Executives Think Encana (TSX:ECA) Stock Is Seriously Undervalued

Description

Encana (TSX:ECA)(NYSE:ECA) stock could be the top-performing investment of 2020. At least that's what company executives think.

In the summer of 2018, Encana shares were trading as high as $18. Today, they're below $6, despite major improvements in its operating model. The market, management argues, has failed to recognize the extreme value that Encana stock represents.

To remedy this, they've begun buying back hundreds of millions of dollars in stock. This is an aggressive move. With energy markets still in flux, leadership is betting big that purchasing its own stock can achieve record results for shareholders.

If Encana succeeds, it's not difficult to see shares double or triple in value. How likely is that to happen? Let's find out.

All the right moves

In recent years, Encana management has been terrific, They've continually made moves to better position the company for the next decade and beyond.

What specifically have they achieved? First, they've transitioned the company toward more profitable revenue sources, even if the market hasn't realized it yet.

Last quarter, Encana earned $149 million in profit, or $0.11 per share. Compare that to 2015, when the company posted a multi-billion-dollar loss. During the recent quarter, free cash flow totaled $251 million, allowing Encana to bump the dividend by 25%.

Results have clearly improved dramatically. What's the cause?

In 2013, the company's sales were dominated by gas, which accounted for 85% of production. This fuel type had some of the worst economics in the industry. Oil, meanwhile, was still generating profits for competitors.

Over the years, Encana strategically moved away from gas, which currently accounts for just 45% of production. Annualized cash flow is now running at $3.4 billion, but if the company still had the production profile it had in 2013, cash flow would total just $800 million.

Demand respect

In 2020, Encana expects to remain free cash flow positive with continued production growth, yet its share price remains in the dumps. Shares currently trade at 2002 prices.

If the market won't assign shares a proper price, management decided that it would force the issue.

Through the third quarter of 2019, Encana repurchased 197 million shares, roughly 13% of the entire company. It achieved this feat while adding to the dividend, repaying debt, and growing energy production. When fourth-quarter results are released, expect even more buybacks to be announced.

By repurchasing billions of dollars in stock, Encana executives are betting that shares are grossly mispriced. If the stock price improves, shareholder gains will be magnified by the massive buybacks.

What might cause a share price improvement? Yet again, management is taking matters into their own hands by re-domiciling the company in the U.S. They argue that this greatly increases the company's exposure and access to capital.

For example, index funds own just 7% of Encana shares, yet they own an average 27% of its U.S.-based peers. Management believes the re-domiciling could instantly increase demand for shares by $1 billion.

If the buybacks and re-domiciling work as planned, early shareholders are in for a major ride. Encana executives have bet the entire company that they're right.

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