



Dividend Investors: Has Cenovus Energy Inc. Bottomed?

Description

Cenovus Energy Inc. ([TSX:CVE](#))([NYSE:CVE](#)) is down 15% in 2015 and more than 35% in the past 12 months.

That doesn't paint an encouraging picture, but contrarian investors are eyeing up the 5% dividend yield and wondering if this is a good time to take a small position in the stock.

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

Earnings concerns, lower costs, and higher production

Cenovus reported a Q1 2015 net loss of \$668 million compared to gains of \$247 million in 2014. The figure looks pretty scary, but it includes unrealized foreign exchange losses of \$514 million that are mostly connected to the company's U.S. dollar-denominated debt.

A better metric for investors to look at is the Q1 operating loss of \$88 million compared to operating earnings of \$378 million in Q1 2014. The Q1 results are certainly ugly, but the company is making good progress on its cost-cutting initiatives, and that bodes well for investors if oil prices continue to improve.

During the first quarter the company reduced its workforce by 15% and cut \$700 million out of the capital budget. The 2015 capital program is now expected to come in below \$2 billion, which should be covered by cash flow if market conditions remain stable.

Meanwhile, total oil production increased by 11% over the same period in 2014.

Dividend risk

Cenovus generated cash flow of \$495 million in the first quarter and this fell short of the \$529 million spent on capital projects. Cash reserves were used to cover the \$34 million capital gap and the dividends.

In February the company raised \$1.4 billion through an equity issue to strengthen the balance sheet. Management evaluated a number of options, including a cut to the dividend, but decided the equity route was a better option, given its capital needs and desire to have some dry powder available for acquisition opportunities.

Cenovus finished the first quarter with \$1.8 billion in cash and cash equivalents. The company also has \$4 billion in available credit lines, so there is enough money available to make the dividend payments for the rest of the year if operating cash flow comes up short.

Cenovus recently implemented a dividend reinvestment discount of 3%, which has proven to be popular and saved the company \$81 million in the first quarter.

Oil prices and refining margins have improved since the end of the first quarter and Cenovus expects to be able to pay both the remaining capital expenditures and the dividend from operating cash flow through the rest of 2015.

NDP effect

Most of the recent weakness in the stock is connected to the recent NDP win in Alberta. Premier Notley plans to review royalty programs and increase corporate taxes. This has analysts concerned that oil companies are going to take a nasty hit before they get a chance to recover from the recent rout.

Some changes will certainly occur, but I think the market is blowing the risk out of proportion.

Should you buy?

Cenovus is doing a good job of driving down costs while it improves output. The company is also taking advantage of the difficult market to invest in long-term opportunities, as was recently demonstrated with its \$75 million purchase of a rail-loading terminal.

With some of the lowest operating costs in the patch, Cenovus is well positioned to ride out the slump. The company has great assets that have the potential to kick out solid cash flow for decades, and the refining division offers a second revenue stream that helps balance out the difficulties on the production side of the business.

The stock could see further weakness in the coming months, especially if oil prices reverse course and start to slide again. For the moment, the dividend looks safe, but investors should consider the stock for its growth opportunity and view the fat yield as a bonus. At this point, the long-term upside potential is appealing, but you should wade in carefully.

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