



Canada's Largest IPO Since 2000: Is PrairieSky a Better Bet Than EnCana?

Description

Once-troubled Canadian oil and gas producer **EnCana** (TSX: ECA)(NYSE: ECA) continues to go from strength to strength under the guidance of CEO Doug Suttle. Not only is the company's turnaround strategy gaining traction, as evidenced by a solid operational performance for the first quarter of 2014, but it has just successfully completed the largest IPO in Canada since 2000.

How did the IPO fare?

The IPO offered 52 million common shares of **PrairieSky Royalty** ([TSX: PSK](#)), a corporation holding EnCana's mineral title land assets. Even more impressively, EnCana was able to garner sufficient interest in the IPO for it to obtain the top-end price for the shares of \$28 each. EnCana raised \$1.46 billion from this IPO, leaving it with a controlling interest of 60% in PrairieSky.

PrairieSky's focus will not be to develop the assets itself, but rather to attract third-party capital investments to develop the oil and gas properties it holds. It was previously projected by EnCana that the assets sold to PrairieSky would have generated \$195 million in free cash flow and \$165 million in dividends in 2013 had the business been an independent company.

There are a number of advantages to operating a royalty company, a key one being the ability to generate a higher operating margin per barrel of crude produced than an oil producer with lower downside risks. This is because the royalty company does not need to invest capital in developing the assets, and is also not responsible for abandonment or environmental liabilities. These risks are carried by the operators, who commit to investing in and developing the oil assets held by the royalty company.

Even more importantly, 97% of the property assets containing oil and natural gas held by PrairieSky are fee simple mineral title, meaning there are no royalties payable to the Crown and that the assets are held by PrairieSky in perpetuity.

EnCana vs. PrairieSky

With all of these advantages compared to Crown and freehold title lands, which is the better

investment: EnCana or PrairieSky?

EnCana's shares have performed strongly over the last year, spiking a healthy 16% in that period. But the company's renewed focus on growing higher-margin oil and natural gas liquids production while also divesting itself of non-core and lower-margin dry gas assets should continue to improve its financial performance.

In the first quarter of 2014 alone, EnCana's oil and natural gas liquids production grew a healthy 3% compared to the previous quarter, and a whopping 56% compared to the equivalent quarter in 2013. The company has also committed to growing liquids production by 30% as a key part in its turnaround strategy.

EnCana holds some significant high-quality oil and gas assets in Canada, including being the largest operator in liquids-rich Montney, one of Canada's most economic natural gas plays. Its acquisition of oil- and liquids-rich land in the prolific Eagle Ford Shale also bodes well for EnCana to realize its goal of significantly boosting its higher-margin crude and liquids production.

The proceeds raised by EnCana from the IPO can also be directed towards strengthening its balance sheet and further developing what management considers to be core assets. Thus, EnCana should see a significant leap in its operational and financial performance.

Overall, PrairieSky is an appealing investment. But with EnCana retaining a 60% controlling stake and showing signs that its turnaround strategy will be successful, investors can benefit from both if they invest in EnCana.

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