Why Cenovus Energy (TSX:CVE) Stock Rose 12.4% in December

Description

With more than 80% of its production being oil, **Cenovus Energy Ltd.** (TSX:CVE)(NYSE:CVE) management is feeling quite optimistic, and this, along with a rise in oil prices, fuelled Cenovus stock price strong performance in December.

So let's take a more detailed look at why Cenovus stock price rose in December and why investors should feel optimistic.

Oil prices rise

Oil prices rallied in December, with the West Texas Intermediate (WTI) oil price up 12% and the Western Canadian Select (WCS) oil price up 25%.

The rise in the price of oil in Canada is a function of improving takeaway capacity in the Canadian oil and gas industry in the form of pipeline expansions continuing to move forward coupled with a sharp increase in crude-by-rail shipments.

Cenovus has recognized these improvements, and as such, we can look no further than the company's 2020 budget that was released in December to see the optimism brewing.

Strong production growth as constraints ease

Cenovus is expecting a growth rate in 2020 production of approximately 7%. According to management, this will be driven by an increase in crude-by-rail shipments and the government of Alberta's easing of production constraints in 2020.

In fact, Cenovus will be shipping approximately 100,000 barrels a day by the end of 2020. For comparison purposes and to highlight the dramatic growth that Cenovus is pushing in its crude-by-rail volumes, we can look to the fact that the company exited the third quarter of 2019 shipping 83,000 barrels a day by rail. By the end of 2020, Cenovus expects to be producing at unconstrained levels.

Highlighting the free cash flow machine that is Cenovus Energy

In its 2020 budget, management increased its capital spending plan from 2019 levels of $1.2 billion. 2020 capital spending is expected to be between $1.3 billion and $1.5 billion, largely a reflection of the easing of mandatory curtailments.

Even with this increased spending, Cenovus can be expected to generate free cash flow after dividends of almost $1.4 billion in 2020 and of roughly $3 billion in the next two years as production rises and costs continue to decline.

Returning cash flow to investors

Management has already outlined its intention to return cash to shareholders. In fact, the company announced a 25% increase to it dividend effective for the fourth quarter of 2019.

With the end of 2019, this increase and future increases (management expects to implement yearly dividend increases of 5% to 10% going forward), are being recognized by investors, and should continue to drive the stock price higher.

Management has also noted that they are in a position to also consider share repurchases, all with the aim of creating shareholder value. Currently, Cenovus' dividend yield stands at 1.96%, and Cenovus stock price trades at an undervalued four times cash flow.

Foolish bottom line

Cenovus Energy stock price rallied in December as the company projected to investors that the state of the Canadian oil and gas industry is improving.

This will be reflected in the company's 2020 capital spending, production numbers, as well as its free cash flow generation. The stock remains undervalued despite the December run-up and remains a solid Canadian energy stock.

In closing, I would like to remind foolish investors of our belief in holding great businesses for the long term. While this belief remains intact, we are also aware that sometimes, short-term stock price movements create opportunities to create wealth.

Blending this long-term focus with a keen eye for short-term stock mispricings, we can use both strategies in harmony, and our quest for financial freedom can be fulfilled.

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Author
karenjennifer