



## Is it Time to Buy Encana (TSX:ECA)?

### Description

Weaker oil and natural gas prices continue to weigh heavily on North American energy stocks, particularly those operating in the Canadian energy patch. One driller that has been heavily marked down by the market is **Encana** (TSX:ECA)(NYSE:ECA). It has lost a whopping 36% since the start of 2019 compared to the North American benchmark West Texas Intermediate (WTI) gaining 19%, triggering considerable speculation that it is attractively valued, making now the time to buy.

### Improved outlook

Encana completed the transformative \$5.5 billion acquisition of **Newfield Exploration** earlier this year, which bolstered its oil reserves and production, pivoting the company to be oil focused rather than a natural gas producer. That deal, which saw Encana become the second-largest North American driller, boosted reserves to two billion barrels of oil equivalent, which is 55% weighted to oil and other hydrocarbon liquids. It also gave Encana a notable presence in the Anadarko and Permian Basins, which have some of the lowest breakeven costs among shale oil basins.

The acquisition immediately gave Encana's oil production a solid lift, seeing it more than double year over year to 179,000 barrels daily for the second quarter 2019, which is 30% of its total hydrocarbon output compared to 25% a year earlier. It also saw total production expand by an impressive 75% year over year, giving net earnings a solid boost regardless of weaker oil and natural gas prices. Encana reported second-quarter net income of US\$336 million compared to a US\$151 million loss for the equivalent period in 2018, emphasizing the considerable benefits generated by the purchase of Newfield.

While this certainly makes Encana a more attractive investment, particularly when it is trading at five times earnings and less than one times its book value, the driller is still struggling to unlock value in a difficult operating environment. This is because natural gas makes up around 48% of Encana's total production, while lower value natural gas liquids comprise another 24%. That means [weaker natural gas](#), with it plunging by 21% for the year to date, will have a sharp impact on Encana's earnings and the fossil fuel's poor outlook will weigh on its profitability for the foreseeable future.

This becomes apparent when reviewing the Encana's second-quarter company-wide operating netback, which was US\$18.63 per barrel, or 7% lower than a year earlier and inferior to many of its peers, whose production is more heavily weighted to oil. **Crescent Point Energy**, which has 78% of its hydrocarbon production weighted to oil, reported a second-quarter 2019 operating netback of US\$27.32 per barrel, while **Vermilion's** was US\$22.51 a barrel. The reason for the driller's weaker netbacks is its considerable exposure to natural gas, particularly with 61% of Encana's natural gas production coming from Canada where the [discount applied](#) to AECO pricing is weighing on earnings.

Another concern regarding Encana's operations is that the high depletion of rates of shale oil wells forces it to spend considerable capital on exploration and well development to ensure that it can maintain production. That means it must spend considerably more on exploration and well development than many of its peers which are focused on conventional oil and natural gas.

## Foolish takeaway

After completing the game-changing Newfield deal earlier this year, Encana has emerged with significantly improved prospects. The deal importantly boosted its petroleum liquids production and gave it prime acreage in the Anadarko and Permian Basins. While that has improved its attractiveness as an investment, Encana's considerable exposure to natural gas and the poor outlook for the fossil fuel will weigh on its profitability and financial performance. For those reasons, many other drillers, whose hydrocarbon production is predominantly weighted to oil, are superior investments.

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