



Cenovus Energy Inc.: Should Dividend Investors Buy the Stock?

Description

Cenovus Energy Inc. ([TSX:CVE](#))([NYSE:CVE](#)) is down more than 10% in the last week and almost 20% in the past three months.

It looks like the stock could be heading for a re-test of the December lows, and investors eyeing up the 5% dividend yield are wondering if they should buy, sell, or hold the shares.

Let's take a look at the current situation to see if Cenovus deserves to be in your portfolio.

Political risks

The NDP victory in Alberta sent energy investors running for the hills this week and Cenovus took a good beating. The brutal slide might have been influenced by comments made by the company's president and CEO, Brian Ferguson, before the election.

Alberta's NDP leader and new premier-designate Rachel Notley had indicated during the campaign that she would review royalty programs if elected. Ferguson told Bloomberg News before the election that that he doesn't think there is any room for royalty increases and any "changes that make the structure uncompetitive" would result in negative investment in the province.

Higher royalty payments would certainly put more pressure on an already fragile oil and gas sector, but I suspect there won't be any big changes happening right away. The NDP is also considering a hike in corporate taxes from 10% to 12%.

Operational outlook

Ferguson made his thoughts known just after Cenovus released its Q1 2015 earnings. The company reported a loss of \$668 million compared with earnings of \$247 million in Q1 2014.

All the news appears to be bad, but investors need to drill down into the results to get a better picture.

Year-over-year oil sands production in the first quarter actually increased 20% and per-unit operating

costs dropped 31%. The Christina Lake location increased production by 16% and operating costs at the site dropped by 38% to \$8.22 per barrel. Foster Creek improved production by 24% compared with the same period last year and operating costs fell by 24% to \$14.48 per barrel.

Cenovus also has a large refining and marketing business. Operating cash flow from refining and marketing in the first quarter was \$95 million, down 61% from the previous year.

The refining numbers look nasty, but investors have to take them with a grain of salt due to the way Cenovus determines margins. The company uses a first-in, first-out inventory accounting method, meaning Cenovus measures margins based on the oldest input cost. When oil prices are volatile, the cash flow numbers can be misleading relative to the current market conditions.

U.S. refiners tend to use last-in, first-out accounting, and this would have increased Cenovus' Q1 2015 cash flow number by \$55 million and reduced the Q1 2014 result by \$83 million.

Dividend safety

Earlier this year, Cenovus evaluated several options to shore up its balance sheet. Instead of cutting the payout, management decided to issue \$1.4 billion in stock, reduce capital expenditures, cut the workforce by 15%, and slash discretionary expenses.

The company also implemented a 3% discount on its dividend reinvestment plan. The incentive was a big success, with roughly one-third of shareholders deciding to receive shares instead of cash. This saved the company about \$81 million.

Crude prices have recovered significantly in the past month. If the oil market stabilizes near current levels, the dividend should be safe.

What should investors do?

There is still a lot of uncertainty in the energy market, and the NDP win in Alberta just added more fuel to the fire. At the same time, Cenovus is making excellent progress in its plan to reduce operating expenses, and the company is sitting on resources that should deliver low-cost production for decades.

If you already own the stock, I wouldn't sell right now. New investors might want to take a small contrarian position, but you should be prepared for more volatility.

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