Is it Time to Buy Cenvous Energy Inc. (TSX:CVE)?

Description

Oil prices continue to recover and investors are starting to search for beaten-up stocks that might offer a shot at some big returns.

Let's take a look at **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) to see if this is a good time to add the stock to your portfolio.

Difficult times

Cenovus was a $30 stock five years ago. Today, investors can buy it for $13, and that's up from $9.50 just four months ago.

The Canadian energy sector is littered with such stories, but Cenovus has suffered more than some of its peers due to company-specific issues.

Cenovus bought out its 50% partner, ConocoPhillips, last year in a $17.7 billion deal that instantly doubled production and the resource base for Cenovus at the Christina Lake, Foster Creek, and Narrows Lake oil sands projects. The purchase also came with three million net acres of land in the Deep Basin natural gas play in Alberta and British Columbia.

As part of the plan to finance the purchase, Cenovus issued $3 billion in stock, tapped out its credit lines, and took on a $3.6 billion bridge loan. Cenovus planned to sell non-core conventional oil and legacy gas assets for up to $5 billion to cover the loan and some of the other financing cost.

The market reacted negatively when the deal was announced, believing that Cenovus was in over its head, especially as oil prices continued to tumble into June of last year. Fortunately, oil recovered through the back half of 2017, and Cenovus was able to find buyers willing to pay enough for the non-core assets to cover the bridge loan.

The stock rallied from $9.25 in late August to about $14.50 in November, but gave back the gains in the first part of this year, even as oil prices continued to rise.

Why?

In order to protect cash flow as it searched for buyers for the legacy properties, Cenovus hedged 80% of its production through the first half of 2018. As it turns out, these contracts were at much lower oil prices than Cenovus would have otherwise received. In Q1 2018, the company booked realized risk management losses of $469 million.

As a result, Cenovus hasn't benefitted much from the rally in oil prices in the first half of this year. Western Canadian Select (WCS) rose above US$55 per barrel in May, but has since pulled back to US$41. West Texas Intermediate (WTI) recently broke back above US$70. A year ago, WTI was US$43 per barrel and WCS was US$35.

Pipeline capacity constraints also caused grief in the first quarter, thereby forcing Cenovus to slow oil sands production and place some product in storage.

Upside opportunity

After the end of the second quarter of 2018, Cenovus will only have 37% of its oil hedged through the end of the year. In addition, rail capacity improvements are expected to materialize in the second half of 2018, which would help offset further pipeline bottlenecks.

Should you buy?

Short-term challenges could keep the stock from taking off, but the worst might be over for Cenovus. If a major pipeline is finally built to carry the company's product to external markets, where it can get international prices, investors could see this stock return to previous highs in the next few years.

If you have some patience and are an oil bull, it might be time to add a Cenovus to your contrarian portfolio.

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