This Energy Stock Is Poised to Benefit From Higher Natural Gas Prices

Description

After underperforming for years there are signs that energy company **Encana Corp.** (TSX:ECA)(NYSE:ECA) is poised to bounce back, having posted solid results for the last quarter of 2016. Despite these positive results, some pundits continue to treat what is one of Canada's largest natural gas producers with disdain. A glaring error I regularly see when pundits are considering Encana as a worthwhile investment is the linking of its fortunes to the outlook for crude.

You see, crude only makes up about a third of its hydrocarbon output with the majority coming from natural gas. This means that Encana's fortunes are tied to the outlook for natural gas rather than oil.

Now what?

While both fossil fuels share some fundamentals that dictate demand and, consequently, prices, there are a range of specific catalysts that apply only to natural gas.

Key among these is the growing demand for natural gas for use in generating electricity.

The need to reduce global warming and prevent further climate change has led to a push among governments globally to reduce their carbon footprints. Because coal-fired power generation is the single largest producer of greenhouse emissions globally, there are a number of initiatives underway to reduce or even eliminate coal-fired electricity from the global energy mix.

Governments across the world have introduced measures, such as stricter emissions regulations, carbon pricing, and taxes aimed at reducing greenhouse gases. One of the main initiatives has been the transition to gas-fired power generation because it produces roughly half the carbon of coal and is more economic than many other forms of energy.

This led to a surge in demand for natural gas that can only continue to grow; the two main markets are the U.S. and Asia.

As a result, it is predicted that between now and 2040 the usage of natural gas in power generation will grow by 2.2% annually.

Even the short-term outlook for natural gas is increasingly positive.

The sharp reduction in U.S. gas production during 2016 caused by a lack of investment in the industry, which was triggered by the prolonged slump in crude and gas**,** has led to a reduction in surplus supply. Along with growing U.S. domestic demand and higher exports to Mexico, this will support higher natural gas prices.

The U.S. Energy Information Administration, or EIA, has forecast that the average 2017 spot price for natural gas will be 23% higher than 2016 and then will increase by a further 12% in 2018.

This is also good news for Encana.

Encana has focused on making its operations more efficient**,** slashing operating expenses in 2016 alone by an impressive 8% compared to a year earlier. Transportation and processing costs also fell significantly during the year to be 9% lower than 2015. These initiatives continue; at the lower end of its 2017 guidance, Encana expects operating costs to fall by another 10%. Coupled with higher natural gas as well as oil prices, this will boost Encana’s margins, giving its bottom line a healthy lift.

Encana is forecasting its 2017 margin per barrel produced to exceed US$10**,** which is 25% higher than originally projected. This is predicated on US$55 per barrel West Texas Intermediate, or WTI, and a NYMEX natural gas price of US$3 per million British thermal units. Now that WTI is trading only marginally lower than the assumed price and natural gas is almost 5% higher, this forecast appears feasible.

So what?

It has been a tough few years for investors in Encana, but there are signs that the company is positioned to unlock value for investors and benefit from higher natural gas prices. This makes now the time for risk-tolerant investors seeking to make a contrarian bet on higher oil and gas prices to add Encana to their portfolios.

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