



Should You Buy Encana Corporation or Cenovus Energy Inc.?

Description

Oil prices appear to be stabilizing and investors are beginning to look at some of the beaten-up names in the hopes of finding a good deal.

Encana Corporation (TSX:ECA)(NYSE:ECA) and **Cenovus Energy Inc.** ([TSX:CVE](#))([NYSE:CVE](#)) used to be one big company. Things haven't gone so well since the split, but some contrarian investors are starting to see value in the names.

Let's take a look at both companies to see if one deserves to be in your portfolio.

Encana

After spinning off the oil sands assets into Cenovus, Encana embarked on a major transition process to switch from being a natural gas producer to an oil titan. The timing of the move wasn't good as the company sold off gas assets at rock-bottom prices and purchased oil properties at the top of the market.

The largest deal was the US\$7.1 billion acquisition of Athlon Energy. Encana negotiated the purchase when oil still traded at sky-high levels, but the deal closed last fall in the middle of the oil crash.

A year ago Encana traded for more than \$26 per share. Today it's at \$15.

Despite the tough times, management is making good progress on the transition. Cash flow in Q1 rose by 31% over Q4 2014 as liquids production increased 13%. The company's four key assets located in the Montney, Eagle Ford, Duvernay, and Permian plays are all operating well.

The big challenge for Encana is its cash flow shortfall. The company plans to spend about \$2 billion on capital projects in 2015, but cash flow guidance is just \$1.6 billion. That means a \$400 million shortage before paying the dividend, which will eat up another \$200 million.

Encana finished Q1 with cash and cash equivalents of about \$2 billion and another \$2.6 billion in available credit facilities, so there is enough money to cover the cash flow gap in the short term.

One item investors need to watch carefully is Encana's \$5.9 billion in outstanding long-term debt.

Cenovus

Cenovus is working hard at reducing costs and is doing good job of increasing production, although the recent shut down due to the wildfires in Alberta will mean lower output in the current quarter.

During Q1 Cenovus cut its workforce by 15% and reduced capital spending by \$700 million. The company now expects to spend \$2 billion on capital projects in 2015, which should be covered by operating cash flow if oil prices remain at current levels.

Cenovus is one of the few companies in the oil patch that hasn't cut its dividend. In fact, the payout currently yields an attractive 5%.

Last quarter Cenovus had a cash shortfall of \$34 million, but oil prices and crack spreads have improved, so the company might actually generate enough cash this year to cover its capital plan and the distributions to shareholders.

Cenovus finished the first quarter with \$1.8 billion in cash and cash equivalents, so there is ample liquidity to get through the current rough patch.

The company just purchased a rail-loading terminal for \$75 million, which shows investors that management is taking advantage of the difficult market conditions to acquire strategic assets.

Which should you buy?

Any investment in the energy sector right now requires the belief that oil prices have seen their worst days. Cenovus is probably a safer bet right now because its cash flow situation is better and the company's refining operations provide a second revenue stream.

Encana has fantastic assets. If it can survive the oil and gas rout, there is a lot of potential upside for the stock. However, if the energy markets go into another nose dive, Encana could find itself in trouble and possibly become a takeover target.

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