Encana Corporation Has a New Plan for Dealing With Low Oil Prices

Description

Encana Corporation (TSX:ECA)(NYSE:ECA) always seems to have bad timing. The company spun off its oil-producing assets into a new company–**Cenovus Energy Inc.**–back in 2009, only to see natural gas prices plummet. Then the company spent billions to move from natural gas to liquids, only to see the oil market tumble.

The results have been disastrous for investors. Since Encana spun off its oil business, its stock price has declined by roughly 75%. By comparison, **Suncor Energy Inc.** shares have fallen by less than 10% over this time and **Imperial Oil Limited** shares have actually gained.

So whenever Encana announces a new plan, investors can be forgiven for being a little sceptical. But it finally looks like the company is taking the right steps. We take a closer look below.

Some big cuts

Encana announced a US$1.5-1.7 billion capital budget for 2016, which is well below the US$2.2 billion estimated outlay this year. And 95% of the company's spending will focus on its four core assets: the Duvernay and Montney formations in Alberta, and the Permian and Eagle Ford formations in Texas. The Permian basin alone will account for roughly 50% of the spending.

But that isn't all. Encana is expecting production efficiency to grow by 15% next year and will be cutting corporate costs by 10%. As a result of these efforts, the company expects operating margins to improve by 10%.

To top it all off, Encana is slashing its dividend for the first time since 2013. The payout will now equal $0.06 per share per year, a drop of nearly 80% from the current amount. Shareholders may not be happy, but it is, without a doubt, the right thing to do.

Will it be enough?

Encana's plan should sound very familiar–it's the same type of plan being put forward by countless other heavily indebted oil producers. But that's exactly the problem: with everyone cutting costs so dramatically, oil prices have that much more downside, and prices will only recover once some producers are forced to turn off the taps. Encana hopes it won't be one of those companies.

Yet its 2016 budget leads to plenty of fresh worries. The company is projecting cash flow of US$1.0-1.2 billion, not enough to cover its capital expenditures. And that's based on an average WTI oil price of US$50, or 38% above the current price.

These kinds of numbers won't do much for Encana's balance sheet, which is already under strain. According to the latest quarterly filing, the company has over US$6 billion of debt, much of it due to its ill-timed takeover of Athlon Energy last year.

Investors haven't reacted kindly to the announcement, driving Encana's shares down by as much as 10%. The stock price is now very near its 52-week low. But given the headwinds this company faces, further lows could easily be reached.

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