



2 Stocks to Own Heading Into September: Encana Corporation and NuVista Energy Ltd.

Description

Notwithstanding recent weakness, over the last year natural gas prices have surprised investors by doing better than they had been anticipating. While some investors have written off this commodity, I believe that it is on the path to continued strength. As such, I am a big believer in **Encana Corporation** (TSX: ECA)(NYSE: ECA) among other natural-gas-weighted companies that I expect will perform well from now into the winter.

Natural gas inventories still low

A cooler-than-normal summer is just wrapping up and natural gas inventory levels in storage are still very low. Last week, the Energy Information Administration reported that inventories rose 78 billion cubic feet versus expectations for an 82 bcf increase. While storage injection was once again above the five-year average gain for this time period, inventories are nonetheless still 19% lower than the five-year average, which is a bullish sign for prices. In my view, despite the fact that this summer has been cooler than normal, this shortfall shows how natural gas supply may very well prove to be tight this winter.

Some experts say that there are signs that the production boom will actually slow down and that natural gas prices will settle higher than previously thought. There are four premises that this case is built on. Three relate to the supply side of the natural gas market, and one relates to the demand side.

First, the decline rate on unconventional wells is very steep, so their lives are shorter than conventional wells. Second, shale reserve estimates are being reduced. Last year, we saw more than one negative revision of U.S. shale reserves. This is concerning, and implies that initial estimates of shale gas recoverability may have been too high.

Royal Dutch Shell last year announced a writedown of just over \$2 billion related to its NorthAmerican shale assets. **BHP Billiton Limited** has also had to write down its U.S. shale assets. This is not only because of low natural gas prices but also because exploration and drilling results are coming in weaker than anticipated.

Third, conventional natural gas production has been declining for years. The final reason that some believe natural gas prices will improve is because liquefied natural gas is a new source of potential big demand.

Heading into September and the winter season, with storage levels already significantly below the five-year average, natural gas prices look to be headed for a healthy increase. Here are two stocks that would benefit from this.

1. Encana Corporation

Although Encana is working feverishly to divest natural gas assets in favour of natural gas liquids production, natural gas still makes up a big part of its production, at 86%. This means that the company will continue to benefit from increases in natural gas prices.

As at the end of the second quarter, Encana had \$2.7 billion in cash on its balance sheet. Additionally, long-term debt decreased by \$1.5 billion. On the conference call, the company did not say what they planned to do with this cash, citing the obvious options such as debt repayment, asset purchases, and/or giving money back to shareholders in some way. Either way, this is obviously a good position to be in.

Over the longer term, with the sales of its natural gas assets and the focus on liquids continuing, exposure to natural gas will obviously continue to decline. In fact, Encana anticipates that by 2017, 75% of its cash flow will be generated from its liquids production.

2. NuVista Energy Ltd.

NuVista Energy Ltd.'s ([TSX: NVA](#)) focus on natural gas, with 70% of its production being natural gas, is also working for the company at this time. The company recently announced its second-quarter results, which were, once again, above expectations. Production was stronger than expected, coming in at 14,493 barrels of equivalent oil per day versus expectations of between 13,000 to 14,000 boe/d. The company's realized natural gas prices were 26% higher in the quarter compared to the same period last year, and accordingly, the operating netback increased over 13%.

The stock was up 8.53% yesterday on higher-than-normal volume.

The bottom line

Now that we're heading into the fall and winter seasons with storage 19% below the five-year average, and because of the risk of reduced production, it looks like natural gas prices are setting up to surprise to the upside. In my view, Encana Corporation and NuVista Energy Ltd. are two names that will benefit from this strength in natural gas.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BHP (BHP Group)
2. TSX:NVA (NuVista Energy Ltd.)

Category

1. Investing

Date

2025/06/28

Date Created

2014/08/20

Author

karenjennifer

default watermark

default watermark