



## New Regulations Threaten Encana Corporation

### Description

Since oil fell from over \$100 a barrel in 2014, **Encana Corporation** (TSX:ECA)(NYSE:ECA) has needed to sell assets to service its mounting debt load. The company also needed fresh cash to complete its goal of producing primarily oil.

The transition has been fairly successful. Since 2015 the company has completed over \$3.4 billion in asset sales. Last month it announced yet another move—a \$625 million deal to sell assets in northwestern Alberta. Moves like this have helped the company reduce debt by over \$2 billion in just 18 months.

Earlier this year, *Bloomberg* reported that Encana was “weighing the sale of some of its shale assets in western Canada.” This comes as no surprise given the company still struggles from a business mix that mainly produces natural gas—a commodity with weak profitability metrics across the industry.

However, Encana's ability to make additional deals just got a lot harder.

### New regulations threaten the status quo

In June the Alberta Energy Regulator opted to toughen rules that make it more difficult to complete mergers and acquisitions in the province. The new regulations set stricter standards on the financial strength an acquirer must have to execute a business deal.

For example, companies seeking to buy oil and gas properties will need assets twice the size of its liabilities after the purchase is complete. Previously, assets only needed to equal liabilities. According to *Reuters*, “More than 200 companies that met the prior standard were ruled out as buyers by the stricter financial solvency test, a move that industry reps say will limit the number of companies allowed to buy oil and gas assets.”

### How will this impact Encana?

As of last quarter, Encana had debts of \$5.8 billion compared to cash of just \$222 million. Assets are currently around \$15.2 billion. While its relatively healthy financial position should help it continue to

acquire companies, the new regulations could limit potential suitors of its own assets. Given that Encana has been a serial seller of assets, its management team may have to shift the strategy a bit to conform to new industry rules.

A slowdown in mergers and acquisitions matters not because Encana needs cash to survive, but because disposing of its natural gas assets is the quickest way to transform it into an oil company. In just three years oil has grown from 5% of production to nearly 20%. Still, that means natural gas comprises about 80% of output. Oil generally has better market conditions and, based on Encana's cost of production, would come with higher-profit margins.

So far, the company has made all the right moves, pushing its stock price to 2016 highs. The latest regulations could put a damper on that run.

## CATEGORY

1. Energy Stocks
2. Investing

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## Date

2025/08/26

## Date Created

2016/07/08

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