2 Key Areas Where Encana is Weak

Description

No company is perfect. It has weaknesses that are clearly visible, and unfortunately some that are not. The key to becoming a better investor is to know where a company is weak so as to not be blindsided if something goes wrong.

While **Encana** (TSX: ECA) (NYSE: ECA) has its share of strengths, it does have a few weaknesses that investors need to keep an eye on. I see two in particular that could impact the company's ability to turn itself around in the future.

Natural gas heavy

Encana has 80 trillion cubic feet of natural gas resource potential. To put that number into perspective, 5 trillion cubic feet of natural gas is enough to meet the needs of 5 million households for 15 years. As far as Encana is concerned, it has enough natural gas potential to keep it producing for the next 75 years at its current rate. It has more gas than it needs, especially with prices in North America still low.

At one time Encana was much more diversified. When natural gas prices were much higher, and shale gas drilling all the rage, it chose to split off its oil focused portfolio to focus on natural gas. In hindsight, letting **Cenovus** (TSX: CVE) (NYSE: CVE) go wasn't a great idea. Cenovus has become a great Canadian oil growth story. Thanks to its solid position in the oil sands the company expects to grow its higher margin oil production by 11% annually for the next decade.

Encana now finds itself having to invest to grow the liquids production it lost by letting Cenovus go. It has had fairly good success as evidenced by the 50% compound annual growth in liquids production over the past two years. It still has a long way to go as a vast majority of its production is still natural gas.

Unfocused capital

Encana's other major weakness is its lack of focus. The company has spread itself thin by investing in more than 17 different resource plays. The chart below shows how that stacks up to its peers.

Encana portfolio

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Source: EnCana

Most of its peers are focused on just a handful of resource plays, with one play that gets at least a quarter of its capital. Not so with Encana, which seemed to have run out of possible colors on the above chart to show where its capital is going.

It's pretty clear that the company needs to become more disciplined in its capital allocation decisions. By investing in its highest returning projects it will better serve its investors. It's a move that **Talisman** (TSX: TLM) (NYSE: TLM) has also embraced as it too has decided to focus its capital program on those plays that will deliver sustainable cash flow over the long-term. Talisman's strategic moves include rationalizing its North American portfolio as well as looking to divest its North Sea operations. In addition to that, it's focusing nearly all of its capital to grow its liquids rich production.

Investor takeaway

Given the current outlook for natural gas prices, Encana needs to diversify into higher margin liquids. At the same time it needs to be smarter in how it allocates its capital by focusing only on its best projects. If it can overcome these weaknesses the company should thrive in the future. It certainly has compelling opportunities, so stay tuned to learn more as this series on Encana continues.

Similar to Encana, uranium – the key ingredient in nuclear energy – could be on the verge of turning a corner. **Click here now** to learn more about uranium's prospects, as well as two ways to play this potential revolution.

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