



## Is Now the Time to Bet on EnCana's Recovery?

### Description

Once-struggling Canadian oil and gas producer **EnCana** (TSX: ECA)(NYSE: ECA) continues to perform strongly as it progresses with its turnaround strategy. This strategy is aimed at boosting higher margin crude production, slashing costs and divesting itself of non-core assets. This has seen the company start to fire on all cylinders for the first time in years as both operational and financial results continue to improve quarter-by-quarter.

#### First-quarter 2014 earnings exceeded analyst expectations

This strategy is paying dividends for EnCana, with the company reporting a net profit for the first quarter 2014 of U.S. \$116 or U.S. \$0.16 per share. That's a stark contrast to the net loss EnCana reported for the previous quarter and the equivalent period in 2013. Even more pleasing for investors is that EnCana surprised the market with its operating earnings of U.S. \$0.70 per share, exceeding the consensus analyst forecast by 30%.

Another important aspect of EnCana's results was significant growth in cash flow, which popped a whopping 62% quarter-over-quarter and 89% year-over-year. This is particularly important for an oil and gas producer due to the capital-intensive nature of the industry, with significant capital investment required to continue developing oil assets so as to ensure the sustainability of future production.

The key drivers of this significantly improved financial performance were higher realized oil prices, higher crude, and natural gas production as well as a higher proportion of that production being composed of higher margin crude. Crude and other liquids production during the quarter grew a healthy 3% quarter-over-quarter and a massive 56% year-over-year to 68,000 barrels of crude daily. This can be primarily attributed to a successful drilling campaign in Canada's liquid-rich Montney shale and the DJ and San Juan Basins in the U.S.

More importantly, EnCana continues to generate a healthy netback per barrel of crude produced. This is a key measure of the profitability of an oil companies operations and EnCana's netback for first quarter 2014 was \$32.63 a massive 106% increase quarter-over-quarter and 155% year-over-year. A key driver of this significant increase in EnCana's netback is the significant growth in the proportion of its production comprised of crude liquids.

But this overall netback is still significantly lower than many of its peers — **Husky Energy's** (TSX: HSE) first quarter netback of \$44.81 per barrel was 50% higher, and **Crescent Point's** (TSX: CPG)(NYSE: CPG) netback of \$52.65 per barrel is almost double EnCana's. The key reason for EnCana's low netback, particularly in comparison to its peers, is that a significant proportion of its production is made up of natural gas, which generates a significantly lower margin than crude and natural gas liquids. As a result, I am expecting EnCana's netback to continue growing significantly as it increases its crude and natural gas liquids production over the short-to-medium-term.

### **Asset divestments and acquisitions continue in order to boost liquids production**

During the quarter, EnCana was able to divest itself of a number of assets and file the prospectus for the listing of its royalty assets as the PraireSky Royalty business. This saw EnCana raise U.S. \$2.3 billion from the sale of dry natural gas assets during the quarter, with those funds earmarked for the acquisition and development of oil and liquids assets.

The company also acquired a range of oil-rich assets comprised of 45,500 net acres in Karnes, Wilson, and Atascosa counties of south Texas in the Eagle Ford shale during the quarter for \$3.1 billion. These assets will significantly boost EnCana's oil and liquids production, producing around 53,000 barrels of crude daily with 75% of that production being made up of oil and natural gas liquids.

Along with EnCana's exploration and development program, this will contribute to a significant growth in crude and liquids production. With crude at well over \$100 per barrel, this will certainly boost revenue and ultimately, EnCana's bottom line.

### **Is now the time to bet on the success of EnCana's turnaround?**

But after all of this good news, the key question for investors is whether now is the time to take a leap of faith and invest in EnCana, particularly with its share price jumping a healthy 30% for the year-to-date.

Even despite this significant spike in its share price, EnCana appears attractively priced with an enterprise value of 8 times EBITDA and a price-per-flowing-barrel of \$42,000. These valuation metrics compare favorably to many of its peers, being lower than Husky's EV of 9 times EBITDA, as well as Crescent Point's EV of 11 times EBITDA. Husky and Crescent Point also have a particularly high price-per-flowing-barrel, at \$137,000 and \$180,000 respectively.

Finally, EnCana continues to pay a dividend with a yield of 1.2% despite slashing it by 65% in 2013 as a means of conserving capital. This dividend is not as high as many of the other operators in the patch, but it will continue to reward patient investors willing to make a bet on EnCana successfully executing its turnaround strategy.

It is clear EnCana's much vaunted turnaround program is gaining traction and the company's operational and financial performance continues to improve. There is also significant room for further

improvement with the company having made a series of divestments and acquisitions aimed at boosting higher margin crude liquids production.

This will see EnCana's financial performance over the short-to-medium-term continue to improve and with a reasonable dividend yield rewarding investors for their patience, now is the time to make that bet and invest.

## CATEGORY

1. Investing

## TICKERS GLOBAL

1. NYSE:VRN (Veren)
2. TSX:VRN (Veren Inc.)

## Category

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## Date

2025/09/10

## Date Created

2014/05/19

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