An Oversold Energy Stock to Buy Now

Description

The Canadian oil and gas sector remains in the depths of despair. Energy stocks have gotten killed, investors have fled the space, and many oil and gas companies are scrambling to survive. Throughout all this, however, we have seen huge amounts of value bubble to the surface as investors shun not only the precarious stocks, but also the high-quality, large stocks that have stood the test of time and that remain profitable.

While **Cenvovus Energy** (TSX:CVE)(NYSE:CVE) is not the energy stock to go to for yield, it is an attractive energy stock for its depressed valuation levels and for its high-quality assets and operating results that continue to see improvements.

Despite its attractive company fundamentals, two issues have plagued this company and sent valuation levels down in the dumps, with the stock tumbling 58% in the last five years. High debt levels (due to the **ConocoPhillips** acquisition) and declining commodity prices will do that to a company. For long-term contrarian investors, it is precisely this type of situation that results in opportunity, especially if the company is taking the right actions.

What the company has control over is its own operating performance and its own financial health. Management has therefore committed to getting these two things in order; it's driving down costs, driving up efficiencies, and reducing debt. With 82% of its production coming from oil and natural gas liquids, Cenovus is highly sensitive to movements in the price of oil and has been vulnerable specifically to the weakness in Canadian oil prices. This is something the company has no control over.

Debt falling fast

At Cenovus, management has made it a mission to reduce debt to get the balance sheet in top shape, thereby reducing the risk inherent in the company and to generate better shareholder returns. Having reached its preliminary debt target in June and quickly closing in on its $7 billion net debt target, we have seen great progress here with the net-debt-to-cash-flow ratio falling from 4.9 times in 2018 to the current 1.8 times. Cenovus management can now consider what it will do with its free cash flow going forward. A shift to returning capital to shareholders is warranted.

After dramatically cutting its dividend in 2015 and 2016, Cenovus's dividend yield has hovered in the 1.5% range — low compared to other energy stocks that are generating similar levels of cash flow. In 2019, free cash flow is expected to be almost $700 million, more than triple what it was in 2016. Cenovus's free cash flow yield is an astounding 15.3% today — a demonstration of the strong cash flow levels that the company is generating.

Operational improvements

Over at Cenovus's oil sands operations, Christina Lake (41.6% of total production) and Foster Creek (33.5% of total production), Cenovus has redesigned its well pads, driving cost improvements and increasing recoveries. This has driven 35-50% in cost savings.

At Christina Lake, the company is enjoying the lowest steam-to-oil ratio in the industry, a very significant feat and a testament to the quality of the operation. The steam-to-oil ratio is a measure of how much oil is produced for every unit of steam. The lower, the better, as it means lower cost production.

Foolish final thoughts

Cenovus Energy remains oversold today, and while this has persisted, despite the strong progress the company has made both in terms of its debt load and in terms of its free cash flow generation, I think it is fair to assume that the market will recognize the value in this stock sooner rather than later.

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