Why Cenovus Energy Stock Soared 70% in 2022

Description

The year 2022 was indeed a challenging one for equities. Rapid interest rate hikes amid adamant inflation notably weighed on markets, bringing Canadian stocks down by 10%. However, TSX energy stocks kept shining and delivered massive outperformance, returning 55% last year. Canada's third-biggest energy company by market cap, **Cenovus Energy** (TSX:CVE) was among the top value creators and returned 72% in 2022.

CVE stock was one of the top gainers in 2022

Not just Cenovus, but almost all energy stocks have changed course since the pandemic. The capital discipline they have retained has made them investor-favourites for the last few years. Even when oil prices were at multi-year highs, they focused on deleveraging, which has notably strengthened their balance sheets. They do not seem to be in any rush to increase production, as their profits are already at all-time highs.

Cenovus Energy is no different. In the last reported 12 months, the company posted free cash flows of $6.2 billion, an increase from $3.6 billion in 2021. Such handsome growth came mainly after crude oil and gas prices jumped on supply woes.

Interestingly, Cenovus focused on repaying debt with its incremental free cash flows in 2022. As of September 30, 2022, its net debt declined to $5.3 billion from over $11 billion in 2021. As debt declines, it will likely spend less on interest expenses this year, notably improving profitability.

This has been the theme for the North American energy sector: to repay debt aggressively and achieve a healthier balance sheet. As a result, the entire sector will likely see an earnings boost in 2023 while the street at large struggles. Inflation and rate hike woes will most likely continue to be an obstacle to corporate earnings growth in 2023. On the other hand, oil and gas companies seem very well placed for solid financial growth and to outperform other sectors.

Improving the balance sheet and aggressive share buybacks

Apart from debt repayments, Cenovus deployed its windfall cash to buy back its own shares. Share repurchases help uplift stock prices in the short term. They also result in a per-share earnings increase. Cenovus bought back 97 million of its shares worth $2.1 billion in the nine months of 2022.

Interestingly, Cenovus will likely see handsome free cash flows this year, too. As for 2023, it aims to allocate a higher portion of free cash flows to share buybacks and relatively less on debt repayments. As it achieved much of the deleveraging target in 2022, share buybacks in 2023 might see a huge boost. This thesis makes CVE stock one of the best bets among TSX energy stocks for 2023.

Conclusion

Fundamentally, global energy markets are highly undersupplied in the short-to-medium term. As China opens up from the pandemic restrictions, the demand-supply deficit could widen further, sending oil prices much higher in 2023.

While energy companies like Cenovus are seeing marginal production increase, higher oil prices could significantly benefit their earnings. Note that even if oil prices remain where they are, energy producers will likely continue to receive investors' affection because of their stronger balance sheets, share buybacks, and relatively weaker broader markets.

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