Does Encana Have the Strength to Turn Itself Around?

Description

By: Robert Zimmerman

One good way to evaluate an investment is a systematic review of a company's strengths, weaknesses, opportunities and threats. From there, you can decide if the company deserves your hard-earned money. Let's run natural gas giant **Encana** (TSX:ECA) through this framework and see what we come up with. First, Encana's strengths.

They need to get better and they know it
Perhaps the company's biggest strength comes from the Encana board room. Newly installed CEO Doug Suttles held his first earnings conference call late last summer. He fully faced the facts: Encana needs to improve its operating efficiency both in the field and in the office. He outlined various steps and goals the company had initiated and projected cost savings. Some are simple things such as changing from drilling one well per pad to drilling multiple wells per pad. Others are more involved, including joint ventures with other companies.

Beyond that, Suttles launched a strategic review of the company's assets and goals. During the recent Barclay's CEO Energy Power Conference, he highlighted the company's assets and challenges. "The status quo is not an option" seems to be Suttles' mantra going forward. Change is needed and Suttles doesn't seem to be flinching. He also isn't letting on regarding the details of this review, or at least not yet.

Cash and assets
Encana's 2013 capital expenditure budget comes in at roughly $3 billion. The company's projected cash flow for the year is roughly $2.4 billion. To help cover the difference, Encana has roughly $3 billion in cash and equivalents plus assets that it could sell. This gives the company a distinct advantage over its competitor **Penn West Petroleum** (TSX:PWT). Penn West has virtually nothing in the bank and limited assets to sell if its own turnaround doesn't happen swiftly. If oil prices drop or extreme weather slows production, Encana looks far better positioned than Penn West to ride out the storm.

Just what could Encana sell? Natural gas assets. The company claims to have enough natural gas reserves to keep it going at current production rates for the next 75 years. Much like its joint venture with **Mitsubishi** in the Cutbank Ridge play, Encana could sell an interest in its Horn River assets. After selling $5.1 billion in assets last year, Encana proved it isn't squeamish about parting with non-core assets to fund its oil and natural gas liquids plays.

In 2012, falling natural gas prices forced EnCana to write down the value of its natural gas assets. While that didn't help the company's finances, it does seem to have enough cash flow, cash, and assets to fund its operations for the near term.

Potential for increasing production and profits
Lastly, Encana owns significant oil and natural gas assets in both Canada and the US with a growing emphasis on liquids production. Between the two countries, Encana boasts proven reserves of 11.6 trillion cubic feet of natural gas and 240 million barrels of oil/liquids (using Canadian protocols) at the end of 2012. As mentioned above, the company's future focus will be liquids and oil production. Encana projects a year-end oil/liquids production rate of 70,000 to 75,000 boe/day.

Just as importantly, Encana claims to have 20% lower production costs for natural gas than its competitors. The company also claims to have reduced production costs by up to 24% in various plays. Further, the company believes it will achieve $100 to $150 million savings in administrative costs by the end of the year. Finally, Encana is leveraging various joint ventures to further increase its natural gas liquids production.

While Encana expands into liquids and oil production, you may be wondering about its 2009 spin-off of **Cenovus Energy**. The idea was that Cenovus would mainly be an oil-producing company while Encana would focus on producing natural gas. It seemed like a good idea at the time, but in hindsight it might not have been. Natural gas prices plunged in 2012, taking Encana's earnings with them. In contrast, Cenovus reported $1.69 billion in operating cash flow that same year. This was reported with declining earnings, however, due in part to increased oil production costs and higher cash taxes.

Final Foolish thoughts
Encana investors took their lumps during 2012. The company responded by changing the CEO, who in turn has taken steps to improve the company's profitability. Encana has plenty of natural gas and liquids assets from which to generate revenue, and has wisely focused on producing more of the latter. Its finances look solid for the near term.

As the company shifts toward more profitable oil and liquids, improves its operational efficiencies in the field and in the office, and manages its various assets more prudently, Encana certainly looks promising. Perhaps the one strength that remains unknown is the company's strategic review. This could initiate further changes that unlock Encana's full potential. Let's hope that the company gets it right.

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