Why EnCana Is Still Bullish on Oil

Description

EnCana Corporation (TSX: ECA)(NYSE: ECA) is one of the few energy companies that's bullish on oil heading into 2015. The company actually boosted its 2015 capex spending plan, in stark contrast to its competitors, which have been slashing capex budgets heading into 2015. There's actually a reason for this bullishness, and that is the fact that the company's transformative 2014 has put it into the position to make more money on drilling new wells even with lower oil prices.

The strategic shift

Over the past year EnCana has undergone a remarkable transformation. The company spent just over $10 billion to transform itself into an oil-focused driller. Along the way the company shed a lot of its natural gas properties. However, despite lower oil prices, the margins it can earn on oil drilling in its new assets are still higher than natural gas drilling on the assets it sold. That's why EnCana can accelerate spending in 2015 while other drillers are hitting the brakes.

Under EnCana's current plan the company will spend $2.7-$2.9 billion in 2015. Not only is that higher than its earlier estimates of $2.5-$2.6 billion, but it's a boost from the company's original $2.5 billion 2014 capital plan. About 80% of that money will be spent on liquids-focused drilling in 2015 across the company's four highest margin plays, which are the Montney, Duvernay, Eagle Ford, and Permian Basin.

A bold bet

What's really interesting about the company's plan is the fact that it represents a pretty bold bet. Given the current commodity price outlook, EnCana only expects to generate about $2.5-$2.7 billion in cash flow, which is down from its previous estimate of $3.2-$3.3 billion. What this suggests is that the company is going to outspend its cash flow by about $200 million instead of generating free cash flow. The company currently expects to fund the shortfall through the receipt of about $800 million in already announced divestitures.

That being said, the company's 2015 plan is based on $70 oil prices, which at the moment look rather optimistic as oil is down to about $55 per barrel. So, it's quite possible that the company could end up cutting its plan down the road as it's committed to protecting its balance sheet by not taking on additional debt to fund growth. Still, given the company's low supply costs of $35-$55 per barrel of oil equivalent it can still generate a lot of cash flow in the year ahead to fund most of its drilling plan.

Investor takeaway

While most oil companies are expecting 2015 to be a bad year, that's not what EnCana sees. That company is one of the few that's planning to accelerate spending in 2015 as it can still make more money on oil, even at current prices, than it could drilling natural gas. That's why it's bullish while others are not.

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Date
2025/08/25
Date Created
2014/12/23
Author
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