Encana Corporation: Is it Time to Bet on This Turnaround Story?

Description

It hasn't just been oil producers who have been hit by the recent weakness in energy prices. Natural gas producer **Encana Corporation** (TSX:ECA)(NYSE:ECA) has also seen its stock fall by more than 50% over the last year.

Part of the issue has been the company's ill-timed acquisition of Athlon Energy as well as the acquisition of approximately 45,000 net acres in the Eagle Ford area of Texas. Together, these two acquisitions set the company back more than US$10 billion, including assumed debt.

Those acquisitions were part of management's grand plan to move the company out of natural gas and back into oil. It sold billions of natural gas assets, putting the proceeds into oil. And then the bottom fell out of the oil market.

But it isn't all bad for Encana. Here's why you should consider making a bet on Encana's turnaround plan.

Great assets

Encana's timing wasn't great, but the assets it bought in the United States are still going to look very attractive once oil goes back to $100 per barrel.

Even with oil flirting with $40 per barrel, the company still isn't losing much on production at both Eagle Ford and Permian. It isn't making money either, but at this point in the cycle, just breaking even is okay.

The company also owns significant portions of land in the Montney and Duvernay areas of Alberta. These are low-cost assets that are running at approximately breakeven levels at today's prices. Even if oil just marginally recovers, these are profitable assets.

Look at the company's latest quarter. On the surface, it looked nasty, with it reporting a loss of $1.47 per share. But that was affected by asset write-downs. Without the asset impairment, Encana actually posted an operating profit of $323 million. That's not so terrible in today's environment.

Solid financials

Encana has been busy paying off debt. Thus far in 2015 it raised more than US$1 billion in cash from a share sale and used the proceeds plus a little cash on hand to pay back US$1.2 billion in debt.

The balance sheet looks pretty good over the next few years as well. The company has no major debt repayments due until 2019, and it still has US$4.5 billion in available credit, which was recently extended from June 2018 to July 2020.

Encana is also making enough cash flow to pay for its capital expenditures and dividends if you include a couple of asset sales in the beginning of the year. The company expects 2016's capital program to come in at a lower level than this year's, which means that it should be able to generate enough cash flow in 2016 to fund all of its requirements. In other words, if it has to borrow, it won't be much.

Unlike some of its competitors, Encana can still save money by suspending its annual US$0.28 dividend. That move alone would save it about US$240 million per year.

One issue with Encana is the number of write-offs it has been taking. It has already impaired nearly US$6 billion in assets thus far in 2015, putting it at a debt-to-assets ratio nearing 50%. It has the potential to get even higher if the company is forced to borrow to pay for its capital expenditures.

Should you buy?

I like Encana's transition away from natural gas towards oil. It also still has non-core assets it can sell to help shore up the balance sheet. And over the long term, there's a lot to like about its core assets in Texas and Alberta. These low-cost assets are going to look very attractive once oil rises again.

But at the same time, Encana has a few issues. The balance sheet is a little weaker than some of its better-capitalized competitors. And from a book-value perspective, many of its peers are more attractively priced, implying that they might have more upside when things return to normal.

Encana looks to be a relatively safe pick, and you'd get a fairly attractive dividend to wait. There may be better opportunities in the energy sector, but it's hard to go wrong with one of the leaders, even if it has momentarily stumbled. Ultimately, an investment in Encana is just a bet on recovering energy prices, which will happen sooner or later.

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