Is Encana Corp (TSX:ECA) at Risk of Mortgaging its Future With its $1.25 Billion Buyback Plan?

Description

Last week on February 13, **Encana** (TSX:ECA)(NYSE:ECA) announced that it had successfully closed its acquisition of U.S. shale producer Newfield Exploration in an all-stock deal valued at approximately $5.5 billion.

In announcing the deal, management also reaffirmed its plans to repurchase as much as $1.25 billion of the company's common shares following the deal.

While I understand the motivation behind buying back the company's outstanding common stock after exchanging 2.719 billion shares as part of the Newfield deal, I'm also not such a huge fan of the decision to allocate such a large percentage of the firm's capital towards a buyback program at this time.

In this post, I'll attempt to explain why I don't love this move and why I think investors would be better off holding off on a purchase in ECA for the time being.

Where's the cash?

At the end of the day, cash is king, and while I'm fully in support of a firm returning cash to shareholders either through dividends or share repurchases, I think it's a strategy that makes the most sense when said firm is sitting on a hoard of cash.

However, I just don't think that's the position that Encana finds itself in today.

At the end of the third quarter of 2018, Encana had US$615 million of cash on its books but only had combined current assets of $1,886 million versus combined current liabilities of $2,702 million, meaning the company has a net current deficit.

I'm not a huge fan of the current ratio (which measures the value of a firms net current assets), because I think that most multi-billion-dollar companies like Encana should have a fairly easy time accessing short-term credit from financial institutions, but the figures above suggest that Encana is far from being a cash cow.

Adding more fuel to the fire, through the first nine months of 2018, Encana managed to generate $1,741 million of cash from operations; meanwhile, it spent $1,626 million on capital expenditures, leaving the company with a relatively small $115 million free cash flow surplus.

That's far cry from being able to organically support a $1.25 billion share-repurchase program.

Is there a better option?

In light of the volatility we've seen in the price of crude oil over the past two or so years, and particularly in light of the wild swings that we've seen in the differential between U.S. and Canadian crude prices over the past six months, I would prefer to see management at Canadian E&P companies following a more prudent approach when it comes to planning their capital-allocation strategies.

In the case of Encana, following on the heels of the multi-billion-dollar Newfield acquisition, I would rather the company had given itself some time to build a war chest before making the commitment to return so much cash to shareholders (including, by the way, an increase to its quarterly dividend payout).

Bottom line

While I'm all for returning cash to shareholders, I think that investors in pursuit of such agendas may find better opportunities elsewhere, including a couple of high-yield stocks.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Date
2025/09/08
Date Created
2019/02/23

Author
jphillips