Cenovus Energy Inc.: The Best Contrarian Bet for 2018?

Description

Cenovus Energy Inc. (TSX:CVE)(NYSE:CVE) shares are up ~45% over the last three months, as crude continues its rally past its 52-week high. Many pundits are predicting that oil prices will hover around US$60 levels next year, and if that's the case, severely beaten-up firms like Cenovus could be slated to enjoy a rally that many bottom fishers have been anticipating for years.

The recent decision by management to acquire **ConocoPhillips's** assets for $17.7 billion ($14.1 billion cash and 208 million CVE shares) was an unpopular one. Shares got pummeled in the weeks following the announcement, but the deal may not be as bad as the stock price movements would suggest. Sure, management made an incredibly aggressive move that left a huge dent in the company's balance sheet, but if you look at the bigger picture, the move makes sense, especially if the recent rally in oil is sustainable.

The sale of non-core assets to raise cash has been going quite smoothly with several sales at a higher price than what analysts were expecting. As oil continues to move towards the US$60 levels, while management sells its assets at or above pundit expectations, I suspect the worst of times for Cenovus may already be in the rear-view mirror.

Be greedy while the majority are fearful?

There's no question that foreign investors are panicking about the Canadian oil sands. There's a massive cloud of uncertainty surrounding the entire oil patch, and it's become a trend for foreign investors to dispose of their stake in the oil sands of late. In addition to the uncertainty, oil sands operations are ridiculously expensive to set up, and they wreak havoc on the environment.

Some bears out there seem to think that most firms will throw in the towel on the oil sands as a whole. To a long-term investor, that has got to be frightening, especially considering that stock price fluctuations in many firms operating in Canada's oil patch are making their stocks too speculative for the average investor to own.

There are many reasons to be bearish on the oil sands and Cenovus's aggressive strategy to go all-in on the oil sands. But most of the bad news has already been baked in to the stock. The stock has fallen ~77% from peak to trough, and based on traditional valuation metrics, Cenovus is trading at a gigantic discount to its intrinsic value.

Bottom line

There's a huge amount of value to be had from Cenovus at these levels. The general public has been overly pessimistic on the stock for far too long, and if oil moves above US$60, I suspect investors will have a second look at Cenovus as it continues to show signs of a reversal.

Based on traditional valuation metrics, shares are severely undervalued at a mere 0.9 price-to-book multiple, substantially cheaper than the company's five-year historical average price-to-book multiple of two. Shares are up ~55% since my summer recommendation following a series of non-core asset divestitures, but I think there's still a huge amount of upside for those who are patient enough to wait.

If you're a deep-value investor with the discipline to buy and forget, Cenovus is an outstanding buy.

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