After Plummeting 10%, Is Encana Corporation a Bargain?

Description

On Friday, **Encana Corporation** (TSX:ECA)(NYSE:ECA) reported earnings for the second quarter of 2015, and investors were not impressed. As a result, the Canadian-listed shares sank by roughly 10% on the day, and now barely trade above $10. At this time last year, the stock traded for about $24.

So why have Encana's shares fallen so much? More importantly, is the stock now a bargain? Below we take a closer look.

A long fall

Encana has a bad habit of being late to the party. Back in late 2009, it spun off its oil assets to focus on natural gas. After gas prices plummeted, the company shifted its focus to oil, spending over US$9 billion on oil acquisitions just in 2014.

The moves left Encana saddled with US$7.3 billion of debt by the end of the year, which was a real problem in a world of falling oil prices. So earlier this year the company raised $1.25 billion by selling new shares.

Any of these moves would have been brilliant, if only they had been done at a different time. But instead Encana has had horrible timing, mainly due to its follow-the-crowd approach. It's a bad habit that's very difficult to get rid of.

And it has clearly caught up with the company. In the most recent quarter, Encana reported a loss of US$1.6 billion, including an impairment charge of US$1.3 billion.

This brings Encana's total impairment charges to US$2.6 billion this year, or roughly 40% of the company's current market value. It's no wonder the stock has cratered so much.

So are the shares a bargain yet?

At first glance, Encana's shares appear to be very cheap. The company's reserves were valued at US$16 billion at the end of last year. That's well above Encana's market value of US$12.1 billion (which includes net debt).

However, Encana’s reserves were valued assuming a robust recovery in energy prices. For example, the average oil price expected for 2015 was US$62.50, and that price is assumed to recover to US$90 by 2019.

Those assumptions now appear to be wildly optimistic. To illustrate, you can lock in an oil price of less than US$65 for December 2020.

So Encana doesn’t appear cheap anymore, especially when considering the company’s poor track record. To be frank, there are much better options for your portfolio.

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Date
2025/07/21
Date Created
2015/07/24
Author
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