Why Cenovus Energy Inc.'s Q4 Results Are Concerning

Description

Cenovus Energy Inc. (TSX:CVE)(NYSE:CVE) released its fourth-quarter results on Thursday, which showed strong growth as it beat expectations. To finish the year, the company posted over $5 billion in sales for Q4, which was up over 52% from last year. For the full year, sales of $17 billion were also up 54% from 2016's totals.

Earnings of $620 million for the quarter were also significantly up from the $91 million that the company posted a year ago. For the full year, the $3.4 billion bottom line was a big improvement over the net loss of $545 million that the company recorded in 2016.

Unfortunately for Cenovus, the strong results did nothing to help give the company's stock a boost, so let's take a closer look at the results to see whether this was as good a performance as it appeared to be at first glance.

Expenses up over 80%

The first problem I see right off the bat is that the company's costs were up significantly from last year. Expenses totaled $6.5 billion for the quarter compared to $3.6 billion a year ago.

The biggest drivers behind the higher costs were exploration expenses of $887 million (which were non-existent a year ago), depreciation costs which were up $379 million, transportation and blending costs rose by $723 million (or 147%), and risk management losses of $887 million were up significantly from $103 million incurred in the prior year.

With the industry being more bullish and optimistic in Q4, and the company's asset purchases in 2017, most of the items appear to be justifiable. The one that sticks out is the risk management losses. We've seen companies in the past benefit from hedging activities and investments in financial instruments to protect against dropping oil prices, but now with prices on the way back up, we're seeing a reversal of some of those fortunes.

Loss from continuing operations up more than 400%

As a result of the increased expenses, the company's pre-tax operating loss from continuing operations was $1.4 billion and well up from the $275 million loss that it incurred a year ago.

Did the company make a mistake in selling some of its big assets?

Cenovus was under a lot of scrutiny after it entered a big deal with **ConocoPhillips** last year where it effectively doubled down on its risk by investing more into the oil sands at a time of low oil prices, while also taking on a lot more debt. It ultimately led to the departure of its CEO and the company agreeing to sell assets to bring its debt back down, it also resulted in the share price hitting new all-time lows.

It was earnings from those operations, however, that helped lift the company's Q4 results into the positive. Net earnings from discontinued operations totaled $1.4 billion, and without that boost Cenovus would have recorded an after-tax loss of $776 million.

Bottom line

Cenovus did see good growth this quarter, but the stock still presents a great deal of risk to investors. With oil prices starting to decline from recent highs, pessimism about whether commodity prices can stay this high has been renewed.

The stock is not far from the all-time low it hit a year ago, and for that reason it could be a great buying opportunity, as the company could rebound if oil prices can stay relatively strong. However, this would not be a suitable investment for risk-averse investors.

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