Has Cenovus Energy Inc. Stock Gotten Ahead of Itself?

Description

The energy sector has undergone a bit of a resurgence as of late. Once home to some of the most undervalued companies on the TSX, many energy companies have rebounded. Over the past three months, the **S&P/TSX Capped Energy Index** has returned 15.16%, handily outpacing the 2.6% gain of the TSX. One company that has benefited from the recent oil surge is **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE). Over the past few months, the company has returned approximately 25% to shareholders. Is the recent run-up warranted? Let's take a look.

First quarter earnings

The company's most recent earnings weren't pretty. The company posted a massive earnings miss, posting a much larger than expected loss of $0.61 per share. Cenovus had a cash shortfall of $123 million in the first quarter, and its operating loss from continuing operations reached $752 million. Ouch!

Management pointed to three factors that played a role in the bad quarter: a wide light/heavy oil price differential, planned maintenance at its U.S. refineries, and an impairment on some assets in the Deep Basin. It wasn't all bad, however, as the company almost doubled oil sands production to 359.6K barrels per per day (bbl) from the same quarter last year. Likewise, the company oil sands unit operating costs declined and its Deep Basin unit operating costs decreased 18%.

Despite the poor earnings, the company's share price has remained resilient. Why?

Hedging impacts and narrowing spread

One of the issues that has held the company back is that it had hedged 80% of production at a time when oil prices were low. The move was made to support financial resilience by establishing downside protection. Unfortunately, oil has been on a tear and the company has missed out. Hedging was also the main reason that the company booked $469 million in risk management losses from continuing operations.

The good news is that at the end of the second quarter, a good portion of that hedging will expire. Only 37% of production will remain hedged for the remainder the year. If oil prices remain elevated, then

Cenovus will start to reap the benefits of higher oil prices in a meaningful way come July.

In the first quarter, the company realized a WTI/WSC spread of $24.28/bbl, which was 67% higher than the same period last year. The good news is that the spread is narrowing. At the time of writing, the spread has narrowed to $18.69, a 23% improvement. As the spread narrows, heavy oil producers such as Cenovus will stand to benefit.

Room to run

Despite the company's recent price run-up, it's still not that expensive. Cenovus is trading at a forward price-to-earnings of 18.7 and a price-to-sales of 0.9; both are below industry averages. Likewise, its enterprise value to earnings before interest, taxes, depreciation and amortization (EBIDTA) ratio of 10.3 is also below the industry average of 12.48. Last and perhaps more important, it is currently trading below book value.

Has the stock gotten ahead of itself? The answer is no, and it still has room to run. With hedging expiring, rising oil prices, and a narrowing WTI/WCS spread, the company is well positioned to continue its run upwards.

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