Cenovus Energy Earnings Next Week: What to Watch for

Description

Oil companies are having a bombastic year, as the energy crisis has boosted oil prices to US$100/barrel. **Cenovus Energy** (TSX:CVE)(NYSE:CVE) is one of the key beneficiaries of this trend. The company's acquisition of Husky Energy in January 2021 couldn't have been timed better, as it made Cenovus the third-largest integrated oil company in Canada.

When the company announced its 2021 earnings, its most bullish 2022 free funds flow guidance was $5.5 billion at US$75 WTI. However, the onset of the Russia-Ukraine war boosted the WTI price from about US$75 on January 1 to US$107.8 on March 30. This has made analysts bullish on Cenovus's upcoming first-quarter earnings on April 27.

2022 is the year of oil

The global oil supply is disrupted as Western countries imposed sanctions on Russian oil. Moreover, the Organization of the Petroleum Exporting Countries (OPEC) refused to accelerate oil production. The United States is looking for alternative suppliers, and Canada is a viable alternative. But there aren't enough pipelines to transmit excess oil from Canada to the United States.

On top of this, oil demand is picking up from the pandemic downturn, adding to the pressure. Considering these factors, oil prices are expected to remain at or above US$100 throughout the year.

Three things to watch for in Cenovus Energy's upcoming earnings

Cenovus's first-quarter earnings could see some upward revisions in three areas:

- Leverage ratio
- Shareholder returns
- Loss from risk-management activities

Cenovus Energy’s leverage ratio

Cenovus’s primary target was to deleverage its balance sheet. In 2021, it paid off all the debt it took to acquire Husky. In its 2022 guidance, it expected a free funds flow (FFF) of $5.5 billion at US$75 WTI, and it is likely to achieve this. Its financial target is to achieve net debt to adjusted EBITDA of one to 1.5 times at US$45 WTI in 2022. To achieve this target, it has to reduce its net debt from $10 billion in 2021 to $6-$8 billion in 2022.

Higher WTI could help Cenovus achieve its target leverage ratio earlier than expected. It could probably revise its leverage ratio guidance for 2022 to one.

Shareholder returns

Cenovus’s second priority for its FFF is to increase shareholder returns. The company has already doubled its dividend and announced a share buyback of 146.5 million shares. In its upcoming earnings, the company could increase its share buyback. A lower number of shares could help it grow its dividend fourfold in the next five years.

Commodity companies decide on the capital spending on exploration and expansion depending on commodity prices. Cenovus’s third priority for its FFF is to increase investment in the business by developing reserves it didn’t include in its five-year plan. But this is still a distant future, and a discussion around it is unlikely in the upcoming earnings.

Loss from risk-management activities

In 2021, Cenovus reported a $995 million loss from risk-management activities, where it hedges its production against a sudden drop in crude prices. Please note that this is the loss for full-year 2021.

But the company expects to report a loss of $970 million from risk-management activities in the first quarter alone and another $410 million in the second quarter. This loss comes as oil prices continue to surge. Hence, Cenovus has suspended risk-management activities and plans to close all the positions by June 2022.

In the wake of higher oil prices, analysts have revised their 2022 earnings estimates for Cenovus Energy. Four analysts have a consensus revenue estimate of $74 billion, up 59% from the 2021 revenue, and an EPS estimate of $4.06, up 1,354%. Cenovus stock has surged 44% year to date and could continue to surge in the run-up to the first-quarter earnings.

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