Why Investors Should Watch Cenovus Energy Inc. (TSX:CVE) Stock

Description

A rebound in the oil sector in recent weeks has investors wondering which energy stocks might offer some attractive upside potential on an extended recovery.

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

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Tough run

Falling oil prices, pipeline bottlenecks, and some ill-timed management decisions have hammered Cenovus in recent years, resulting in steep dividend cuts and a 75% drop in the share price from peak to trough.

The company was formed in 2009 when **Encana** decided to spin off its oil sands assets with a plan to focus on natural gas. That turned out to be a disaster move for Encana as natural gas prices tanked amid the shale gas boom in the United States and have never really recovered.

Cenovus initially enjoyed the benefits of a surge in oil prices after the financial crisis, trading above $30 per share through much of 2011 to mid-2014, but the party didn't last very long, and things have been rather ugly ever since.

Oil prices tanked in the back half of 2014 and the rout continued through the first part of 2016. By then, Cenovus had fallen below $15 per share, and investors figured that would be the bottom, but the situation continued to deteriorate, even as oil prices recovered over the past three years.

What happened?

In 2017, Cenovus decided to buy out its 50% partner **ConocoPhillips** for $17.7 billion. On the surface, the deal appeared to make sense, as Cenovus already operated the oil sands facilities and instantly doubled its resource base and production. The deal also came with attractive positions in the Deep Basin plays in Alberta and British Columbia.

Unfortunately, Cenovus took a $3.6 billion bridge loan to pay part of the purchase cost and had to find buyers for a string of non-core assets to pay back the loan. Oil weakened in the first half of 2017 but recovered through the second half of the year, and Cenovus was able to get enough for the assets to cover the loan, but the company lost out on some significant margins due to large hedging positions that were put in place while the company searched for buyers.

In fact, Cenovus hedged about 80% of its oil production through the first half of 2018, essentially the exact timeline that saw a nice upswing in oil prices. The hedging level dropped in the back half of 2018 and is lower in 2019, but oil tanked again through Q4 last year.

Investors who held on for the ride are not very happy. The stock hit a new low around $9 just before the holidays in December 2018.

Upside

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Cenovus is back up to $11.50 per share and has gained 15% in just the past week. The move could be another head fake before a dip to a new low, but contrarian investors might want to start nibbling.

Why?

Cenovus owns attractive assets and is ramping up its oil-by-rail capabilities to help bypass the pipeline glut. At some point, the pipeline issue will likely be resolved, and that could lead to a big recovery for Cenovus.

In the meantime, investors could also pick up the stock as a potential takeover target. Cenovus appears very cheap today, assuming all the resources can be tapped in the coming decades. **Imperial Oil**, which is controlled by U.S. giant **ExxonMobil** and continues to invest in oil sands facilities could decide to take a run at Cenovus. **Suncor** could also be a suitor, given its strong position in the oil sands segment and its solid balance sheet.

Should you buy?

You have to be an oil bull to buy Cenovus today. If you fall in that camp, the stock might be an attractive contrarian pick. A few things would finally have to go right, but this stock could potentially see $20 again in the next couple of years.

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