1 Hidden Catalyst for Cenovus Energy Inc.'s Stock

Description

Weak oil prices are a big problem for energy companies around the world. The longer oil prices stay low, the weaker the cash flows of oil companies become, which could further strain already tight balance sheets.

According to the *Financial Post,* **Cenovus Energy Inc.** (TSX: CVE)(NYSE:CVE) expects a US$1.3 billion funding gap between its cash flow and its cash outflows for capex, and paying dividends this year could require the company to take on additional debt. However, Cenovus' refining business could help it fill the gap thanks to the widening of the crack spread, as this hidden catalyst could save the company from having to borrow more money to bridge its cash-flow gap.

What is the crack spread?

As an integrated oil company, Cenovus Energy owns oil and gas assets, as well as refining assets. Those refining assets earn their profits from what is called the crack spread. The crack spread is the difference between buying oil and selling refined petroleum products. When oil prices are high, this spread is really squeezed. However, when oil prices are low, the spread widens and the profits pile up.

For 2015 Cenovus Energy expected the crack spread to be US$11.75 per barrel. That would provide the company with US$250 million in refining cash flow. However, the crack spread recently has been near US$30 per barrel due to the widening gap between the U.S. oil benchmark WTI, where Cenovus buys oil, and the global benchmark Brent, which is used to price refined petroleum products. This widening gap, which is seen on the chart below, is really sweetening the crack spread for Cenovus and other refiners.

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CVE crack spread

As we see on that chart, over the past year Brent has sold at a premium to WTI, but that premium has really widened in recent weeks and is upwards of US$10 per barrel. That adds a hefty premium to the crack spread and to Cenovus' profit potential, and could be the key to eliminating its funding gap.

Flowing with cash flow

According to Cenovus, for every US$1 per barrel, the crack spread moves and will impact the company's refining cash flow by US$90 million. So, if the crack spread averages $16.75 this year it would boost the company's refining cash flow to nearly US$700 million and cut the company's cash flow shortfall to US$850 million. Meanwhile, if the crack spread can maintain its $30-per-barrel margin for the full year, it would boost the company's refining cash flow by US$1.6 billion.

This same crack spread will also help boost the cash flow of other Canadian integrated oil companies like **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Husky Energy Inc.** (TSX:HSE). Suncor has been using its refining and marketing assets to boost its profitability for years, as those assets enable it to enjoy Brent-based prices on 97% of its oil production, while just 3% of its production is exposed to weaker WTI pricing. The company is working to boost its refining margins by providing greater access to cheap crude oil at its Montreal refinery.

Meanwhile, Husky Energy has a handful of refineries that will provide it with additional cash flow this year due to the crack spread. Like Suncor, it's working to provide better access to cheaper North American oil at its Lima refinery so that it has the flexibility to take advantage of cheap oil and a wide crack spread in the future.

Investor takeaway

Cenovus Energy might have a better year than investors expect, thanks to the very robust crack spread its refining operations are enjoying right now. If that spread stays where it is, the company's cash flow shortfall could be eliminated. It's a hidden catalyst that could really provide a boost to Cenovus and other integrated peers like Suncor and Husky.

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