Why Cenovus (TSX:CVE) Stock Fell 6% in August

Description

Cenovus Energy (TSX:CVE)(NYSE:CVE) stock could have made you rich — as long as you bet on the stock going down. Over the last decade, shares have lost two-thirds of their value.

Meanwhile, the **S&P/TSX Composite Index** *increased* in value by around one-third. That losing streak continued in August when shares shed another 6% in value. The TSX, overall, was flat last month.

While many investors continue to flee the stock, some believe a bottom has been formed. If energy prices play along, it's not difficult to see shares *doubling* over the next 12 months. How likely is that to happen? Let's find out.

Here's what happened

August was a quiet month for Cenovus, as investors tried to make sense of the company's second-quarter earnings release on July 25. Last quarter, total production fell 15% year over year to just 443,300 barrels per day. The stock dropped 3% the day earnings were announced.

Typically, the company can rely on counter-cyclical refining margins to soften the blow, but that didn't happen. Downstream operating profit fell by nearly 50%.

These issues weren't necessarily management's fault. Most Canadian energy companies are still struggling with mandatory production cuts, high transportation costs, and regionally discounted prices.

Late last year, a supply surge overloaded pipeline capacity, forcing producers to bid aggressively against each other to secure capacity. Local oil prices fell to as low as $15 per barrel. In response, Alberta instituted a province-wide supply cut. While that improved pricing, it's impacted output and top-line revenues ever since.

While the curtailment limits have eased a bit, Alberta announced on August 20 that they will remain in place until at least December of 2020. "While curtailment is far from ideal, under the current context it is necessary," Energy Minister Sonya Savage commented. "But we have to do this in the short term because of a lack of pipeline capacity."

What to expect

Cenovus wasn't hurt due to poor capital efficiencies, hedging mistakes, or falling oil prices. Its biggest issue was production cuts killing revenue growth. Management continues to pursue a "diversified transportation strategy" so that it can ship its oil to high-price regions, including roughly 100,000 in crude-by-rail capacity. But that diversification will come at a cost given rail is normally a higher-cost alternative.

At some point, Cenovus shares will become a bargain, but it's always tough to bet on a company that doesn't control its own future. If additional pipeline capacity doesn't come online, it's hard to see Albertan curtailments disappearing anytime soon.

Because pipeline upgrades and replacements can take years to permit and build, there's a good chance Cenovus will be dealing with the same issues in 2020 and beyond. Combine that with new marine fuel regulations that could render 20% of all Canadian oil sands production uneconomic, and you have one difficult investment case.

Cenovus stock will continue to be volatile, but I'm sticking to the sidelines. There are plenty of other industries, like cannabis or tech, that have high-growth opportunities with much less exogenous risk.

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