Is Today the Day to Buy Encana Corporation?

Description

It's amazing what a difference one year can make. Last year **Encana Corporation** (TSX:ECA)(NYSE:ECA) CEO Doug Suttles was being praised for steering a dramatic turnaround. The troubled natural gas producer was shifting into liquids production, and even made a US$6 billion deal in July to accelerate this shift. The company's U.S.-listed shares peaked at about US$24 after trading for less than US$16 the year before.

Now, the story is very different. Collapsing oil prices have crushed Encana's profitability, and expectations for the company are once again rock bottom.

To illustrate, the company just reported earnings for the first quarter of 2015. At first glance they weren't pretty—operating earnings dropped to US$0.01 per diluted share, a fall of more than 98%. Yet these results were still good enough to beat expectations.

So, what should investors make of all this?

Strong operational results

How exactly did Encana beat expectations? Well, it achieved "significant improvements in well performance, drilling, and completion cycle times and cost savings in the company's four most strategic assets, the Montney, Duvernay, Eagle Ford, and Permian." The company also said it's well on track to achieve US$300 million in capital savings and $75 million in cost savings.

While this is a great sign, it shouldn't be particularly surprising. Energy companies across the continent have been slashing costs, partly by squeezing suppliers, and also by focusing on higher-margin plays. Encana is no exception. In fact, its four core strategic plays (the Montney, Duvernay, Eagle Ford, and Permian) are generating higher margins than the entire company did in 2013 when energy prices were much higher.

Are Encana's shares a good deal now?

To answer this question, we only need to look at its most recent annual information form. According to the document, the company's reserves can be valued at about US$16 billion after tax (assuming a 10% discount rate). Using that number, and adjusting for net debt, Encana would be worth roughly US$11 billion. That's right in line with where the company trades today, indicating it's a fairly priced stock.

However, that doesn't tell the whole story. When calculating the value of Encana's reserves, there are some pretty generous assumptions used. Oil prices are assumed to average U$62.50 this year and US$75 next year, then predicted to rise by US$5 per year until 2019. In other words, oil prices are assumed to rebound strongly. Likewise, natural gas prices are assumed to recover in a big way.

A stock to avoid

There's another big reason to avoid Encana. The company has a very poor track record of creating value. Big decisions—including the US$6 billion acquisition—always seem to be a year too late, costing shareholders dearly. At this point, I would even question Encana's corporate culture.

With that in mind, I would pass on Encana. The stock isn't overly cheap, and I doubt it would make a great long-term investment either. Your best bet is to look elsewhere.

CATEGORY

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