



## Is There a Silver Lining to Encana Corporation's Q2 Loss?

### Description

There's no way to sugar coat it. **Encana Corporation's** (TSX:ECA)(NYSE:ECA) second-quarter results were atrocious. Not only did the company record a \$1.3 billion impairment charge, but even after adjusting for that charge the company still reported a loss on an operational basis. Worse yet, the loss was greater than analysts feared as the company simply couldn't control its costs as well as it needed to in order to offset weak oil and gas prices. That said, the company did deliver some promising news that investors won't want to overlook.

### What went wrong?

The biggest culprit behind Encana's weak second quarter was oil and gas prices, which is no surprise. Encana's natural gas production endured a double hit; not only was it down 38% year over year due to asset sales and under-investment, but the company realized 14% less per mcf than the year-ago quarter. Meanwhile, its liquids production was up 87% year over year, but Encana realized 27% less than last year's second quarter.

As a result of these weaker price realizations, Encana's cash flow dropped from \$656 million to just \$181 million. That said, we can't blame the entire 72% plunge on oil and gas prices as Encana's costs are still a bit too high. That's one reason why the company cut another 200 jobs in the quarter.

### What went right?

In addition to making another round of tough job cuts to trim its operating costs, Encana was also able to sign an oil-gathering agreement in the Permian Basin, which will improve its operating margins in the basin by up to \$2 per barrel. As a result of these and other reductions, the company has now achieved two-thirds of its goal to deliver \$375 million in efficiencies this year. It also remains on pace hit its cost reduction target by the end of the year, which it expects will be sustainable even in a higher commodity price environment.

The company is also working feverishly to get its drilling and completion costs down, so that it can improve its results per well. One area where it did a great job of this was in the Eagle Ford Shale as it slashed \$1 million off its cost per well, which is down 18% year over year. Encana is also generating

\$1 million per well in cost savings in the Duvernay as a result of the start-up of water infrastructure, which is lowering its water handling costs.

Finally, the company has saved a total of \$18 million, or \$400,000, per well in the Montney as a result of commissioning a water resource hub to support development in that play. The company needs to continue to improve upon these costs, as well as deliver production results on new wells in order to be in a better position to create solid value amid lower commodity prices.

### **Investor takeaway**

Encana delivered very poor second-quarter financial results largely due to the continued weakness of commodity prices. However, the company is making solid progress on getting its costs down, which should improve its profitability and cash flow not just in a lower commodity price environment, but even when prices improve. This is putting the company in a better position to deliver stronger future results even if commodity prices don't improve.

### **CATEGORY**

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