SMEAD capital management

Missive

NOVEMBER 12, 2026

Dancing with the Pretty Girls

Dear Fellow Investors,

I think about life a lot differently as a 42-year-old man than when I was younger. Junior high dances come to mind, particularly where there were two groups of guys: those that dance and those that don't. The proverbial wallflowers found their place outside the dance floor. As a fine young cannibal, a good rule that my dad taught me was to dance with all the girls because it was the right thing to do and it let all the girls know that you wanted to dance. My real goal was to be dancing with the pretty girls.

The oil producers Cenovus Energy Inc. (CVE) and Strathcona Resources Ltd. (SCR) have taken it on themselves to do the same. These two companies have made it a goal to consolidate what we believe are the most valuable wells in North America: thermal SAGD (steam-assisted gravity drainage) oil sands. There are wallflowers in this story, though. There are Suncor Energy Inc. (SU), Canadian Natural Resources Limited (CNQ), and Imperial Oil Limited (IMO), as well as American producers and most investors in the energy space also acting as wallflowers, standing on the outside of this dance floor looking in. At some point, you think these people would wanna dance with the pretty girls.

What makes these SAGD assets so pretty is that they are long duration in nature. 50 years of reserve life is not out of the question. We think of this like buying a long-duration bond. In the oil business, your coupon payment is based on the price of oil and how efficiently you are pulling the oil out of the ground. There are also ways you can manage the bond. If you think the next 10 years are going to be good in prices, you can pull more of your reserves out of the ground. This would bring forward your last five years of cash flows closer to today. Much like a bond, the last 10 years have the least amount of value today because of the present value discounting.

Now that we understand how to contextualize these assets, let's talk about the multiples being paid by Cenovus and Strathcona. MEG Energy Corp. (MEG), a former holding of ours, was bought out at C$85k (Canadian dollars) of enterprise value per flowing barrel in late 2025 by Cenovus. They had to pay up to get the deal done. That set a new plateau of comps for SAGD assets. Looking back, we can learn two things. MEG had large net operating losses that could be realized in the following 12 months post-acquisition by Cenovus. Cenovus was also going to increase production on MEG Energy's existing asset, Christina Lake. In other words, they were bringing the out years of payments in our bond analogy forward. Just in year one tax savings, we believe that it reduced the price paid for MEG by 25%. What a benefit to dance with a pretty girl.

Fast forward to October 2026, Cenovus announced that they were buying out Athabasca Oil Corporation (ATH). The headline price was C$127,000 of enterprise value per flowing barrel. If you look at the net operating losses and assume Cenovus will be using those in the first 12 months, they are only paying C$93,700 per flowing barrel. Once Cenovus bought MEG, they understood the value of the NOLs of these SAGD assets more than before they began dancing. Athabasca was a rinse and repeat. The more you dance with these pretty girls, the easier it gets.

While Cenovus has been the most active in the last 18 months, it all began about seven years ago. Adam Waterous had started to invest countercyclically in the energy business beginning in 2016. He figured out much earlier on than others how valuable SAGD assets are. His private equity firm began rolling up assets over the last decade and brought him into the ownership of SAGD assets in Alberta and Saskatchewan, creating Strathcona Resources. Strathcona put MEG Energy in play. Out of that transaction, Strathcona got more contiguous SAGD assets down in Saskatchewan. One of his private equity funds had taken over a company called Greenfire Resources Ltd. (GFR). Greenfire followed that with a transaction to buy Connacher Oil and Gas Limited, a private company, this last summer. Adam is now purchasing Greenfire with his company Strathcona (SCR). He is doing this for C$25,400 of enterprise value per flowing barrel, net of the recognizable NOLs. His stock trades for C$73,000 per flowing barrel. That's one way to dance with a pretty girl!

Dancing with the Pretty Girls

We now know that these SAGD assets are the pretty girls of the energy business. Based on the Athabasca comp, net of the NOLs, the market price for a SAGD thermal asset with the ability to grow barrels is CA$93,700. International Petroleum Corporation (IPCO) is building a SAGD asset called Blackrod. It fits this profile. We own it and think it's one of the pretty girls. We believe the markets are clamoring for companies like these to be built or exposed out of larger companies in the public markets. Calling all bankers to help the wallflowers to get up and dance! It's just like junior high dance in the end; everybody's gonna wanna be dancing with the pretty girls.

Play The Long Game,



Cole Smead, CFA
CEO & Portfolio Manager

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