term perspective remained unchanged.

2014 outlook remains optimistic
Cenovus estimates 2014 oil production will grow by 10% in comparison to 2013 to between 190,000 to 208,000 barrels per day. With the increased production driven by added volumes from Cenovus' key oil sands projects Christina Lake and Foster Creek. Such solid growth is particularly promising in an operating environment where the price differential between Canadian heavy crude and West Texas Intermediate is continuing to narrow.

Even more impressively, Cenovus expects Christina Lake and Forster Creek to generate cash flow in excess of capital requirements, essentially making ongoing development of these assets self-funding. All of which bodes well for Cenovus to boost revenue, cash flow and its bottom line.

How attractively priced is Cenovus?
But this leaves the question, just how attractively priced is Cenovus? To determine this I have taken a closer look at a range of key industry valuation metrics and compared to three of Cenovus' peers, Suncor, Canadian Natural Resources and Husky.

The key industry ratios considered are enterprise-value to EBITDA, enterprise-value to oil reserves and enterprise-value to barrels of oil produced daily, seen in the table.

CVE Val Metrics 270214[1]

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Cenovus' EV/EBITDA of 9 appears expensive in comparison to its peers, but it's EV to oil reserves and EV to barrels of oil produced daily makes it appear attractively priced. Clearly the market is not pricing in the value of Cenovus oil reserves or its production.

Foolish final thoughts
Despite the short-term issues dogging the Forster Creek optimization program, Cenovus is attractively priced, particularly when a dividend yield of almost 4% taken into account. Add to that projected growth in oil production and increased oil reserves and Cenovus is an appealing long-term play.

CATEGORY

1. Investing

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Author
mattdsmith