



Independent Stock Idea

April 29, 2015

Cenovus Energy Inc. New Buy on Operating Leverage

<i>Symbol</i>	CVE	<i>Ebitda Next Twelve Months ending 3/31/16 (US\$m)</i>	1,800
<i>Rating</i>		<i>North American Natural Gas/Ebitda (%)</i>	9
<i>Price (US\$/sh)</i>	18.82	<i>Natural Gas and Oil Production/Ebitda (%)</i>	80
<i>Pricing Date</i>	4/29/15	<i>Adjusted Reserves/Production NTM</i>	15.1
<i>Shares (mm)</i>	825	<i>EV/Ebitda</i>	11.2
<i>Market Capitalization (US\$m)</i>	15,500	<i>PV/Ebitda</i>	20.8
<i>Debt (US\$m)</i>	5,000	<i>Undeveloped Reserves (%)</i>	75
<i>Enterprise Value (EV) (US\$m)</i>	20,500	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	19.94
<i>Present Value (PV) (US\$m)</i>	38,000	<i>Present Value Proven Reserves(US\$/boe)</i>	16.58
<i>Net Present Value (US\$/share)</i>	40	<i>Ebitda Margin NTM (%)</i>	46
<i>Debt/Present Value</i>	0.13	<i>Earnings Next Twelve Months (US\$/sh)</i>	-0.16
<i>McDep Ratio - EV/PV</i>	0.54	<i>Price/Earnings Next Twelve Months</i>	-118
<i>Dividend Yield (%/year)</i>	4.7	<i>Indicated Annual Dividend (US\$/sh)</i>	0.89
Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.			
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.			
Estimated present value presumes a long-term price for oil of US\$90 a barrel and natural gas, \$6 a million btu.			
For historical analysis of Cenovus since 2009 see www.mcdep.com/2cve.htm			

Summary and Recommendation

Trading at a McDep Ratio of 0.54, the stock of Canadian deep oil sands producer **Cenovus (CVE)** is an automatic Buy as a result of our recent decision rule to recommend current purchase of the two lowest McDep Ratio stocks in each peer group (see *Meter Reader*, April 14, 2015). Operating leverage demonstrated in sensitivity of cash flow to oil price contributed to the decline in Enterprise Value that lowers McDep Ratio. In first quarter results disclosed on April 29, unlevered cash flow (Ebitda) from oil and gas production, as we calculate it, declined 69% from the fourth quarter of 2014 compared to 44% for Cenovus oil price and 27% for benchmark West Texas Intermediate crude oil price (see table Operating and Financial Estimates on page 2). Because leverage works both ways, we expect Cenovus to be a disproportionately greater beneficiary of oil price gains we are expecting over the next year and a half or so. In addition another 50,000 barrels daily of new capacity (25% of current oil production) should be completed in 2016. At the same time, Chief Executive Brian Ferguson, a conservative financial manager we first met some 25 years ago, places a high priority on the 4.7% dividend yield. So much so, that Cenovus had a surprise C\$1.4 billion share offering earlier this year that further strengthened a strong balance sheet to a low 0.13 ratio of Debt to Present Value. The offering is neutral with respect to McDep Ratio because Enterprise Value is unchanged. The increase in equity is matched by an equal reduction in debt. Overall, high operating leverage is balanced by low financial leverage. In the end, we think the risks are not as great as the low stock price suggests and the upside looks quite attractive.

Kurt H. Wulff, CFA



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Cenovus Energy Inc.										
Next Twelve Months Operating and Financial Estimates										
(Canadian Dollars)										
										Next Twelve Months
	Q1 3/31/14	Q4 12/31/14	Year 2014	Q1 3/31/15	Q2E 6/30/15	Q3E 9/30/15	Q4E 12/31/15	Year 2015E	Q1E 3/31/16	3/31/16
Volume										
Natural Gas (mmcf/d)	476	479	488	462	462	407	359	422	359	397
Oil (mbd)	197	216	204	218	211	205	199	208	193	202
Total (mmb)	25	27	104	27	26	25	24	102	23	98
Total (mbd)	276	296	285	295	288	273	259	279	253	268
Price										
Henry Hub (US\$/mmbtu)	4.95	4.02	4.43	2.99	2.64	2.75	2.92	2.82	3.15	2.86
Currency (US\$/C\$)	0.91	0.88	0.91	0.81	0.83	0.83	0.83	0.82	0.83	0.83
Henry Hub (C\$/mmbtu)	5.46	4.56	4.89	3.71	3.18	3.32	3.51	3.43	3.79	3.45
Differential	0.99	0.67	0.06	0.66	0.14	0.16	0.52	(0.24)	0.56	0.35
Company (\$/mcf)	4.47	3.89	4.37	3.05	3.04	3.16	3.00	3.06	3.23	3.10
WTI Cushing (US\$/bbl)	98.74	73.18	93.04	48.62	55.71	59.06	60.31	55.92	61.24	59.08
WTI Cushing (C\$/bbl)	108.88	83.16	102.54	60.32	67.14	71.17	72.68	67.83	73.80	71.20
Differential	67%	66%	69%	52%	61%	62%	63%	62%	65%	65%
Company (\$/bbl)	73.12	55.02	71.16	31.08	43.64	46.26	47.24	41.92	47.97	46.22
Total (\$/bbl)	59.83	46.47	58.33	27.74	36.86	39.47	40.47	35.97	41.20	39.42
Revenue (\$mm)										
Natural Gas	191	171	777	127	128	118	99	472	105	450
Oil	1,296	1,093	5,287	610	840	873	865	3,187	833	3,411
Royalties	(103)	(100)	(465)	(11)	(11)	(11)	(11)	(44)	(14)	(47)
Other	3,627	3,073	14,043	2,415	2,415	2,415	2,415	9,662	2,415	9,662
Total	5,012	4,238	19,642	3,141	3,372	3,396	3,368	13,277	3,339	13,475
Expense	3,818	3,756	15,391	2,799	2,847	2,860	2,845	11,350	2,727	11,278
Ebitda (\$mm)										
Natural Gas and Oil	949	804	4,040	247	430	441	429	1,547	462	1,762
Other	245	(322)	211	95	95	95	95	380	150	435
Total	1,194	482	4,251	342	525	536	524	1,927	612	2,197
Deprec., Deplet., & Amor	454	531	1,961	499	499	499	499	1,996	499	1,996
Hedging and other	29	789	944	(135)				(135)		-
Interest	128	71	377	110	110	110	110	440	110	440
Ebt	582	(908)	969	(132)	(84)	(73)	(85)	(374)	3	(239)
Income tax	204	(318)	339	(46)	(29)	(26)	(30)	(131)	1	(84)
Net Income (\$mm)	379	(590)	630	(86)	(54)	(47)	(55)	(243)	2	(155)
Per share (\$)	0.50	(0.78)	0.83	(0.11)	(0.07)	(0.06)	(0.07)	(0.30)	0.00	(0.19)
Shares (millions)	757	757	759	779	825	825	825	808	825	825
Ebitda Margin (NG&Oil)	68%	69%	72%	34%	45%	45%	45%	43%	50%	46%
Tax rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%



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Cenovus Energy Inc.					
Functional Cash Flow and Present Value					
	<i>NTM</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<u><i>Ebitda</i></u>	<u><i>R/P</i></u>	<u><i>Ebitda</i></u>	<u><i>Value</i></u>	
North American Natural Gas	170	5.5	19.4	3,300	9%
Oil	1,590	18.3	20.3	32,200	85%
Downstream	440		5.7	2,500	7%
	2,200	15.1	17.3	38,000	100%
Debt					5,000
Net Present Value (\$mm)					33,000
Shares					825
Net Present Value - Standard Estimate (US\$/sh)					40
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					38

Disclaimer: This analysis was prepared by Kurt Wulff, Manager of McDep LLC. The firm used sources and data believed to be reliable, but makes no representation as to their accuracy or completeness. This analysis is intended for informational purposes and is not a solicitation to buy or sell a security. Past performance is no guarantee of future results.

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