Encana Corp. Just Posted a Surprise Profit: What Now?

Description

Crude oil prices are still down over 50% from highs set in 2014. Since then, natural gas prices have also fallen roughly 40%. **Encana Corp.** (TSX:ECA)(NYSE:ECA) responded, surprisingly, by posting a net profit of US$317 million this quarter compared with a massive loss of US$1.2 billion in 2015.

Many energy analysts are writing this off as an accounting fluke. But savvy investors should know that something deeper is happening: Encana is completing its radical multi-year business transformation.

Let's look at the numbers

The biggest reason for Encana's surprise profit was dramatically lower costs. Expenses fell to US$600 million from US$3.1 billion in 2015. This allowed it to post an operating profit of $0.04 per share. The average analyst was expecting a *loss* of $0.04.

Additionally, Encana sizably reduced its interest expense by paying down US$3.5 billion of debt since 2015. It retired US$2 billion of debt in the third quarter of this year alone.

How were these impressive cost efficiencies achieved?

Over the last 18 months Encana has engaged in a major operational pivot. Over $3 billion in assets have been sold and half of its workforce laid off. For example, it sold its Gordondale assets in Alberta to **Birchcliff Energy Ltd.** for US$625 million, and its Denver Julesburg basin oil and gas assets in Colorado for US$900 million.

On September 20 it agreed to sell 107,000,000 shares at a public offering price of US$9.35 per share, generating a total inflow of more than US$1 billion. Underwriters have an option to sell an additional 16,050,000 shares, which would result in another US$150 million cash inflow.

This fresh financing has allowed it to not only pay down debt, but refocus spending on only the most lucrative projects. The biggest strategy has been to shift towards oil production.

As with 2016, the 2017 capital program is focused on only a handful of properties with the highestquality reserves and the lower production costs. Already, 96% of Encana’s capital expenditures are dedicated to its four core properties: the Permian, Eagle Ford, Duvernay, and Montney basins. This quarter over 70% of production came from these four regions.

Because these areas of focus have higher levels of crude oil, oil output has naturally grown from 5% of production to over 20%. If you’re an Encana shareholder, this is great news. Oil generally has better market conditions and, based on Encana’s cost of production, would come with higher profit margins.

Encana is finally getting the respect it deserves

Fundamentally, Encana has continually improved as a business for years. While the stock price hasn’t always reflected this, considering the historically weak commodities market, Encana’s management team has proven itself to be incredibly savvy.

If energy prices continue to rebound, expect Encana to continue following suit.

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