Is it Time to Buy Cenovus Energy Inc.?

Description

Cenovus Energy Inc. (TSX:CVE)(NYSE:CVE) is up 35% from the lows reached in late August, and investors are wondering if the rally can continue.

Let's take a look at the current situation to see if Cenovus deserves to be in your portfolio.

Cash flow

Energy prices were brutal in the third quarter, but Cenovus managed to report decent results.

Cash flow came in at $444 million, down from $985 million in the same period last year. That's a pretty scary change, and it has really shown how much energy prices have fallen in just the past 12 months.

The company has adjusted well to the downturn and only spent $400 million on capital projects in the quarter, so cash flow covered the costs of keeping the business running. Unfortunately, it wasn't enough to pay the full amount of the reduced dividend, which ate up another $133 million. As a result, the $89 million gap had to be covered with other sources of funds, but Cenovus is sitting on a lot of cash.

Balance sheet

Cenovus finished Q3 with $4.4 billion in cash and cash equivalents and long-term debt of $6.3 billion. The large cash position is a result of the $3.3 billion sale of its royalty and free-land holdings, as well as a $1.5 billion equity issue completed earlier in the year.

Investments

The company has more than enough cash to weather the storm in the oil market and could start making more acquisitions as its weaker peers begin to dump assets.

Cenovus spent $75 million in the summer to buy a crude-by-rail trans-loading facility. The deal is important for investors because oil sands producers are struggling to get product to higher-priced markets, and delays on the major pipeline projects look like they will continue for some time.

By purchasing the rail-loading facility, Cenovus acquires direct ownership of a key asset and should be able to move more of its oil by rail as a result.

Production

Cenovus has cut back spending on its conventional oil plays, and that is showing up in the production numbers. Overall output from the segment dropped 14% as compared with Q3 2014.

Most of the capital expenditures are focused on the oil sands operations. As a result, output from the company's Christina Lake and Foster Creek projects actually rose by 14% compared with the same period last year.

Cenovus has very low per-unit operating costs in its oil sands segment and the efficiency gains continue. Christina Lake and Foster Creek saw year-over-year Q3 operating expenses drop by 28%.

Takeover rumours

As merger mania heats up in the oil patch, some pundits are looking at Cenovus as a possible target. The company has a 50% stake in both its oil sands and refining operations, and those assets could be of interest at the right price.

With a market capitalization of $18 billion and net debt of about $2 billion, one of the majors would have to cough up $20 billion plus a premium of another $5-10 billion to get a deal done. That's certainly possible, but unlikely right now.

Dividend safety

The company has more than enough cash on hand to cover the $0.16 per share quarterly dividend. If oil prices move higher in the next few months, the company should be able to generate enough cash to cover both the capital expenditures and the payout.

Should you buy?

Cenovus is in much better shape than many of its peers. The company offers decades of potential cash flow from its vast oil sands assets, and the current price is a steal if oil is destined to return to its previous highs.

If you are a long-term oil bull, it might be a good time to step in, but more volatility should be expected in the coming months.

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aswalker