



Why Investors Should Avoid Natural Gas and Encana (TSX:ECA)

Description

There is [growing speculation](#) that natural gas is due to rebound in coming months as growing consumption and a range of emerging supply constraints work together to bolster prices. If this occurs, it will be a boon for beaten-down natural gas producers that have been harshly treated by the market because of the fossil fuels prolonged slump. These types of claims have existed for some time, yet gas continues to weaken, tumbling in recent weeks to prices not seen since the commodities crash of 2016.

Natural gas has lost 27% since the start of 2019 and appears poised to fall further despite the bullish assertions of some pundits. The latest decline has dragged upstream energy producers who are focused on natural gas lower. One of North America's largest natural gas drillers **Encana** (TSX:ECA)(NYSE:ECA), has followed the fossil fuel lower seeing its stock plunge 30% since the start of 2019, whereas **Chesapeake Energy** has plummeted 39% and **ARC Resources** is down 28%.

Encana has experienced this sharp decline despite completing the \$5.5 billion transformative acquisition of Newfield Exploration earlier this year, which further diversified its assets. Even the much-vaunted share buyback, launched by Encana on completion of the deal and the sale of non-core assets, has failed to support its market value.

Poor outlook

While there are pundits who believe that this has created an opportunity for a company ranked as the sixth largest U.S. natural gas producer, there appears to be little upside ahead for investors. The growing view is that natural gas production growth will outpace demand, with U.S. output alone having expanded by 91% over the last 14-years.

It is poised to keep expanding at a solid clip because of the shale oil boom which has seen a massive expansion in oil and natural gas production over the last five years, despite weaker prices. Then you have the booming Montney and Duvernay plays, which have propelled Canada to become the fourth largest producer of gas globally.

While prices typically spike during winter, there are fears that weaker economic growth, the rising

possibility of a U.S. recession and stalled industrial growth in China will cause the consumption of energy to wane. That certainly doesn't bode well for natural gas producers like Encana which reported some lackluster second quarter 2019 results, despite total hydrocarbon production expanding by 75% compared to the same period a year earlier.

Even a notable reduction in transportation and processing expenses, which fell by a healthy 15% year over year or a 12% decrease in operating expenses, did little to improve Encana's fortunes. This is because benchmark prices during the quarter were softer than a year earlier and have weakened even further since the end of the second quarter 2019, boding poorly for Encana's performance over the remainder of the year.

The price differential between the [Canadian AECO](#) natural gas benchmark and North American Henry Hub price remains wide, with the AECO price having softened by 15% since the second quarter. This sees Canada produce natural gas trading for less than half of the US\$2.23 currently being received for Henry Hub pricing which, with domestic natural gas making up over 60% of Encana's total output, will further impact earnings.

Foolish takeaway

It is difficult to see any upside for Encana in the current difficult operating environment. Now that energy prices have softened sharply since the end of the second quarter and with natural gas poised to remain weak, along with a deeper discount being applied to Canadian AECO pricing, it is likely that Encana's earnings will weaken further.

CATEGORY

1. Energy Stocks
2. Investing

PARTNER-FEEDS

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

Category

1. Energy Stocks
2. Investing

Date

2025/09/28

Date Created

2019/08/16

Author

mattdsmith

default watermark