



Encana Corporation Starts to Panic

Description

Despite the collapse in natural gas and oil prices, **Encana Corporation** (TSX:ECA)(NYSE:ECA) has thus far put on a tough face. It cut its 2016 capital budget by 55%, reduced its workforce last year by over a third, and reduced its production focus to just four core properties.

These moves helped lower debt by roughly \$2 billion last year, and its next maturity is not until 2019. Over 75% of long-term debt isn't due until at least 2030. It also has access to \$3.5 billion in fully committed, unsecured, revolving credit facilities.

On the surface, things are looking all right. **Moody's Corporation** seems to disagree, however, cutting the company's credit rating below investment grade last month, citing a "material decline in Encana's cash flow" in 2016 and 2017.

Rating downgrades often don't predict the future of a business, but they typically raise borrowing costs in the short term. According to *Bloomberg*, "many funds can't hold high-yield notes, so a cut from investment grade to junk could trigger a wave of selling."

Restricted access to the capital markets is the last thing Encana needs right now, considering it still has \$5.4 billion in debt and it posted a \$5.2 billion loss last year. That's why the recent downgrade seems to have put Encana into panic mode.

Magnifying previous cuts

Encana had already been positioning for a prolonged downturn by selling assets, shedding its workforce, reducing its dividend, and lowering spending. After the downgrade, the company took these measures to new levels.

This month, *Reuters* reported that Encana is "exploring the sale of more non-core assets in the United States and Canada that could be worth about \$1 billion." The company already sold \$2.8 billion in assets last year, but sources now say that it's open to offers on every one of its non-core assets.

In addition to asset sales, Encana is also reducing its workforce by 20% for the second time in six

months. The latest job cuts will bring total workforce reduction to more than 50% since 2013. The dividend will also be cut to \$0.015 a share from \$0.07.

Keeping such a meager dividend is likely to avoid having income-oriented funds being forced to sell shares.

The good news

Encana is clearly scrambling to ensure investors that it can retain its financial viability. If it can survive for another few years, however (which is increasingly likely), the business model should be much improved.

With its capital budget now focused on just four core areas (Eagle Ford, Permian Basin, Montney, and Duvernay), the company's production profile should slowly shift towards oil rather than natural gas. By 2018, natural gas will likely comprise less than 50% of production, down from 82% in 2014. If the company can unload any of its natural gas assets in the meantime, it could transform itself into an oil producer fairly quickly, resulting in a more profitable business.

As long as energy prices rebound over the long term, Encana may be setting itself up for a massive turnaround.

CATEGORY

1. Energy Stocks

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