



# RESEARCH REPORT

October 22, 2018

Stock Rating **BUY**  
Stock Price **CAD 11.27**



Ticker	CVE
Market Cap. (MM)	\$13,700
2019E EV/DACF	7.0x
2019E EV/(BOE/D)	\$46

## 52 Week Performance



## Energy & Utilities

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# Cenovus Energy Inc. Trust the Process

The Canadian Energy landscape has faced tumultuous turbulence over the last quarter as differentials continue to widen to record highs and the market has correspondingly shown no mercy to upstream producers as the outlook for much needed takeaway capacity is bleak. While these names have been getting pressed downward, it is important to remember that these are quality companies with excellent operations. The QUIC E&U team decided to take a look at one of the names most under the spotlight, Cenovus Energy Inc., to analyze the effects of the headwinds facing these producers. We believe there is value to be had in this name, and will monitor the Canadian landscape very closely to determine a proper entry point.

Cenovus Energy Inc. was formed in 2009 when Encana Corporation, a QUIC E&U holding, spun off its heavy oil business into its own entity. Cenovus Energy Inc. is an integrated oil company focused on exploring, extracting, and refining crude oil in Canada. The name has taken a hit, along with its peers, through the current vicious WCS-WTI pricing differential. This report contains a deep look into the Energy landscape, and two theses which center around:

- i) Capitalizing on the Current Macro Landscape
- ii) Overcoming the Market's Cenovus-based Grudge through Operational Excellence

Through a relative valuation as well as regression analysis, we see immense value into entering Cenovus Energy and will consider an entry point in the near future.

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## Company Overview: Cenovus Energy

Cenovus Energy Inc. is a Canadian integrated oil and natural gas company formed through the corporate split of Encana Corporation on December 1<sup>st</sup>, 2009. Headquartered in Calgary, Alberta, its shares are listed on the Toronto (TSX) and New York (NYSE) stock exchanges. Cenovus specifically deals with developing, producing, and marketing crude oil, natural gas liquids, natural gas, and refining operations in Canada and the United States, with almost 500 MBoe/d of upstream production. In 2017 Cenovus’s average crude oil and natural gas liquids production was 360,704 barrels per day, their natural gas production was 659 MMcf per day, and their overall production was 470,490 BOE per day, meanwhile their refining operations handled 442,000 gross barrels per day of crude oil feedstock, processing them into an average of 470,000 gross barrels per day of refined product. They are currently lead by CEO Alex Pourbaix, CTO Harbir Chhina, and CFO Jonathan McKenzie. On May 17<sup>th</sup>, 2017 Cenovus acquired ConocoPhillips Company and their subsidiaries 50 percent interest in the FCCL Partnership, as well as the majority of their western Canadian conventional assets in the Deep Basin in Alberta and British Columbia, for a total consideration of \$17.9 billion.

Cenovus has four core operating segments which includes oil sands, deep basin, refining and marketing, and corporate and eliminations. Cenovus’s oil sands segment involves the development and production of bitumen and natural gas in northern Alberta. Their bitumen assets include Christina Lake, Narrows Lake, and Foster Creek and they have increased their interest in these properties from 50 to 100 percent, effective on May 17<sup>th</sup>, 2017. Cenovus’s oil sands segment is the largest Steam-Assisted Gravity Drainage (SAGD) producer in the oil sands and their operations are concentrated on two of the assets mentioned above in Christina Lake and Foster Creek which have proven to be some of the first-rate SAGD assets on the Western Canadian Sedimentary Basin.

Their Deep Basin segment includes roughly three million net acres of mineral rights spanning across Alberta and British Columbia, specifically the Kaybob-Edson, Clearwater, and Elmworth-Wapiti operating areas, which are rich in natural gas and natural gas liquids. These assets were acquired from ConocoPhillips on May 17<sup>th</sup>, 2017 and create significant running room to offer potential growth outside of the oil sands, while granting a

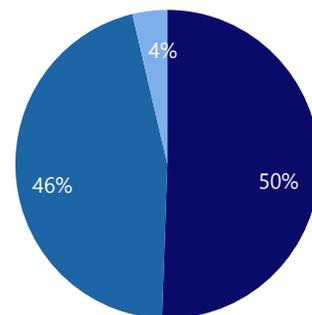
large degree of internal processing and gathering infrastructure.

Cenovus’s Refining and Marketing Segment consists of two jointly owned refineries in Illinois and Texas. Cenovus currently has 50 percent non-operating ownership in this joint partnership with Phillips66. Their Refining and Marketing concentrates on the selling, refining, and the transportation of crude oil into chemical products and downstream petroleum. It also brings together Cenovus’s transportation and marketing initiatives to enhance their product mix, delivery and transportation, as well as diversify their customer base.

The final operating segment of Cenovus is their Corporate and Eliminations, which accumulates general and administrative expenses, unrealized hedging endeavors, and financing activities and research costs. Their eliminations incorporate adjustments for internal usage natural gas production across segments, crude oil production used as feedstock for Refining and Marketing, and unrealized intersegment profits in inventory.

In 2017, Cenovus announced its aim to dispossess of its conventional segment which consisted of its heavy oil assets at Pelican Lake, their Weyburn CO2 enhanced oil recovery project, conventional crude oil, and natural gas liquids and natural gas assets in southern Alberta. As of January 5<sup>th</sup>, 2018 all of these assets had been divested.

Revenue by Operating Segments



■ Oil Sands ■ Refining and Marketing ■ Deep Basin

## Canadian Production Overview

The production of heavy oil in Canada can be split into two distinct categories: thermal operations/oil sands (includes thermal heavy oil, SAGD, and oil sands mines), and conventional heavy oil. Whilst the former possesses high initial capex costs, once running, ongoing costs are relatively modest. Further, production remains relatively steady over the course of the asset's life. The latter asset class can be characterized by low initial capex requirements, but relatively steep production declines.

Thermal operations/oil sands extraction techniques focus on the production of bitumen. However, such hydrocarbons are incredible viscous, and are combined with water, sand, heavy metals and clay. As a result, the oil must be "mined" from the ground (i.e. dug-up along with sand, metals, etc.), or heating processes must be used to make the oil flow (i.e. SAGD production). From there, the bitumen must be upgraded (i.e. mixed with diluent) in order to be converted into higher-valued products for end markets. Conventional oil is recoverable at a well from an underground reservoir, and is liquid when at atmospheric pressure and temperature. Unlike bitumen, conventional oil requires no stimulation to flow through a well, and no processing or dilution to flow through a pipeline.

Within the oil sands, the recent trend has revolved around cost-cutting. Brownfield expansions have been the main focus, as opposed to greenfield projects. The vast potential of technology (ex. solvent-assisted extraction techniques, modular and compacted design, extension of horizontal wells) will likely push the cost of supply to around US\$50.00/bbl WTI, assuming typical differentials of around US\$15.00/bbl. As of the time of this report, the aforementioned metric is at US\$60.17/bbl WTI for greenfield projects, and US\$54.00/bbl WTI for expansion projects. Oil sands production has been growing as-of-late, with 3.4MMbbl/d of output expected in 2020.

Conventional oil production is significantly lower than that of the oilsands; such is expected to remain at

around 1.0MMbbl/d over the course of the upcoming years. However, the breakeven costs of conventional heavy oil lies at a mere US\$30.00/bbl WTI.

Genovus possesses various heavy oil projects in the oil sands (Foster Creek and Christina Lake), as well as within the Deep Basin play of Western Alberta.

### EXHIBIT II

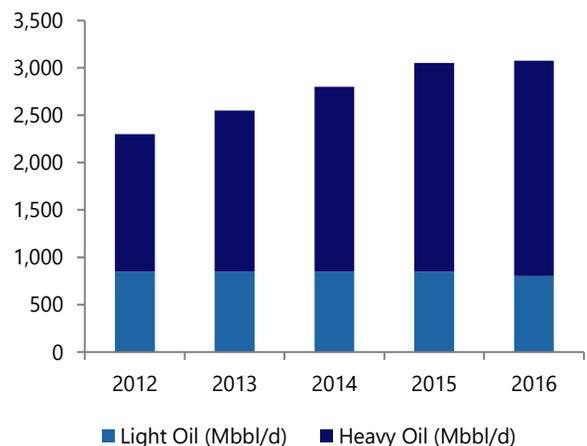
Alberta Oil Mining



Source(s): Mining.com

### EXHIBIT III

Canadian Crude Exports



Source(s): Canaccord Genuity, National Energy Board

## Downstream Capacity in Canada the U.S.

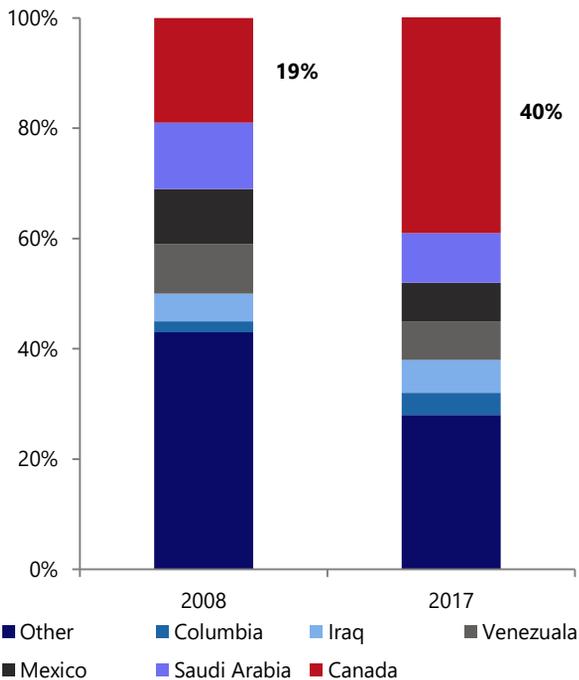
Within Canada, some bitumen production is immediately refined or upgraded; 0.9MMbbl/d of oil sands production is upgraded to a combination of light sweet and light sour synthetic crude and diesel directly in Alberta. Moreover, there exists 0.683MMbbl/d of Western Canadian refining capacity (split between Edmonton, the Lloydminster Upgrader, the Lloydminster Asphalt Refinery and the Gibson Facility). Thus, over 2.5MMbbl/d of raw heavy oil must be transported to markets in the Midwest, Gulf Coast and overseas for refining. Whilst there does exist 1.174MMbbl/d of refining capacity in Eastern Canada, most of such capacity is not served by Canadian oil, as

it is much easier to simply import foreign crude.

Within the United States, there exists 18.6MMbbl/d of refining capacity. In recent years, U.S. imports have been moving toward heavy oil. Heavy oil imports in the U.S. have grown by 28% to 6.1MMbbl/d, and currently represent 58% of total imports – up from 37% in 2008. Overall, the average API of U.S. imported oil has been decreasing steadily over the course of the past decade. Canada’s share of such imports has grown from 19% in 2008, to 40% as of today. Such is due to a variety of factors: for example, the shortfall in domestic supply (as exports are now permitted), as well as the collapse of heavy oil-rich Venezuela.

### EXHIBIT IV

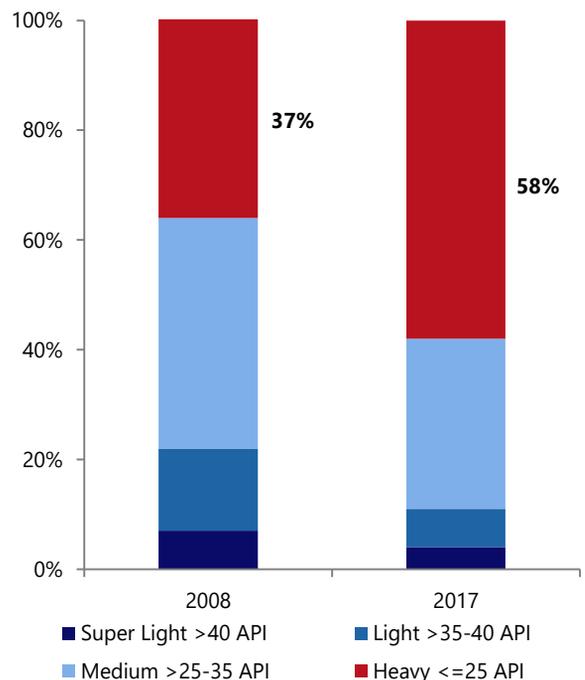
U.S. Imports by Country



Source(s): Canaccord Genuity, U.S. EIA

### EXHIBIT V

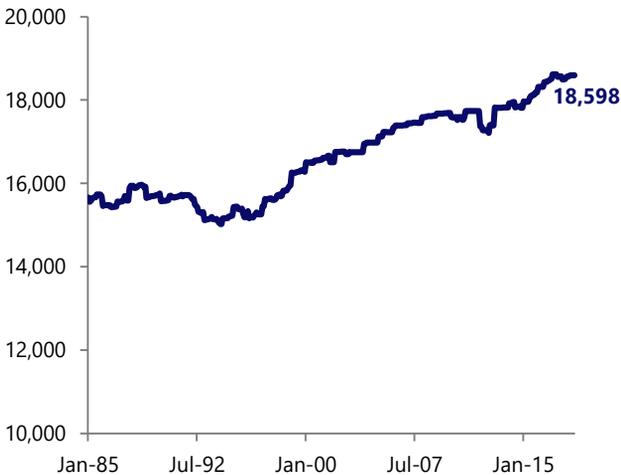
U.S. Imports by API



Source(s): Canaccord Genuity, U.S. EIA

**EXHIBIT VI**

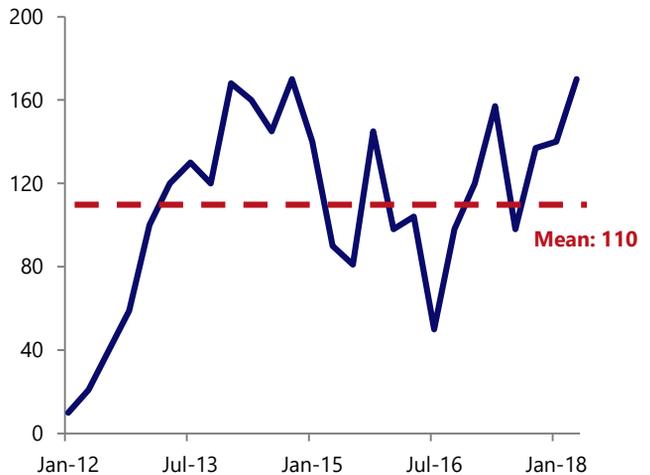
U.S. Refinery Capacity (Mbbbl/d)



Source(s): U.S. EIA

**EXHIBIT VII**

Canada Crude-by-Rail Exports (Mbbbl/d)



Source(s): Canaccord Genuity

## Canada's Egress Conundrum

Despite the healthy level of crude production in Canada, there remains the issue of moving the oil to downstream markets. Currently, pipeline capacity is significantly constrained; such is expected to contract even further come the winter, as the lower temperatures will require additional diluent to be added to the highly-viscous heavy oil and bitumen.

Presently, Canada possesses 4.9MMbbl/d of takeaway capacity (both rail and pipeline); 0.8MMbbl/d of the aforementioned metric is represented by rail capacity. However, just 4.2MMbbl/d is readily available; such is due to pressure limitations (within the pipelines), as well as rail track capacity and locomotive and conductor availability constraints.

Presently, the deficit in Canadian egress capacity is around 0.28-0.34MMbbl/d; transportation bottlenecks are expected to continue through to 2020. Whilst the usage of locomotives has been growing, such has not

been sufficient to close the egress gap. Each locomotive can only transport around .006MMbbl per haul (.0024MMbbl/d) – a substantially lower quantity than that of pipelines.

The imposition of rail transportation has led to significant cost increases (to the tune of US\$22.00/bbl) for upstream producers. The wide bid/ask spread between producers and rail companies has only served to exasperate such a situation.

Whilst upstream producers have attempted to lobby for increased pipeline capacity, staunch political opposition within various regions of Canada and the U.S. has rendered such campaigning largely futile.

Despite the aforementioned issues, Cenovus is in a fairly strong position, as it possesses a 0.1MMbbl/d rail terminal at Bruderheim; such facilitates the shipment of its production to end-markets for sale and refining.

## The Resulting Differential

The egress constraints (both pipeline and rail), as well as increasing inventory levels (along with concerns over storage levels) have led to deep discounts being realized for WCS crude. Moreover, such differentials will likely face additional pressure in 2020, due to the IMO's ruling on bunker fuel sulphur levels. Given that Canadian crude possesses high sulphur levels, heavy oil E&P's whom possess no downstream diversification will face downward demand pressure for their crude.

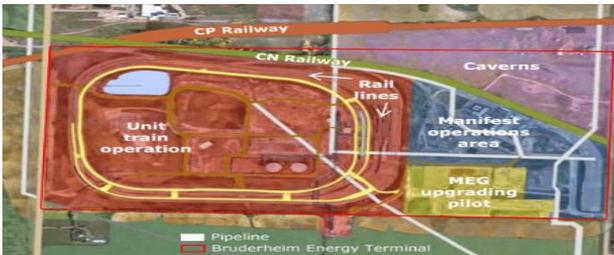
The impact of the WCS differential is rather profound upon the economy as-a-whole. For example, for each upward US\$1.00/bbl shift in differentials, the Alberta government receives an incremental \$100MM per year

in royalties.

Recent consensus analyst estimates have predicted the differential to be around \$18.50/bbl for the remainder of 2018, and then shift down to \$17.00/bbl in 2019. However, as-of-late, the differential has been hovering at a staggering \$40.00/bbl, thus challenging the notion that differentials will return to more reasonable (historical) levels.

### EXHIBIT VIII

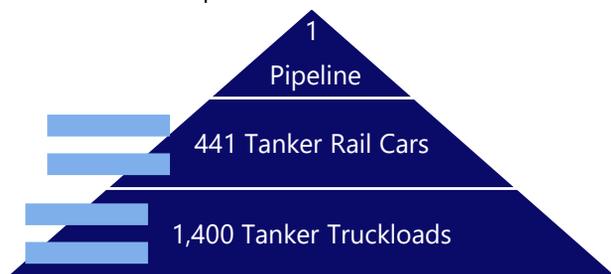
CVE Bruderheim Terminal



Source(s): Company Reports

### Exhibit IX

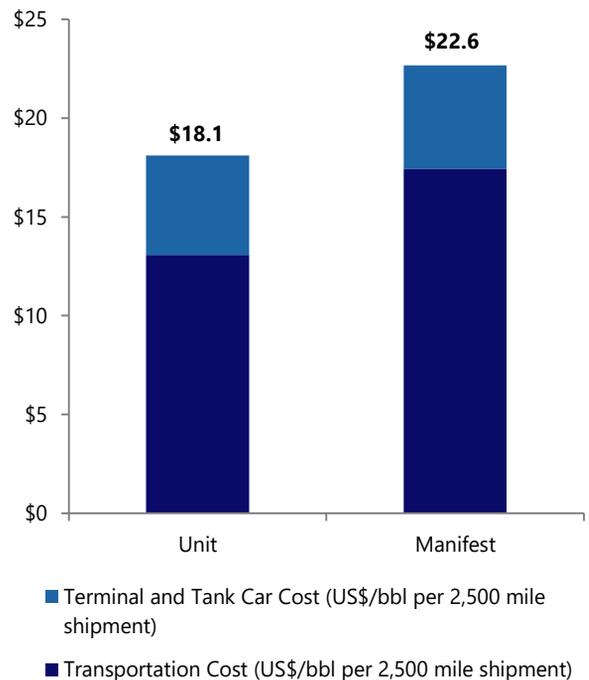
Petroleum Transportation Alternatives



Source(s): Canaccord Genuity

### EXHIBIT X

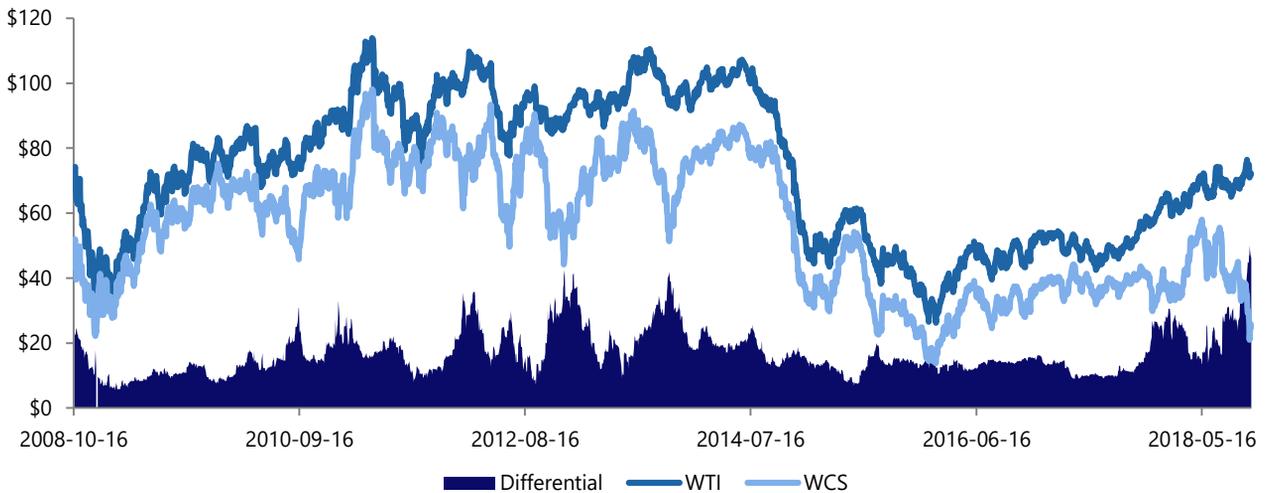
Unit Train versus Manifest Train Costs



Source(s): Canaccord Genuity, Altex-Energy

**EXHIBIT XI**

Historical WTI vs WCS Crude Oil Prices (\$USD)



Source(s): Bloomberg

## Investment Thesis I: Capitalizing on Unsustainable Macro Landscape

There have been very few times in the past ten years where the macro landscape has been comparatively as unfavourable for Canadian oil as it is today. From 2012-2013 there were three visible spikes in the WTI-WCS differential, with the highest point reaching ~\$43 USD (Exhibit XI). This was due to heavy capacity constraints within the U.S. that restricted Canadian output from getting to the gulf coast. Instead the oil became stuck at Cushing due to a lack of pipeline capacity further south. This was mitigated by reversing the flow on the Seabridge pipeline and incrementally adding capacity when the need built up.

(50%)  
 (50%) ential landscape of 2012 offers many similarities to today, however, the main differentiation is the location of the capacity constraints. The U.S. operates with a much lower level of regulation creating a more business-friendly environment. However, in Canada there has been far too much red-tape and bureaucracy to take a confident stance on the viability of proposed pipelines, and therefore the

length of abnormally wide price spreads.

The few projects that could have a large impact on available takeaway capacity are the completion of Enbridge's Line 3 replacement (~390Mbb/d), the eventual approval of the Trans Mountain pipeline (~590Mbb/d), as well as Kinder Morgan's Keystone XL (~830Mbb/d). It is of the opinion of most analysts and industry professionals that we will eventually see these projects completed, but there continues to be heavy debate about a realistic timeline.

We cannot base our investment decisions around macro events, however CVE has proved to be a company that can benefit significantly from an improving differential while also using operational hedging, such as crude-by-rail contracts, downstream capacity, and the optional use of dynamic storage, to protect themselves from the downside.

## Investment Thesis I: Capitalizing on Unsustainable Macro Landscape

### Hedging the Downside

CVE has employed many strategies to increase downside protection, one of the most recent of which was incredibly detrimental to their cash flows and realized pricing. The company engaged in an aggressive hedging program concurrent with the Conoco acquisition to offset some of the risk that was being assumed with the large degree of debt associated with the transaction. This included a large amount of WTI and Brent fixed contracts and collars and a small amount of WCS differential hedges. However, WTI/Brent prices lifted considerably while the WCS differential widened, materially weighing on the company's cash flows.

Moving forward (with new management) the company is focusing on non-financial hedging such as vertical integration and the implementation of rail contracts. CVE's 50% ownership in two Phillips66 refineries (Wood River and Borger) gives them the capacity to refine ~230M bbl of their own heavy oil production, representing about 30%. This allows the company to benefit from abnormally large spreads between heavy

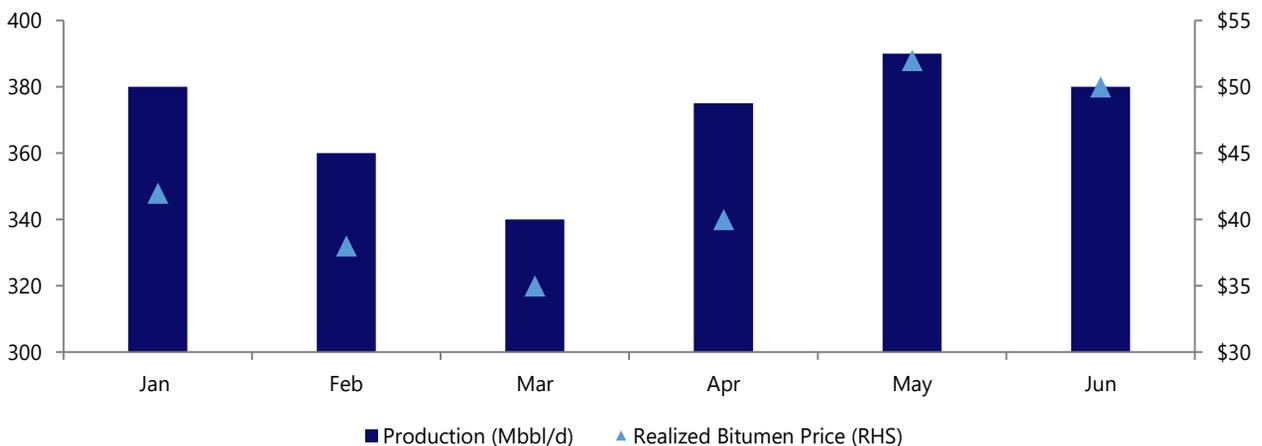
oil inputs and refined products.

CVE also owns a crude-by-rail trans-loading facility which links to the CP and CN rail lines. CVE recently announced the signing of long-term rail deals to transport ~100 MBbl/d to the U.S. Gulf Coast, which involve moving oil with CN through Bruderheim beginning in Q4/18 and with CP through a third-party terminal through 2019. The expected cost is ~\$18/bbl, representing the opportunity to take advantage of WCS-Maya differentials that are currently sitting around \$30.

Lastly, CVE has the ability to use dynamic storage to curtail production in order to wait for a more favorable pricing environment. This involves slowing production pumps and building up a fluid level of mobile oil to be sold at a later date. Analysts and short-term investors have cited this as a detriment to CVE, as it creates uneven quarterly costs/bbl. However, we believe this strategy demonstrates management's long-term orientation and much prefer to have a team that prioritizes absolute returns versus trying to smooth out quarterly profits.

### EXHIBIT XII

CVE H1/2018 Production Profile



Source(s): Company Reports

## Investment Thesis I: Capitalizing on Unsustainable Macro Landscape

### Capitalizing on Upside

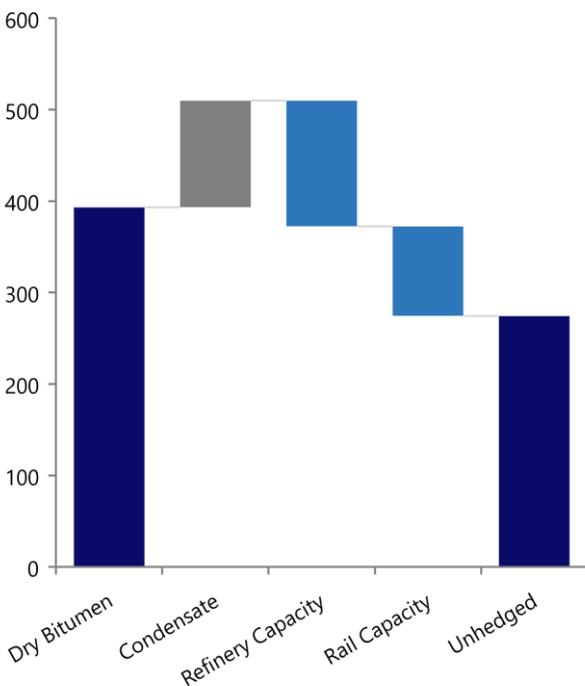
Exhibit XIII demonstrates CVE's ability to operationally hedge ~50-55% of its blended bitumen production, and in the scenario where differentials narrow, dynamic storage can be ignored as it is a variable hedge that can be undone as soon as the pricing environment strengthens. This leaves ~45-50% of production available to capture spot prices, and for every \$1 decrease in the differential, the company can expect a CFPS increase of ~4%.

One of the most difficult elements of value investing is the invariability of being early, as timing the market is

something not even the professionals have mastered. Therefore, it is much more advantageous not to guess when we will see more capacity come online, but instead to focus our energy on looking for an operationally excellent company that will be able to capitalize on the eventual narrowing of differentials, while having enough hedging in place to stick it out until that happens.

**EXHIBIT XIII**

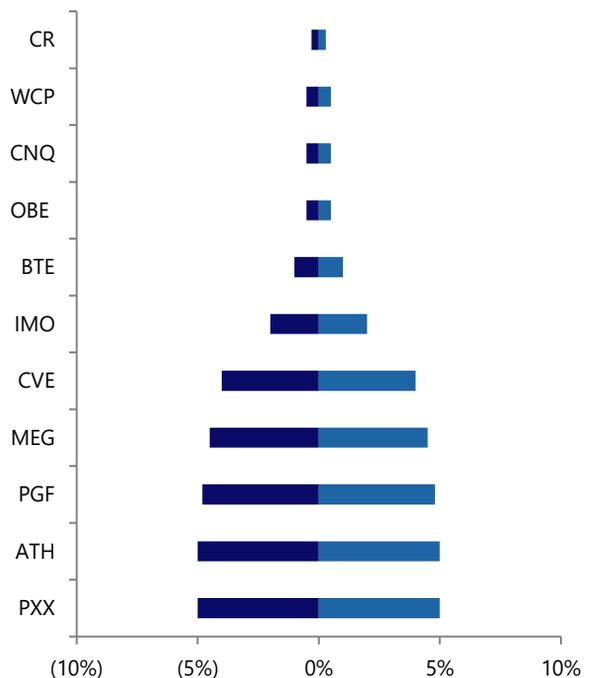
Hedged vs Exposed Production



Source(s): Company Reports

**EXHIBIT XIV**

CFPS Sensitivity to \$1 Change in WCS Differential



Source(s): Desjardin, Company Reports

## Investment Thesis II: Market Grudge Overhangs Operational Excellence

CVE's former management team made missteps that the market has been unwilling to forgive the stock for; however, it is our team's belief that this grudge casts a shadow on the core fundamentals of CVE's business model and creates negative noise for the firm's prospects moving forward. It appears the new CEO, Alex Pourbaix, will use these mistakes as learning opportunities and has made changes to put his firm back on track. Our team believes it's a matter of time until the market forgives these errors and sees CVE for the firm it has become, not the firm it has been.

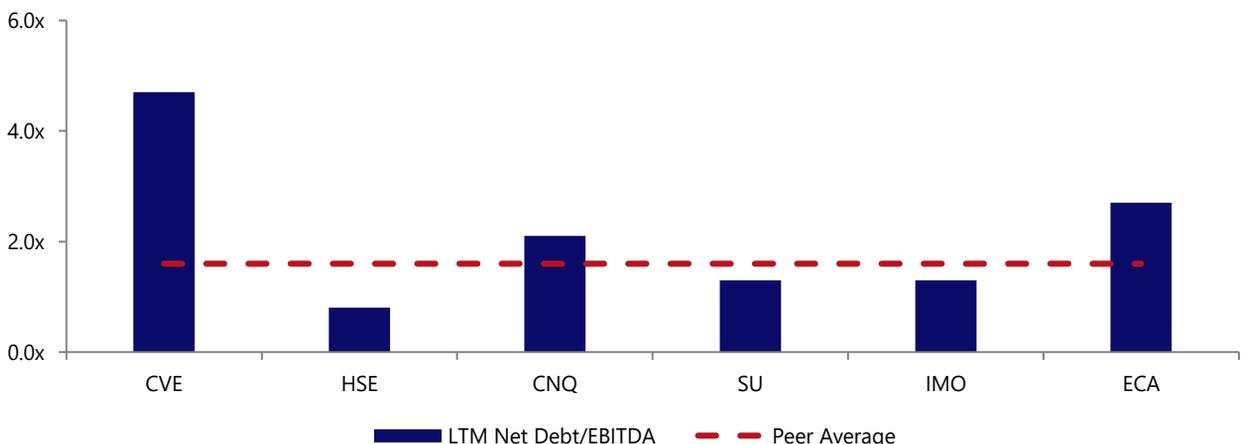
In 2017, CVE acquired ~300Mbb/d of oil project interests at Christina Lake and Deep Basin from ConocoPhillips for \$17.7B, a highly scrutinized deal. CVE heavily levered up to raise cash for the acquisition, using ~\$7.5 in debt to fund the deal, rendering the company amongst the most levered players in the space. The market did not like the deal, resulting in a 50% market cap decrease in the first 6 weeks following the transaction and tarnished relationships with many long-term shareholders. In addition, CVE issued 208 million shares to ConocoPhillips in the deal, making

them the largest shareholders with a 17% ownership stake, a position they have declared they plan to move out of.

The market's grudge for the balance sheet issues have been compounded by CVE's poor hedge book through 1H18. CVE engaged in an aggressive hedging program to offset risk assumed through the financial engineering of the ConocoPhillips deal. The hedge book took a turn for the worst when global oil prices increased and the WCS differential widened, resulting in CVE missing on a lot of upside and cash flow. Many analysts argue that without the program, the balance sheet would be in much better shape, with 2018E D/CF less than 2.0x instead of its current state above 3.5x. CVE has cleaned its hedge book for 2H18 (37% hedged vs. 80% hedged in 1H18) and nearly closed it for 2019, understanding that a clean balance sheet is the best hedge. The balance sheet hedge is supplemented by CVE's operational hedge through its downstream operations as an integrated player, as previously discussed.

### EXHIBIT XV

LTM Net Debt/EBITDA Multiples of CVE's Comparable Universe



Source(s): Capital IQ

## Investment Thesis II: Market Grudge Overhangs Operational Excellence

The conversation surrounding CVE since the ConocoPhillips acquisition has been one of viewing the firm as a write-off. Howard Mark's wrote in his book, *The Most Important Thing*, "The biggest investing errors come not from factors that are informational or analytical, but from those that are psychological"; we believe this statement accurately depicts the market's perception as Cenovus, using its recent missteps as justification for not entering the name while ignoring its undisputable operational excellence.

While the market has been seemingly focused on its grudge for the leverage position stemming from the transaction, CVE has been working to make it right with a crafted de-levering program centered around the sales of assets that are not deemed to be core to the firm's strategy moving forward. CVE has reduced net debt by over \$3.3B in the last year, and will continue to support its de-levering program through asset divestiture, with a net debt to EBITDA goal of less than 2.0x. Additionally, CVE has a very manageable repayment schedule, which does not

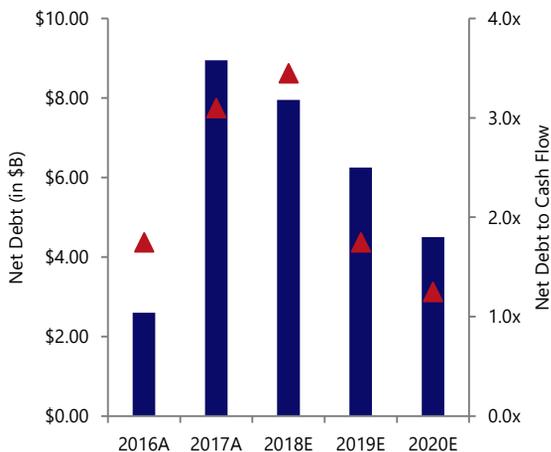
require further payments until 2022. Our team can acknowledge the risk of CVE's leverage position; however, we see it more as an opportunity than a risk to enter the name while it has this overhang.

Finally, QUIC believes in buying great businesses with strong operational performance. CVE runs an outstanding operation with industry leading operational metrics. In a heavy oil environment plagued with adverse pricing, efficiency is key to performance and stability. CVE owns and operates the best SAGD project in the country at Christina Lake, which has industry-leading Steam-to-Oil ratio's at 1.8x, which creates a competitive advantage through lower capital and operating costs (\$5.30/bbl).

CVE has made mistakes. CVE has a very highly levered position. In an adverse heavy oil market, its timing could not have been worse. However, we believe that CVE has paid its price and aligned its strategy to properly deploy capital, restructure its balance sheet, and continue to be the leading operator in the oil sands.

### EXHIBIT XVI

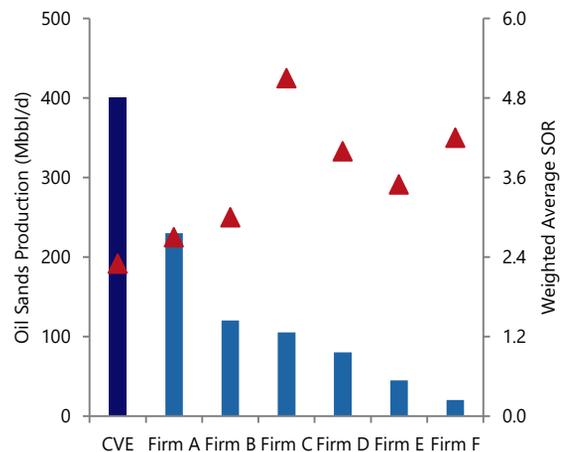
CVE's Debt Reduction Outlook



Source(s): CIBC World Markets

### EXHIBIT XVII

CVE Leads Oil Sands Producers in Efficiency



Source(s): Company Filings

## TSX:CVE – What is the Margin of Safety?

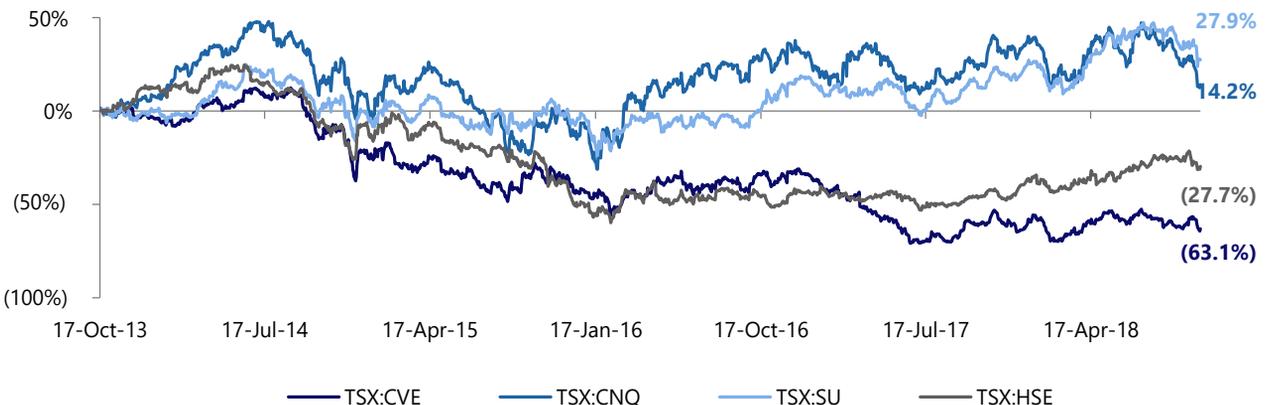
As of late, Cenovus' shares have been depressed due to a myriad of factors such as its peer-high levels of debt, Conoco Phillips ownership stake overhang, negative sentiment surrounding WCS differentials, and uncertainty surrounding the capabilities of the new management team.

We believe that investors have overemphasized the potential negative implications surrounding these considerations and have failed to understand that market cyclicalities are at play here. Right now, Canadian oil sands assets are viewed as unfavourable because of the weak economics stemming from egress issues. However, it is critical to take a long-term view based on where we currently sit in the market cycle and use this view to guide our investment decisions. We also believe that future egress resolutions such as increased rail and pipeline capacity are not fully priced into Canadian oil stocks as investors are valuing Canadian oil businesses on current differentials rather than that which represents a normalized state. Moreover, investors are failing to appreciate the FCF generation quality of CVE's assets and how profitable these assets will be for the company when the differential closes.

Even as prices are depressed and that CVE is the most levered of its peers, it still upholds the highest LFCF yield in their comp set. Regarding solvency, CVE's strong FCF profile coupled with the new management team's strategy of selling non-core assets will allow the company to clean its balance sheet and become more attractive to investors who were spooked by its relatively high levels of debt. Accordingly, we view the current levels of debt more mechanically. Moreover, CVE's debt maturity schedule limits immediate risk as most of their debt is due in 2023-2024. Notwithstanding CVE's debt, the company deserves to trade at a premium to peers solely because of the quality of its assets. Despite the price paid in the COP deal, the transaction only strengthened the quality and size of CVE's resources. It seems that the market isn't attributing any value to CVE for the quality of their assets at the moment, as made clear in Exhibit XXX. Given the price of WT-WCS differentials and the significant potential for upside that the market isn't appreciating, we view the CVE/s risk/reward profile as very asymmetric and feel that now is an opportune time to enter the name.

### EXHIBIT XVIII

Historical Share Price Performance



Source(s): S&P Capital IQ

## TSX:CVE – What is the Margin of Safety?

To further understand the risk/reward opportunity in Cenovus, we ran a regression between the company's share price and the price of WCS (Exhibit XIX). At a 95% level of confidence, this test is statistically significant and provides a line of the best-fit equation of  $6.6 + 0.32(WCS)$ , where WCS represents the price of WCS on the market. Despite being statistically significant, we used the best-fit equation with the price of CVE's stock and that of WCS annually for the past five years to calculate the delta between the model-implied price and what CVE's shares were trading at on that day. Exhibit XX depicts the results of this test, highlighting the fact that for the past five years, the model accurately predicted the share price within a few dollars of the actual market price. The deviation in October of 2017 is attributable to CVE's share price being depressed by the COP deal, but the analysis holds once again in the following year. It was also interesting to note that of all the large cap/integrated players, CVE has the highest correlation to both WCS and WTI. The association is explained by the fact that they have less downstream operations than the listed peers. We view this result favourably as it will provide CVE with more torque than peers when the WTI-WCS differential begins to close.

### EXHIBIT XIX

#### TSX:CVE – WCS Regression Results

Model 1: OLS, using observations 2009-11-06:2018-01-12 (T = 428)  
Dependent variable: TSXCVE  
HAC standard errors, bandwidth 5 (Bartlett kernel)

	coefficient	std. error	t-ratio	p-value
const	6.62527	1.51086	4.385	1.46e-05 ***
WCS	0.318009	0.0205887	15.45	4.68e-043 ***
Mean dependent var	25.63909	S.D. dependent var	8.111562	
Sum squared resid	7301.168	S.E. of regression	4.139915	
R-squared	0.740130	Adjusted R-squared	0.739520	
F(1, 426)	238.5720	P-value(F)	4.68e-43	
Log-likelihood	-1214.352	Akaike criterion	2432.705	
Schwarz criterion	2440.823	Hannan-Quinn	2435.911	
rho	0.940079	Durbin-Watson	0.130794	

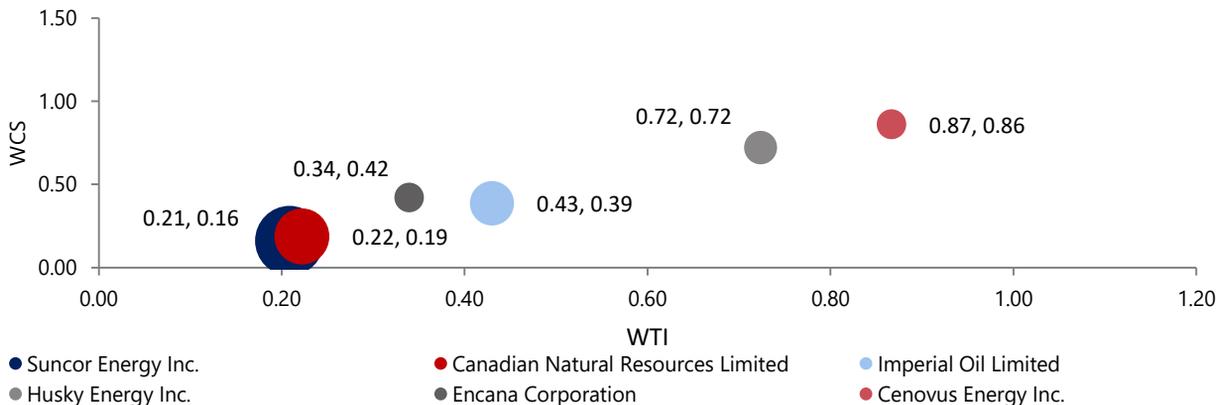
### EXHIBIT XX

#### Model Back test

Date	Model Implied Price	CVE Price	Delta
Oct 17 2014	\$28.10	\$26.38	\$1.72
Oct 17 2015	\$19.02	\$21.41	-\$2.39
Oct 17 2016	\$18.56	\$20.52	-\$1.96
Oct 17 2017	\$15.95	\$12.14	\$3.81
Oct 17 2018	\$12.92	\$11.71	\$1.21

### EXHIBIT XXI

Large Cap/ Integrated Canadian Oil Companies Correlation to WCS & WTI, respectively



Source(s): S&P Capital IQ

## TSX:CVE – What is the Margin of Safety?

To arrive at our implied share price of \$15.34, we used a weighted average comps and a regression (Exhibit XXIII). In the comps analysis, the EV/EBITDA, EV/(BOE/D) and the EV/DACF multiples were calculated from 2020 estimates. Moreover, the EV/NTM EBITDA analysis assumes a 7.0x NTM EBITDA multiple, which is ~2.7x above where Cenovus currently trades. The divergence is attributable to the COP-CVE deal done in 2017, as the company has still yet to fully rebound from the initial selloff per its

announcement. We then took a weighted average of 5 WCS cases whereby our regression analysis outputted an implied share price. In the spirit of conservatism, each market scenario was then weighted, and current WCS prices were more heavily weighted. To arrive at our final share price, the comps analysis received the majority of the final weighting, as we felt more comfortable attributing value to analysis that leaned more towards fundamentals as opposed to technical, despite how compelling the regression results were.

### EXHIBIT XXII

#### Comparable Company Analysis

Company	Market Cap	Enterprise Value	EV / EBITDA			EV/(BOE/D)			EV/DACF			LFCF Yield	Price / NAV
			LTM	FY2019E	FY2020E	LTM	FY2019E	FY2020E	LTM	FY2019E	FY2020E		
Suncor Energy Inc.	\$75,054	\$87,961	5.9x	5.3x	5.6x	\$118	\$105	\$103	8.2x	7.0x	6.4x	5.4%	0.9x
Canadian Natural Resources	\$45,144	\$67,465	5.6x	5.3x	5.2x	\$62	\$60	\$59	6.8x	6.3x	5.9x	5.5%	0.7x
Imperial Oil Limited	\$34,401	\$38,440	8.6x	7.5x	8.3x	\$103	\$96	\$94	9.4x	8.3x	8.0x	2.5%	1.0x
Husky Energy Inc.	\$19,972	\$24,282	5.2x	4.5x	4.3x	\$79	\$74	\$69	5.6x	5.0x	4.6x	8.1%	0.9x
Encana Corporation	\$13,879	\$17,731	7.9x	5.7x	4.7x	\$48	\$40	\$37	10.3x	6.8x	5.6x	-5.7%	1.0x

Mean	6.7x	5.7x	5.6x	\$82	\$75	\$72	8.1x	6.7x	6.1x	3.1%	0.9x
Median	5.9x	5.3x	5.2x	\$79	\$74	\$69	8.2x	6.8x	5.9x	5.4%	0.9x

Cenovus Energy Inc.	\$13,663	\$22,566	11.6x	5.4x	5.3x	\$45	\$46	\$43	14.5x	7.0x	5.8x	8.4%	0.6x
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Source(s): S&P Capital IQ

### EXHIBIT XXIII

#### Implied Share Price Calculation

Comps	EV/ EBITDA	EV/(BOE/D)	EV/DACF	P/NAV	EV/ NTM EBITDA
Enterprise Value	\$24,043	\$36,040.17	\$23,513.68	\$32,446	\$29,196
Net Debt	-\$8,903	-\$8,903	-\$8,903	-\$8,903	-\$8,903
Market Cap	\$15,140	\$27,137	\$14,611	\$23,543	\$20,293
S.O	1228.8	1228.8	1228.8	1228.8	1228.8
Implied Price	\$12.32	\$22.08	\$11.89	\$19.16	\$16.51
Current Price	\$11.12	\$11.12	\$11.12	\$11.12	\$11.12
Implied Upside	11%	99%	7%	72%	49%
Weighting	0.25	0.125	0.25	0.125	0.25
Weighted Upside	2.70%	12.32%	1.73%	9.04%	12.13%
W.A Implied Upside	37.9%				
Implied Share Price	\$15.34				

#### Regression

Implied CVE Price	% Upside	Weighting	W.A. Upside
\$12.92	16.2%	0.3	4.9%
\$14.60	31.3%	0.3	9.4%
\$16.20	45.7%	0.2	9.1%
\$17.80	60.1%	0.1	6.0%
\$19.40	74.5%	0.1	7.4%
<b>Blended Return</b>			<b>36.8%</b>

All in Return Analysis	Implied Return
Comps (75%)	37.9%
Regression (25%)	36.8%
<b>W.A Return</b>	<b>37.6%</b>
Add: Dividend	1.80%
<b>All in Return</b>	<b>39.4%</b>

## References

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1. Altex Energy
2. Bloomberg
3. Canaccord Genuity
4. CIBC World Markets
5. Company Filings
6. Desjardins
7. EIA
8. National Energy Board
9. S&P Capital IQ