Oil-Price Volatility Is Shifting Attention to These Integrated Energy Companies

Description

The CBOE Crude Oil Volatility Index jumped about 6% today on news that prominent OPEC nations signed an oil-cooperation agreement, which could lead to a freeze in output levels. The index neared its 52-week low in mid-August, but has risen about 20% since.

While upstream energy companies continue to be at the mercy of this price volatility, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) have relied on their downstream or refining businesses to maintain earnings stability.

Integrated oil companies, or those with refining operations, are able to capture the value from crude oil production and refined products, such as gasoline, jet fuel, and diesel, to partially mitigate volatility associated with crude oil–price fluctuations. This allows them to raise capital more efficiently, grow their dividends, and plan their businesses with greater certainty.

These two integrated energy companies have seen their share of attention in the first half of the year due to the Albertan wildfires and their indirect affiliation to **Berkshire Hathaway Inc.'s** (NYSE:BRK.A)(NYSE:BRK.B) buying spree of **Phillips 66**.

In Q2 2016 Berkshire and its subsidiaries purchased an additional 18 million shares, or $1.39 billion worth, of Phillips 66. This increases its stake to 15.2% of the company, which owns and operates of 14 refineries in U.S. and Europe. Two of the company's refineries are jointly owned by Cenovus.

During this same period, Berkshire reduced its position in Suncor to 22.3 million from 30 million shares, or by approximately $300 million. The company did not disclose why it reduced its stake in the integrated oil company; however, in that same period it purchased additional shares of Phillips 66.

Refining margins are influenced primarily by 3-2-1 crack spreads, which indicate the gross margin on a barrel of crude oil that is refined to produce gasoline and distillates and by light/heavy and light/sour crude differentials. More complex refineries can earn greater refining margins by processing less expensive, heavier crudes. This method helps mitigate lower crack spreads associated with low benchmark crude prices.

In Q2 2016 Suncor reported a gain of $930 million in its refining division, which was 7% lower year over year, but offset the $1,995 million loss from its oil sands and conventional segments.

Higher refined-product differentials and a weaker Canadian dollar helped offset lower benchmark cracked spreads, as well as the sourcing of more expensive crudes at the Edmonton refinery due to the forest fires in the Fort McMurray region. The only segment of Suncor's business that did not post an operating loss in the first half of the year was its refining segment.

Cenovus also report an operating income gain from its refining and marketing business of $143 million, or 75% of its total operating income. Operating cash flow was still 40% lower year over year primarily due to lower crack spreads and higher operating costs. Some of this decline was offset by increased utilization due to consistent performance at its refineries, improved margins on the sale of secondary products, widening crude oil differentials, and softening of the Canadian dollar relative to the U.S. dollar.

Suncor and Cenovus remain attractive investments for dividend-focused investors looking for energy companies that can mitigate some of the volatility associated with crude oil–price fluctuations.

CATEGORY

1. Energy Stocks
2. Investing

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3. NYSE:CVE (Cenovus Energy Inc.)
4. NYSE:SU (Suncor Energy Inc.)
5. TSX:CVE (Cenovus Energy Inc.)
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