Is This Oil Sands Stock a Top Contrarian Pick Today?

Description

Oil producers have had a rough run in recent years, and investors with a contrarian investing style are wondering which stocks might offer opportunities for big future gains.

Let's take a look at **Cenovus Energy** (TSX:CVE)(NYSE:CVE) to see if it might be an attractive pick right now.

Huge acquisition

Cenovus decided to swing for the fence last year when it spent $17.7 billion to buy out its oil sands partner **ConocoPhillips**. In theory, the deal made sense, as it instantly doubled production and the oil sands resource base. Cenovus also picked up strategic assets in the growing Deep Basin plays.

The market didn't like the move, however, and the resulting drop in the stock price might have contributed to the exit of the CEO. This set up a perfect storm, with falling oil prices, a leadership void, and a ballooning balance sheet combining to drive Cenovus to a low near $9 per share in July 2017. That was a sore point for investors who had owned the stock from the time it was spun out of **Encana** in late 2009. At one point in 2012, Cenovus traded for close to $40 per share.

Better prices help, but not much

Oil staged a recovery through the back half of 2017, enabling Cenovus to find buyers willing to pay enough for non-core assets to cover a $3.6 billion bridge loan the company took out to close to deal earlier in the year. Today, Cenovus trades at $12.70 per share, which isn't much of an improvement, given the solid rally in oil prices over the past year.

What's up?

Cenovus had to protect cash flow when it signed the ConocoPhillips deal and hedged 80% of production for the first half of 2018 at prices that turned out to be much lower than the resulting market value. As a result, the company missed out on the benefits of the price surge through the first six months of this year.

Cenovus reported risk-management losses of nearly $1.17 billion in the first two quarters of 2018. The Q1 hit was $469 million, and the company booked a loss of $697 million in Q2 2018. Things should be better in the back half of the year, as the hedging position drops down to 37% of production.

Outlook

On the positive side, Cenovus reported record production in Q2 and benefited from better refining results after the completion of planned maintenance work. The operating margins for the Refining and Marketing division came in at $357 million compared to $20 million in the same period last year.

The company slashed its dividend during the downturn but investors could see Cenovus join its peers and start to raise the payout again, once the hedging pain goes away. The current distribution of $0.05 per share provides a yield of 1.6%.

Should you buy?

Cenovus just announced a deal to sell its Pipestone natural gas and liquids business for $625 million. The funds will be used to bring down debt, which should ease ongoing balance sheet concerns.

Pipeline bottlenecks in western Canada remain an issue, but it looks like Trans Mountain and Keystone XL will eventually get built. If you are an oil bull over the long run, Cenovus might be an attractive contrarian pick today.

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Date
2025/08/28
Date Created
2018/08/15
Author
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