Could Cenovus Stock Be a Big Winner in 2023?

Description

As one of Canada's premier oil and gas companies, **Cenovus Energy** (TSX:CVE) has really lived up to its reputation. As the third-largest Canadian oil and gas producer and the second-largest Canadian-based refiner and upgrader, Cenovus has been making a fortune. And, of course, Cenovus stock has been making its shareholders a fortune as well.

What will 2023 hold for this successful energy stock?

A new year brings a shift in priorities — and a cash windfall for shareholders

Since early last year, Cenovus's management said that their priority was to pay down their massive debt load that exceeded $10 billion. Thankfully, strong oil and gas prices really played an integral part in making this happen. Fast forward to the end of September 2022, and we've seen that the debt had been slashed by $4.3 billion in 2022. In early December, management confirmed that the company's net debt would fall to $4 billion by the end of 2022.

This $4 billion debt level has been management's targeted level. At this point, the company's credit rating and outlook understandably improve. As a result, Cenovus promised to embark on their next phase — returning capital to shareholders. The company already tripled its dividend in 2022 and declared its first variable dividend. But once the target debt level is reached, this return of capital will accelerate.

This shift in spending priorities looks like this — excess free funds flow will be 100% directed toward shareholders. This will take the form of increases in the regular dividend, share buybacks when the stock price is around the $20 level, and special dividends when Cenovus stock price is around the $30 level. Right now, Cenovus's stock price is trading at just over $25.

What about commodity prices?

For energy stocks, a year can't be a blowout year unless oil and gas prices remain strong. As of today, many of the issues that drove higher prices are still lingering. For example, low supply levels after years of underinvestment in oil and gas assets still poses a challenge. Also, demand remains pretty strong as countries continue to recover from COVID-19 shutdowns. Finally, global tensions are still high, and Canada remains one of the top sources of energy supply for its political stability, security, and relatively low-cost production.

As of the time of writing, crude oil is trading just above $80. This represents a 7.6% decrease relative to a year ago, but a 54% increase compared to two years ago. In any case, oil prices above $50 are considered really good for oil and gas companies, as their breakeven prices are well below that. As for natural gas, it's currently trading at $3.09. While it's significantly lower than recent highs of over $9, the natural gas market is enjoying strong fundamentals, as North American natural gas is opening up to global demand.

Cenovus stock price still trades at attractive valuations and should trend higher

Even after Cenovus stock's strong performance, it's still very attractively valued. The is because cash flows are rising fast, as are the company's dividend payments and returns. Currently, Cenovus is generating a return on equity (ROE) of approximately 20%. This is being driven by strong commodity prices, of course. But it's also being driven by the company's operational and strategic performance, creating real value along the way. For example, Cenovus's acquisition of Husky Energy at the depths of despair in the energy sector a few years ago was perfection.

Chief Executive Officer Alex Pourbais said that Cenovus acquired Husky at a "once-in-a-generation valuation." This is the way to create long-term shareholder value — acquiring companies when they're trading at cyclical lows, or "once-in-a-generation" valuations. Cenovus has already captured much of the estimated $1.2 billion in synergies that were expected through this acquisition. At this point, it looks like they will exceed this run rate.

And there remains plenty of opportunity to further drive production efficiencies at the acquired assets. You see, before the acquisition, Husky Energy neglected to invest in its production because oil and gas prices were so low and there was not enough cash to do so. Today, Cenovus can add production to the Husky assets with minimal capital investment.

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