Does EnCana Corporation Have the Most to Lose With $75 Crude?

Description

Here in Canada, **EnCana Corporation** (TSX: ECA)(NYSE: ECA) was once one of the top natural gas producers around. That is until new leadership at EnCana decided to abandon its natural gas roots in favor of a having 80% of its production being crude oil. At the time this was seen as a sound approach with WTI crude priced over $100 per barrel and an oversupply of natural gas dragging down prices. All of that has changed now that WTI crude is trading at $76.85 and shows little signs of moving.

With crude trading at these prices several questions arise, such as: Is EnCana's capital expansion program at risk, and at what price does it become unprofitable for EnCana to drill?

The Eagle Ford gamble

Almost two months ago EnCana spent $7 billion to purchase **Athlon Energy Inc.** and its 56.656 acres of land located in the oil-rich Permian basin. This new addition brought EnCana's footprint in the region to 140,000 acres. EnCana is drawn to this region because the U.S. Energy Information Administration has declared that the Permian Basin area "is the nation's most prolific oil-producing area" — it has about 3 billion barrels of oil and oil equivalent.

When the deal was announced there was a sense of skepticism about the purchase, as a good portion of the land that was acquired was unproven and would require a large investment to develop.

EnCana holds the line on capital spending

Recently EnCana reported that 85% of its 2015 capital would be deployed in the Eagle Ford and Permian regions of the U.S. along with the Montney and Duvernay regions here in Canada. It should be noted here that EnCana is already 24 months ahead of schedule for meeting its increased production benchmarks.

There appears to be little change to the company's capital strategy following the drop in crude prices. EnCana CEO Doug Suttles recently referred to the drop in prices as "annoying, but it's not threatening."

A recent report from **Goldman Sachs** estimates that crude will continue to remain around the $75 mark well into Q1 2015. Combine this with a report from Bloomberg New Energy Finance, which believes that up to 19 U.S. shale regions will cease profitability at current prices. Other reports have placed the breaking point in between $70 and $80 per barrel of WTI crude, depending on the region. Either way, shale crude is sitting in the danger zone of profitability.

During a recent conference call, EnCana CEO Doug Suttles said, “I do expect our budget to grow substantially from this year to next year because even in an $80 or an $85 oil price world, we’ll still see substantial cash flow growth from where we started”.

The investor’s gamble

Crude prices for the most part are sitting this low thanks to the game of chicken that OPEC is playing with North America in terms of oil production. OPEC meets this Thursday and afterward we will have a clearer picture of when oil prices will creep back up to normal levels.

Like most oil companies, EnCana has had its stock battered in the past six weeks and is trading at $20.88, near the low end of its 52-week range. The average price target is suffering, sitting at $24.30, below EnCana’s 52-week high of $26.85 in June.

Considering all of this, investors have a gamble of their own to consider when it comes to EnCana. By forgoing its natural gas diversity for a primarily oil production model EnCana is sitting at a disadvantage compared to several of its Canadian counterparts. However for those investors who are bullish on crude prices, the next three days might be a good time to make a bet.

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