



## Should You Be Worried About Cenovus Energy Inc.'s \$700 Million Shortfall?

### Description

In late January **Cenovus Energy Inc.** ([TSX:CVE](#))([NYSE:CVE](#)) released their 2015 guidance estimates, and it most notably included a funding gap of between \$500-700 million. This funding gap refers to the difference between the companies estimated cash flow and their estimated capital expenditures.

Unfortunately, this funding gap doesn't include Cenovus' fairly large dividend, which works out to about \$888 million annually. In Q1 about 37% of shareholders chose to take their dividend in shares through the DRIP program, meaning Cenovus needed to pay out less of their dividend in cash, and if this were to continue throughout the year, Cenovus will need to payout about \$560 million in cash for their dividend.

The end result? Cenovus could potentially be \$1.3 billion short in 2015, and this could spell bad news for their dividend or capital expenditures. Fortunately, there have been several developments in Q1 that could ease this situation.

### Refining margins and crude prices seem to be recovering

Cenovus is an integrated energy player, which means the company has both upstream production assets, and downstream refining assets. The company uses the heavy oil and light oil produced by its upstream operations to provide feedstock to its two refining operations, which in turn allows Cenovus to benefit from the spread between Western Canadian Select (WCS) heavy oil and refined products, which are based off much higher Brent crude prices.

A refiner's profit margin is known as the crack spread, and it is calculated as the difference between refined products (such as gasoline and diesel) and crude oil. In Q4 2014 Cenovus actually noted a loss of \$362 million in its refining segment largely due to the fact that crack spreads declined substantially during the quarter.

This decrease was caused by the rapidly declining spread between West Texas Intermediate (WTI) crude and Brent crude. Since refineries buy crude at WTI prices and sell refined products based off Brent prices, a smaller spread means smaller profits.

Cenovus was hit even harder because its refineries are also configured to process heavy oil, which is priced based off WCS prices. This is an advantage when WCS prices are low, but Cenovus saw WCS prices rise relative to WTI prices due to better Gulf Coast access for heavy oil and more demand from refineries. This means Cenovus had increasing feedstock costs.

Fortunately for Cenovus, these margins seem poised to improve. Cenovus' January guidance incorporated a very low crack spread of US\$11.75, but since this point, the differential between Brent and WTI has risen substantially, and crack spreads have risen with it.

The Energy Information Administration estimates that the Brent-WTI spread will be higher for 2015 than 2014 due to building crude inventories in the U.S. This means the low Brent-WTI spread at the end of 2014 and in early 2015 and the low crack spread that Cenovus used in their guidance may be overly conservative.

Cenovus estimates that every \$1 increase in the Chicago 3-2-1 crack spread will add \$90 million to refining margins, and analysts at **TD Bank** suggest a 2015 crack spread of US\$16.75 may be more realistic for 2015 than US\$11.75, given the rising Brent-WTI differential.

The result? Cenovus could see \$450 million more in cash flow, which has the potential to reduce the funding gap significantly. Even better, Cenovus' previous guidance assumed WTI prices of US\$50 for 2015. Current prices are approaching \$60, and a \$10 increase in WTI prices would add \$580 million to Cenovus' cash flow. If prices remain at current levels, Cenovus could see its funding gap close.

### **Cenovus has significant liquidity to fund any remaining shortfall**

Should there be any shortfall, Cenovus is fully prepared. The company issued \$1.4 billion in equity, and after paying off some maturing debt, the company has \$1.8 billion in cash on its balance sheet. Should this not be sufficient, Cenovus has access to a \$3 billion credit facility, none of which is drawn.

### **CATEGORY**

1. Energy Stocks
2. Investing

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1. Editor's Choice

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1. NYSE:CVE (Cenovus Energy Inc.)
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