

## Cenovus Energy Inc. Is Downgraded: Is This a Signal to Sell?

### Description

It has been a tough six months for oil investors and the energy patch, with crude prices falling to their lowest point in over five years. This has triggered a savage sell-off of energy stocks as they cut expenses, capital expenditures, and dividends in order to preserve cash flow and balance sheets.

This has also triggered a round of analyst downgrades for a number of oil companies, with the latest being **Cenovus Energy Inc.** ([TSX:CVE](#))([NYSE:CVE](#)). Investment bank and money manager Macquarie downgraded Cenovus from “outperform” to “neutral”.

This leaves the key question for investors; does this signal that now is the time to sell?

### So what?

Cenovus, like its peers, has had to slash capital expenditures and costs in order to remain viable in the difficult operating environment we are now witnessing, but it has yet to cut its dividend.

This now sees total upstream or oil exploration and production capital expenditure of \$1.5 billion or less than half of what Cenovus spent in 2014. As a result, annual production is expected to fall by 6% to an average of 265,000 barrels of crude daily. This will have a marked impact on Cenovus cash flow and earnings.

More worrying is that the majority of Cenovus' oil production, or approximately 63%, is made up of heavy crude extracted from oil sands. Canadian heavy crude trades at a considerable differential to West Texas Intermediate (WTI), the North American benchmark oil prices. At this time, heavy crude trades at a 37% discount to WTI and 22% compared to Canadian light crude.

This sees Cenovus' oil sands operations generating significantly lower margins than conventional oil operations. For 2014, the operating netback of Cenovus' oil sands operations was \$44 per barrel, whereas the netback from its conventional oil operations was 25% higher at \$55 per barrel.

At an assumed price for WTI of US\$52.50 and after projected capital expenditures, Cenovus expects to generate cash flow of \$1.3 billion to \$1.5 billion. After allowing for capital expenditures and the annual dividend payment, there is a cash flow deficit of around \$1.5 billion.

However, I don't believe that Cenovus will cut its dividend at this time, because there are a number of levers at its disposal to manage this situation.

These include cost-cutting initiatives that will improve margins. Cenovus also has a high degree of liquidity with \$883 million in cash and cash equivalents as well as an unused credit facility of \$3 billion. As a final resort, it could consider selling non-core assets to raise much needed funds.

It can also mitigate some of the impact of weaker crude prices through its refining or downstream operations. Weaker crude prices make these operations more profitable and Cenovus can increase its

refinery utilization rates and throughput to boost revenue from these operations. This also gives it the ability to better manage the pricing differentials between Canadian crude blends and the WTI benchmark price.

### Now what?

Despite the outlook appearing considerably poor for Cenovus because of recent softness in crude prices, it still remains one of the better operators in the patch with high quality, long reserve life assets. This makes it an appealing investment opportunity for long-term investors seeking to bet on the much anticipated rebound in oil. While it is certainly not a risk-free investment with any further weakness in crude prices set to negatively impact its share price, it will continue to reward investors with its dividend for the foreseeable future.

### CATEGORY

1. Energy Stocks
2. Investing

### TICKERS GLOBAL

1. NYSE:CVE (Cenovus Energy Inc.)
2. TSX:CVE (Cenovus Energy Inc.)

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