Contrarian Investors: Is Cenovus Energy Inc. (TSX:CVE) Stock Ready to Soar?

Description

Contrarian investors are always searching for unloved stocks that might offer a shot at some oversized gains in the next couple of years.

Let's take a look at **Cenovus Energy** (TSX:CVE)(NYSE:CVE) to see if it deserves to be on your buy list right now.

Bad timing

Cenovus had a rough run last year and through the first half of 2018, but better days should be on the horizon.

The company made a huge long-term bet in the spring of 2017 when it spent $17.7 billion to buy out its oil sands partner, **ConocoPhillips**. The move instantly doubled the company's production and resource base on the oil sands operations that it already operated and knows very well. In addition, Cenovus picked up strategic assets in the growing Deep Basin plays in Alberta and British Columbia.

Oil prices continued to slide until June last year, and investors figured Cenovus might have a difficult time selling non-core assets at high enough prices to cover a large bridge loan the company tapped to get the deal done. As a result, the stock slid from $20 in January to below $10 in the summer.

In order to protect cash flow while it shopped the assets, Cenovus hedged a significant part of its production through the first six months of 2018 at prices that turned out to be very low. A recovery in the oil market that began last July has continued right through most of 2018.

The rally helped Cenovus find buyers for assets at high-enough prices to cover the $3.6 billion bridge loan by the end of last year. The hedging positions, however, resulted in realized risk-management losses of $469 million in Q1 and $697 million in the second quarter of this year. In the Q2 report, Cenovus said it had 37% of production hedged for the second half of 2018 compared to 80% for the first six months.

Opportunities

Despite the huge hit, Cenovus still generated free funds flow of $482 million in Q2, so the Q3 and Q4 numbers could come in even better, and 2019 should deliver some impressive results.

Cenovus just announced a deal with Canada's two national railways to ship 100,000 barrels of oil per day to the U.S. Gulf Coast. The three-year agreements will see the oil start to move in Q4 and ramp up through next year. Cenovus says the all-in cost is expected to be US$15-20 per barrel. At the time of writing, the price differential between WTI and Western Canadian Select is about US$40 per barrel, so the move currently makes sense.

Should you buy?

Cenovus continues to streamline its operations in an effort to shore up the balance sheet. The company sold additional non-core assets in August for $625 million and used the funds to reduce debt. With oil prices holding gains and the hedging positions coming down, Cenovus appears to be back on track. In fact, investors could see a dividend increase in 2019.

If you have some cash sitting on the sidelines, it might be worthwhile to start a small position in Cenovus while the stock remains out of favour.

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