4 Takeaways From Cenovus' Earnings Report

Description

Cenovus (TSX: CVE, NYSE: CVE) reported its third-quarter earnings on Wednesday. The company's refining operations were a drag on performance and Cenovus missed the street's expectations for a second straight quarter. But let's dig a little deeper into the results. Here are the top four takeaways from the report.

1. Turnaround complete at Foster Creek
Upstream results were solid. Operating cash flow totaled $915 million, up 40% year over year. Primarily this was due to a 6% sequential increase in volumes and higher crude oil prices.

But it was apparent that Cenovus is struggling with exactly how to optimize production at Foster Creek. That isn't surprising, given that the project was one of the first steam-assisted gravity drainage (SAGD) facilities in commercial operation. No doubt other industry players will be watching the company's result closely to learn best practices.

This has started to show up in the company's operating results. During the third quarter, production at Foster Creek fell 22% year over year due to planned maintenance. A higher number of wells were also shut down during the quarter. However, the turnaround at the facility has been completed.

2. Stung by the downstream
In the past, Cenovus has benefited from its integrated business model, which allowed it to profit from the widening price discount for Western Canadian oil. But that hedge came back to bite the company this quarter. Downstream operating cash flows fell 75% year over year (to $133 million) due to higher feedstock costs.

Last year, refineries benefited from a wide discount for Canadian heavy oil prices, caused largely by insufficient pipeline capacity to move supplies. However, that glut has been alleviated due to the advent of crude by rail. In the past year, the crack spread, or difference between the price of gasoline and the cost of oil feedstock, has fallen by more than half.

Refining margins were also negatively impacted by the cost for renewable identification numbers, or RINs, which increased fivefold to $55 million. Cenovus refineries that do not blend renewable fuels such as ethanol into their products are required to purchase RINs to comply with EPA regulations. However, the regulator is considering a reduction of biofuel blending requirements next year, which should reduce the cost of RINs.

3. New market access is a top priority
Finding ways to access the market remains a top priority for Cenovus. During the third quarter, the company reserved 200,000 bpd of capacity on **TransCanada's** proposed Energy East pipeline, which would send Alberta crude to refineries in Montreal and Saint John. Cenovus also booked an additional 175,000 bpd to west coast ports on **Enbridge's** Northern Gateway project and **Kinder Morgan's** Trans Mountain expansion.

The company is also ramping up its crude shipments by rail due to the widening discount for Western Canadian heavy oil. Cenovus expects to expand its rail capacity to up to 10% of marketable oil production by the end of next year.

4. Possible dividend hike and share buyback
At the end of management's opening remarks, CEO Brian Ferguson highlighted that the company is expected to produce significantly higher free cash flow next year. That means only one thing for shareholders: more room to fund a juicy dividend.

When confronted by analysts to implement an additional share buyback as well, management expressed some interest. The ultimate decision will be made in December, when the company provides its 2014 budget. But more capital returned to shareholders could be a catalyst for the stock.

Foolish bottom line
For investors, there was nothing this quarter to suggest that Cenovus won't be able to hit its long-term expansion goals. However, shareholders will have to watch how management addresses growing challenges, such as bitumen transportation and optimizing its Foster Creek facility, closely.

Disclosure: Robert Baillieul has no positions in any of the stocks mentioned in this article. The Motley Fool owns shares of Kinder Morgan.

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