Contrarian Investors: Could Cenovus Energy Inc. Double in 2018?

Description

Contrarian investors are searching for beaten-up stocks that could be on the verge of a recovery in 2018.

Let's take a look at **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) to see if it deserves to be in your portfolio.

Cenovus started 2017 at about $20 per share, but the stock went into a nasty slide through the first half of the year, bottoming out around $9 in June.

What happened?

Falling oil prices were primarily responsible, but Cenovus added to the pain when it announced a $17.7 billion deal to buy out its oil sands partner, **ConocoPhillips**.

On the surface, the deal made sense. Cenovus already operated the facilities and instantly doubled its reserves and production. The agreement also came with strategic assets in the Deep Basin regions of Alberta and British Columbia.

Investors, however, sold the stock on the news.

Why?

Cenovus took out a $3.6 billion bridge loan to cover part of the deal, while it lined up buyers for non-core assets it wanted to sell.

With WTI oil falling from US$55 in January to US$43 in June, the market figured Cenovus would have trouble finding buyers willing to pay the prices needed to generate the $4-5 billion the company hoped to get for the properties.

As it turned out, oil recovered through the back half of the summer, and in the past three months Cenovus has announced four deals for a total of $3.7 billion. The combined net proceeds are being used to fully pay the bridge loan.

Cenovus saw its share price recover as high as $14.50 in early November on the news of the deals and stronger oil prices, but the stock has given back some of the gains.

At the time of writing, Cenovus trades for $11 per share.

Could the stock double next year?

WTI continues to hold its gains, but the Western Canadian Select (WCS) price that Canadian oil sands producers receive has not fared so well. In fact, the price gap between WCS and WTI recently hit US$25 per barrel.

Rising production and ongoing pipeline bottlenecks are expected to keep the differential above the averages seen in recent years, but that could change beyond 2019 if Keystone XL and the Trans Mountain Expansion get built.

In the meantime, Cenovus is cutting is workforce by 15% and expects to see operating costs fall another 8% on a per-barrel basis in 2018.

That should help margins improve, but unless oil prices rally significantly, investors probably won’t see a big move to the upside next year.

Should you buy?

Contrarian investors who think the pipelines will go ahead and who are long-term bulls on oil might want to start nibbling while Cenovus is out of favour. If Keystone XL and Trans Mountain get built, the differential between WCS and WTI should close, and that could bring buyers back into the beleaguered Canadian producers beyond 2018.

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