Is It Time to Buy Cenovus Inc. (TSX:CVE)?

Description

Oil continues to see-saw wildly as a combination of good and bad news emerges over the outlook for crude. Despite the latest pullback, the North American benchmark West Texas Intermediate (WTI) is still up by around 33% since the start of 2019, and there are signs that firmer crude is here to stay.

This has sparked considerable speculation among pundits that now is the time to boost exposure to Canada's energy patch. The third largest oil sands operator, **Cenovus** (TSX:CVE)(NYSECVE), which has only gained 18% for the year to date, is attracting considerable attention.

Improved first-quarter 2019 results

Cenovus was struggling to operate profitability when Canadian heavy crude known as Western Canadian Select (WCS) plunged to record lows. It was one of the oil sands operators that was lobbying Alberta's provincial government to introduce mandatory production cuts to drain local oil inventories and boost WCS prices.

Those cuts, while responsible for significantly bolstering WCS, are the reason for Cenovus' first-quarter 2019 production declining by 8% year over year to 447,270 barrels daily.

They are also the rationale behind Cenovus reducing its 2019 production guidance to see it anticipating oil sands output of around 350,000 to 370,000 barrels daily. At the midpoint of that range, Cenovus' annual oil sands production will be roughly 1% lower than 2018.

Nonetheless, significantly higher oil prices have had a positive effect on the company's earnings despite the decline in oil and natural gas output. First-quarter cash from operating activities was $436 million compared to negative cash flow of $123 million for the same period in 2018, while net earnings soared to $110 million against a loss of $914 million a year earlier.

That significant improvement in Cenovus' financial position can be attributed to substantially higher WCS prices, which saw it realize an average sale price of $46.66 per barrel over the quarter that was 80% higher than a year earlier. This more than offset the moderate increases in transportation and operating expenses reported for the period.

As a result, Cenovus reported a notable operating netback of $26.99 per barrel pumped before the application of commodity price hedges, which was more than five times greater the prehedging netback reported for the same period in 2018.

The oil sands company is also focused on boosting market access by ramping up the volume of crude by rail shipments to around 100,000 barrels daily during 2019. Cenovus' has also secured 275,000 barrels daily of capacity on the Keystone XL and the Trans Mountain pipeline projects, but there is no indication that those pipelines will be completed anytime soon. It is here that the real risk associated with investing in Cenovus emerges.

External risks abound

Once Alberta ends the compulsory production cuts, it is feared that WCS will plunge once again, sharply impacting Cenovus, because 77% of its petroleum output comes from oil sands and is bench marked to WCS. The cuts have only provided temporary relief from a lack of pipeline exit capacity, which has yet to be addressed through the construction of new pipelines or the expansion of existing infrastructure.

Even the company's much-vaunted Line 3 Replacement Project has been delayed by roughly a year after permitting issues forced the midstream services giant to push back its scheduled in-service date to the second half of 2020.

There is also speculation that the cuts have failed to drain local oil stocks, with industry consultancy Genscape estimating that local inventories in April 2019 hit a record of 3.71 million barrels. While the mandatory cuts have curtailed production growth, all of Canada's major oil sands companies will ramp-up activity once they come to an end.

This means that WCS will collapse once again when Edmonton ends the cuts and production outstrips the transportation capacity of existing pipeline and rail infrastructure. Unlike **Suncor Energy**, Cenovus lacks substantial refining capacity, meaning that it can't profit from a wide price differential between WCS and WTI — and the profitability of its operations will therefore suffer once again.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

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

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise

4. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date
2025/07/28
Date Created
2019/05/21
Author
mattdsmith