Cenovus Energy Inc.: Buy the Dip?

Description

Cenovus Energy Inc. (TSX:CVE)(NYSE:CVE) is a Calgary-based, integrated oil company that is focused on oil sands development. This oil producer is deeply in debt, but it's making efforts to lighten its debt burden by selling assets.

In March, the company bought the majority of **ConocoPhillips's** oil sands and Canadian natural gas assets for $17.7 billion. Cenovus's share price has fallen by more than 40% since then. Investors are afraid the company won't be able to pay down the debt caused by the acquisition. Cenovus is now under pressure to deleverage its balance sheet.

Cenovus is selling assets to lower its debt

On September 5, Cenovus announced that it has signed a deal with its rival, **Canadian Natural Resources Limited**. Cenovus will sell its Pelican Lake heavy oil assets, as well as other miscellaneous assets in northern Alberta, to Canadian Natural Resources for $975 million in cash. The sale is expected to close on or before September 30.

Cenovus will use the sale proceeds to pay down the $3.6 billion bridge loan it took to finance the ConocoPhillips deal.

Cenovus got a good price for its Pelican Lake assets. However, it still needs to sell more assets to reach its $4-5 billion divestment target.

To get more money, Cenovus plans to sell its Suffield oil and natural gas assets as well as its Palliser assets in southern Alberta and its Weyburn carbon-dioxide enhanced oil recovery operation in Saskatchewan. The sale process for Suffield is well advanced, and the company is getting interest in its Palliser and Weyburn assets.

However, the sale of all those assets may not be sufficient to reach the $4-5 billion target. According to Chris Cox, an analyst at Raymond James, Cenovus could expect $3.8 billion of proceeds, given the lower quality for the remaining packages.

Cenovus is considering selling other non-core assets, which will likely include some infrastructure-related assets. The company intends to apply proceeds from these additional asset sales against its outstanding debt. It remains focused on reaching its target of being below two times net debt to adjusted EBITDA in 2019. Net debt to adjusted EBITDA was 1.6 times in Q1, but it rose to 6.1 times in Q2, showing the impact of ConocoPhillips's purchase.

However, despite rising debt levels, the purchase of ConocoPhillips's Canadian oil sands assets helped to boost Cenovus second-quarter profits. The oil producer reported a net profit of $2.64 billion, or $2.37 per share, in the second quarter compared to a loss of $267 million, or $0.05 per share, a year earlier. Its revenue climbed to $4.08 billion from $2.75 billion a year earlier.

Cenovus's share price is deeply undervalued

Cenovus's share price is very cheap right now, trading below $10 and at a P/E of only four. In contrast, the oil industry's average P/E is 13.1.

I feel that this undervaluation is due mostly to the debt caused by the acquisition of the ConocoPhillips assets, which worries investors. I don't think those concerns are justified, since Cenovus is on its way to improve its balance sheet by paying down the debt caused by this acquisition and because this acquisition will increase its production and its profit.

Furthermore, the company's oil sands reserves have long-term potential, which the market doesn't recognize yet. Cenovus uses solvent-aided process (SAP) technology, a low-cost oil sands production method. SAP should improve the cost structure of Cenovus's oil sands reserves, which will help the company compete with other supply sources in a context of low oil prices.

However, since the cash flow benefits of SAP won't show for a few years, the market still doesn't appreciate the potential of the company, hence the share price undervaluation. I'm confident that Cenovus's share price will rise soon, and that it's time to buy the dip.

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