Why Encana (TSX:ECA) Stock Is So Cheap — and Why That's About to Change

Description

Encana Corp. (TSX:ECA)(NYSE:ECA) has provided investors with a disappointing ride over the last many years, with a lack of business and strategic focus that's destroyed plenty of shareholder value.

Through it all, the company has made numerous ill-timed acquisitions and dispositions, and has seen its stock price plummet 81% in the last 10 years.

Going deeper — why is Encana stock so cheap?

As I touched upon in my introduction, Encana has a sordid history of making bad investment decisions and destroying shareholder value.

As an example of these types of decisions, look no further than Encana, which bought natural gas assets when these assets were hot and valuations were high, which meant that Encana overpaid for them.

When natural gas began to tank, the company then proceeded to sell these gas assets when they were undervalued.

A similar dynamic occurred with many of the other acquisitions and dispositions that the company has made over the years, which seemed to be reactionary moves as opposed to proactive decisions that would ensure transactions were made at better prices for Encana.

So Encana is incredibly cheap today, and as we review the stock's valuation metrics, it's easy get excited; the value here is huge.

Encana stock trades below book value (0.6 times book value), at a price to cash flow multiple of four times, and at an earnings multiple of well below eight times.

The stock has languished since investors lost hope in this once great Canadian energy giant. And as these things go, it is no surprise to see valuations and investor expectations reflect this reality, as

Encana continues to be surrounded by skepticism.

It is now very clearly a “show-me” stock. Investors have been burned one too many times, it seems.

Encana’s bright future is being driven by strong growth at its prolific resource plays

But today, Encana is hitting its stride. The company is focused on three core growth assets that are all free cash flow positive as the company is cutting costs dramatically and efficiencies are rising impressively.

Anadarko assets production, for example, is hitting record levels as costs are falling far faster than expected. It currently costs $6.5 million to drill a well, which is 5% below Encana’s original target and 20% below legacy Newfield costs.

High intensity cube style completions are driving lower costs and better returns.

At Encana today, higher-return liquids production rose 55% in the latest quarter and market diversification strategies have increased price realizations and added to cash flows.

Given that Canadian natural gas prices have been trading at a huge discount to NYMEX prices, this is impressive.

Currently, we can see that profitability and returns are rising, and debt is falling. In 2018, free cash flow increased 83%, EPS increased 87%, and Encana’s debt to cash flow multiple hit 1.7 times, down from over five times cash flow just three years ago.

These trends continued into the second quarter of 2019, which means that the financial risk in Encana is falling as the potential reward is rising dramatically.

Foolish bottom line

This is a “show-me” stock, and for good reason. But there is a light at the end of the tunnel as things are changing for the better.

Encana’s valuation and expectations are at rock bottom. Encana’s operating performance, cost structure, resource plays, and balance sheet are better than ever — combination that makes for an interesting and dynamic thesis for Encana stock.

While we know that the macro environment in the oil and gas industry is fraught with many uncertainties and risks, with Encana, we’re getting big upside at a very low price.

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