Why I Prefer Cenovus Energy Inc. Over Baytex Energy Corp. in the Oil Sands

Description

It's an interesting time to be looking at energy stocks such as **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) and **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE).

While to date energy has been the weakest performer in 2017, there are signs of a recovery as energy stocks were the hottest sector last week and were the hottest sector throughout the month of September.

Prices for Brent crude, the international benchmark for oil prices, are already in a bull market, up 25% since June and the differential between Brent and West Texas Intermediate (WTI) crude is at a two-year high, suggesting WTI still has room to run.

Perhaps not surprisingly, this has investors turning their attention to the oil sands, once again in search of promising opportunities.

In particular, both Cenovus and Baytex are interesting because both companies have seen their shares decimated in the wake of lower oil prices, which have persisted since 2014.

As Warren Buffett says, "be greedy when others are fearful."

Cenovus shares are down over 60% since 2014, reaching a 10-year low of $8.85 in the start of July but have rebounded sharply, up 42% in the 10 weeks since.

Baytex, meanwhile, has lost over 90% of its value since the middle of 2014, and while shares doubled in price early in 2016, they have lost most of those gains so far in 2017.

But there's good reason for the outperformance of Cenovus this year.

Cenovus is an integrated oil and gas producer, while Baytex is strictly an exploration and production company. Integrated producers like Cenovus extract oil from the earth and then refine it into products like gasoline, diesel, and petrochemicals.

Baytex, however, owns assets that retrieve the bitumen from the ground, but the company does not refine the end products; rather, it sells the crude oil to refiners like Cenovus, who take it the rest of the way to end markets.

The distinction is important, because it means that Baytex's performance is directly linked to the direction and level of crude oil prices.

Cenovus's performance is tied to the differential between crude prices and the price of refined products like gasoline, or what is referred to as the "crack spread."

With oil currently sitting just shy of US$50, it's going to be hit and miss for Baytex this year, as the company needs a price of US$55 to be able to reinvest in production growth going forward. If oil were to fall back down to $40, it could mean "lights out" for Baytex and its shareholders.

While oil prices rose during September, they remain well below 10-year averages.

Cenovus at least partially benefits from lower oil prices. Essentially, cheaper oil helps to keep costs in check for Cenovus; meanwhile, the prices for refined products like gasoline, diesel, and jet fuel haven't fallen by nearly the same magnitude during the current decline in oil.

Because of the relationship between crude oil and refined products, Cenovus is on pace for a three-year high in sales this year and is on track to record its highest profits dating all the way back to 2008.

Conclusion

Risk seekers may be drawn to the binary nature of an investment in Baytex. If oil prices were to surpass the "magic" $55 threshold, BTE shares could rise sharply and could even double in a matter of months.

Yet Cenovus has proven the better investment to date and pays a yield of 1.5%, while Baytex shares do not pay any dividend.

Unless gas prices start to fall in line with the decline in crude over the past three years, Foolish investors may find that Cenovus shares offer one of the premier plays in the oil sands today.

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