What does the Future Hold for Cenovus Energy?

Description

Cenovus Energy Inc. (TSX: CVE) (NYSE: CVE) began operating as an independent company just over four years ago when natural gas giant, **Encana Corporation** (TSX: ECA), split off its oil operations. After the split, Cenovus became one of the largest integrated oil-focused companies in North America which included enhanced oil recovery projects in Alberta at Foster Creek and Christina Lake. In addition, the split gave Cenovus the second largest refinery in the Midwest region of the U.S. located in Roxana, Illinois, capable of processing 311,000 barrels-per-day, as well as a refinery in Borger, Texas with a capacity of 146,000 barrels-per-day. Both refineries are part of a joint venture with **Phillips 66** (NYSE: PSX).

A quick look at 2013

Overall, total crude oil production for the company was up 9% through the first three quarters of 2013 to 176,085 barrels-per-day. Carrying most of the load was the performance at the company's Christina Lake project with a 58% increase to 45,211 barrels-per-day. This helped make up for the disappointing results at Foster Creek which saw production fall 7% to 53,450 barrels-per-day. The significant increase at Christina Lake was the result of phase D of the project reaching full capacity during the first quarter of the year and new production from phase E. Foster Creek was negatively impacted by a planned turnaround which resulted in six days of a full production outage in the third quarter as well as work on a backlog of well maintenance at the project. Going into 2014, Foster Creek is expected to be back at normal production levels.

On the earnings front, Cenovus fell short of expectations in every quarter except the first when it beat expectations by 10% reporting operating earnings of $0.52. Analysts currently expect the fourth quarter to come in at $0.41 per share which has been significantly reduced over the last 90 days from $0.53 per share.

The master plan

Management has laid out a 10-year business plan in which it shows net production at its oil sands projects reaching 435,000 barrels-per-day with total production including conventional oil reaching

525,000 barrels-per-day by the end of 2023. The early part of the plan is focused on land positions already held by the company primarily in the oil sands using steam-assisted gravity drainage (SAGD). The forecast calls for a compounded annual production growth rate of 11% over the 10-year period.

In order to achieve the target production rate, the company expects to invest between $3.3 billion and $3.7 billion on average in each year for the next decade. Management currently expects the large capital investment to be internally funded through cash flow from operations and existing financial capacity. While the company is primarily an oil producer, it does produce natural gas which management considers purely a means to an end by providing fuel for the company's oil sands and refining facilities as well as helping fund the capital spending program.

Projections for 2014

In order for the company's 10-year plan to be successful, it must take one year at a time and meet specific goals for that year. Management met a number of its targets in 2013 and has put forth a new set of objectives for 2014. Some of the key milestones for 2014 include drilling 300 stratigraphic test wells in the first quarter, reaching sustainable production capacity at Christina Lake phase E in the second quarter, achieving initial production at Foster Creek phase F in the third quarter and increasing rail takeaway capacity for oil to approximately 30,000 bbls/d by the end of the fourth quarter.

If management is able to reach its goals, it expects oil production to increase by 10% in 2014 to an estimated 199 Mbbls/d. However, it will have to achieve this on a 13% cut in capital investment to between $2.8 billion and $3.1 billion in order to align spending with cash flows that are expected to be in the range of $3.0 to $3.7 billion. Approximately 90% of the estimated expenditure will be focused on upstream oil operations with the lion's share going to enhanced recovery projects in the oil sands and roughly 27% going to conventional oil. Approximately 7% of the capital investment is directed at natural gas and refining operations.

Final thoughts

Analysts are currently positive on the stock as most surveyed rate it with a "buy" with a mean price target for the next 12 months of almost $39.00 per share. If the analysts are right, 2014 is shaping up to be a very good year for investors in Cenovus which could see shares move nearly 28% higher. However, this is unlikely to occur unless the company can exceed the current 2014 earnings estimate of only $1.68 per share. In order to exceed expectations, management will have to come through on its stated goals, be successful in efforts to attack the cost structure and with luck, get a little help from higher oil prices.

At current prices, Cenovus certainly seems worth a look as a possible portfolio addition for 2014.

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