Investors Catch a Glimpse of Encana's Future

Description

Big changes are in store at **Encana** (TSX: ECA, NYSE: ECA). New Chief Executive Doug Suttles has promised to chart a new course for the struggling natural gas company by cutting costs, refocusing operations, and increasing liquids production. But so far, the specifics behind his plans have remained unclear. On Thursday, however, investors caught their first glimpse of the company's future.

Changes are needed
Shareholders have been anxious to see a turnaround at the company, which has been struggling with low natural gas prices for years. When Doug Suttles took over as the Encana's CEO in June, one of his first tasks was to take an inventory the company's assets and develop a new strategy.

"The resounding message I have received from our shareholders and staff through surveys, focus groups, meetings, and interviews across the organization is that they are ready for change and maintaining the status quo is not an option," Suttles said in the company's press release. "I have every intention of making significant change in the areas where improvement is required."

What might be coming this fall
The review found the company must focus its capital on areas that play to its strengths and deliver the best returns. In his presentation to analysts at the Barclays CEO Energy Conference on Thursday, Mr. Suttles was critical of Encana's past strategies. "Our capital allocation process is broken," he told analysts, "We're funding too many plays. We're not prioritizing. We're not focusing our efforts."

"We have something like 28 or so different asset opportunities in the portfolio and every single one of them is being funded right now. I think we all understand that focus and discipline in capital allocation is the real key to performance and it's one of the things we love to make radical change in to be successful."

Suttles didn't list specific projects that might be on the chopping block. However, he did name the Duvernay shale play in western Alberta as a key area of focus going forward. Suttles admitted Encana has been slow to develop its large Duvernay acreage but that the formation is rich in condensate — a light hydrocarbon needed to dilute bitumen for transport in pipelines — which is particularly prized in the oil sands right now. Suttles also highlighted the Tuscaloosa Marine Shale in Louisiana and Mississippi as a promising oil asset.

Two plays down; only 26 more to go.

To grow, Suttles thinks the organization is going to have to get smaller. “The first priority has to be profitability. And in fact, I think you can grow profitability without growing production.” Accomplishing this will require wringing efficiencies out of existing operations shifting to a more liquid production mix.

Suttles also hinted at more layoffs to come. “Our existing organization, both its structure and its size, is aligned with the past and not the future. It’s built around a bigger capital program and cash flow than we have today and we need to get that realigned.” Encana has already cut 7% of its staff during the first half of 2013. The company is looking to shave an additional $150 million in general and administrative expenditures by the end of the year.

Suttles didn’t provide more specifics behind his turnaround plan. However, the company is expected to release its full business strategy by year-end. But the changes signal a new era of discipline for the company that finally seems to be responding to what shareholders are looking for.

Don’t get too excited
Investors were obviously encouraged by what they heard. Following Suttles’ presentation, Encana shares rose 4% in trading.

But shareholders should temper their enthusiasm. The company’s shrink-to-grow strategy closely matches that of **Talisman’s** (TSX: TLM, NYSE: TLM) Chief Executive Hal Kvisle, who last year promised to refocus operations, sell off underperforming assets, and increase liquids production. However, nearly 12 months after taking over the company, Talisman is still struggling to maintain profitability and the stock is hovering near 52- week lows. The case illustrates how challenging turnarounds are to pull off.

Foolish bottom line
New Encana will look smaller and oiler than its predecessor. We know the destination. Now shareholders want to know how management is going to get there.

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Disclosure: Robert Baillieul has no positions in any of the stocks mentioned in the article.

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