

## Equities

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# EnCana Corp (ECA)

## Alert: 'Quick Read' – Slight Q4 Miss But China Deal Overshadows

### ■ Company Update

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- **Q4 Bottom Line** – ECA reported Q4'10 operating EPS/CFPS of \$0.09/\$1.25 which was slightly below our \$0.15/\$1.30 estimate and consensus \$0.11/\$1.30. Variance emanated largely from modestly weaker gas price realizations (down 5% sequentially versus our projection of a 3% drop) coupled with a substantially higher Canadian lease operating costs, while other expenses were essentially in-line.
- **Production** – Increased 1% sequentially to 3.35 Bcf/d, or marginally below our 3.39 Bcf/d expectation. The uptick was driven entirely from the LA Haynesville (up 75 MMcf/d) while output at all of its other areas was either flat or showed slight declines. For the full year, production of 3.32 Bcf/d was up 10% year-over-year which was aided by material production shut-ins in 2009.
- **PetroChina Deal** – ECA finally signed its long-awaited PetroChina JV selling one-half of its Canadian Cutbank Ridge play. We view the transaction favorably. For full details, see our note from yesterday: [EnCana Inks Mega ~\\$5.4B Canadian JV](#).
- **2010 Proved Reserves** – Rose by 1,561 Bcfe (~12%). Excluding acquisitions/divestitures, ECA added 3,074 Bcfe (with large contributions from Haynesville and B.C. Horn River) or ~250% "organic" reserve replacement. However, the company's PUD% rose substantially to 49% (from 41% at year end 2009). Based on total CapEx spend of \$4.77 billion, this equates to an F&D tab of ~\$1.55/Mcfe.
- **2011 Guidance/CapEx** – For this year, ECA has set a production range of 3.475-3,525 Bcf/d (5-6% year-over-year increase). Importantly, it appears this does not include the impact of the PetroChina deal which will reduce ECA's output by ~250 MMcf/d (~8%) after the transaction closes (slated for mid-year). Budgeted CapEx of \$4.6-\$4.8 billion is flat to down versus last year's actual \$4.77 billion spend.
- **New Liquids Areas** – EnCana has identified 640k acres across its existing Rockies acreage with strong liquids potential and has already drilled 5 test wells with 3 more slated for H1'11. ECA also finally acknowledged its large land position in the emerging, liquids-rich AB Duvernay shale although did not provide specifics.
- **Earnings Call** – 1pm EST today. Dial-in: 888-231-8191.

EnCana Corp (ECA.N; US\$30.83; 2M)

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 1. EnCana 4Q 2010 Variance Analysis (in US\$, production after-royalties)

	Q3 2010 Actual	Q4 2010 Actual	Q4 2010 Citi Est.	Q4'10 Act. vs. Q4'10 Citi Est. % Diff.	Q4'10 Act. vs Q3'10 Act. % Diff.
Canada NGLs (Bbls/d)	14,262	11,327	14,800	-23.5%	-21%
Canada Natural Gas (Mcf/d)	1,390,000	1,395,000	1,450,000	-3.8%	0%
Total Canadian Equivalent Production (BOE/d)	245,930	243,828	256,468	-4.9%	-1%
U.S. NGLs (Bbls/d)	9,142	9,206	8,900	3%	1%
U.S. Natural Gas (Mcf/d)	1,791,000	1,835,000	1,800,000	2%	2%
Total U.S. Equivalent Production (BOE/d)	307,642	315,039	308,900	2%	2%
Total NGL production (Bbls)	23,404	20,533	23,700	-13%	-12%
Total natural gas production (Mcf)	3,181,000	3,230,000	3,250,000	-0.6%	2%
Total equivalent production (BOE/d)	553,572	558,867	565,368	-1.1%	1.0%
Breakdown: Liquids	4.2%	3.7%	4.2%		
Gas	95.8%	96.3%	95.8%		
Liquids Price (\$/Bbl)	\$61.79	\$68.91	\$68.13	1%	12%
Hedged Natural Gas (\$/Mcf)	\$5.27	\$5.03	\$5.18	-3%	-5%
<b>INCOME STATEMENT (\$ .000)</b>					
Total Operating Revenues (net)	1,720,000	1,654,000	1,697,800	-3%	-4%
<b>Upstream</b>					
Lease Operating Expense	251,000	280,000	254,710	10%	12%
Production Taxes	49,000	47,000	50,930	-8%	-4%
Transportation and Selling Expense	217,000	217,000	221,860	-2%	0%
D.D. & A. - Upstream	781,000	797,000	798,706	0%	2%
Upstream Operating Expenses	1,298,000	1,341,000	1,326,206	1%	3%
Upstream Operating Income	422,000	313,000	371,594	-16%	-26%
<b>Marketing/Midstream</b>					
Marketing/Midstream Margin	5,000	7,000	6,000	17%	40%
Operating Income - Total	341,000	208,000	267,594	-22%	-39%
Interest Expense	119,000	121,000	120,000	1%	2%
Total Other Expense (Income)	(155,000)	(181,000)	0	NM	17%
Corporate Expenses	(463,000)		0	NM	-193%
Accretion of Asset Retirement Obligation		11,000	12,000	-8%	
General & Administrative	82,000	98,000	95,000	3%	
Income Taxes (Benefit)	271,000	(120,000)	36,899	-425%	-144%
% Effective Tax Rate	32%	25%	25%	0%	-23%
Reported Net Income (Loss)	569,000	(42,000)	110,696	-138%	-107%
Reported NI (Loss) Per Share	0.77	(0.06)	0.15	-138%	-107%
Recurring, Diluted NI (Loss) Per Share	0.13	0.09	0.15	-39%	-31%
<b>Discretionary Cash Flow</b>					
Cash Flow Per Share	1.54	1.25	1.30	-4%	-19%
Cash Flow Per Diluted Share	1.54	1.25	1.30	-4%	-19%
Wtd. Average Shares Outstanding	736,300	736,300	736,300	0%	0%
Wtd Average Diluted Shares Outstanding	736,300	736,300	736,300	0%	0%
<b>COMPONENT ANALYSIS (\$/net BOE Prod.)</b>					
O&G Operating Revenues - net of royalties	33.77	32.17	32.64	-1%	-5%
Lease Operating Expense	4.93	5.45	4.90	11%	10%
Production Taxes	0.96	0.91	0.98	-7%	-5%
Transportation and selling expense	4.26	4.22	4.27	-1%	-1%
D.D. & A.	15.34	15.50	15.36	1%	1%
Accretion of Asset Retirement Obligation	0.24	0.21	0.23	-7%	-9%
General & Administrative	1.41	1.91	1.83	4%	35%
Interest Expense	2.34	2.35	2.31	2%	1%
Discretionary Cash Flow/BOE	22.23	17.87	18.42	-3%	-20%
Non-recurring items	471,000	(110,000)	0	NM	-123%
Deferred Income Taxes	367,000	(95,000)	36,899	-357%	-126%
Deferred Income Tax %	135%	79%	100%	-21%	-42%
<b>Discretionary Cash Flow (\$ in Thousands)</b>					
Net Income (recurring)	569,000	(42,000)	110,696	-138%	-107%
D.D. & A. (upstream and other)	810,000	800,000	798,706	0%	-1%
Accretion of Asset Retirement Obligation	12,000	11,000	12,000	-8%	
Deferred Taxes	367,000	(95,000)	36,899	-357%	-126%
Unrealized Derivatives, FX	(652,000)	207,000	0	NM	NM
Other	26,000	38,000	0	NM	NM
Discretionary Cash Flow	1,132,000	919,000	958,300	-4%	-19%

Source: Company Reports, Citi Investment Research and Analysis

## EnCana Corp

### Valuation

Our \$28 price target is based on ECA's stock achieving an EV multiple of 5.2x our 2011 debt-adjusted cash flow estimates based on 'normalized' WTI spot oil and composite spot gas prices of \$90.00/Bbl and \$5.25/MMBtu, respectively, and ~133% of NAV.

### Risks

We rate EnCana Medium Risk

Our risk rating on ECA is Medium based on a combination of quantitative and qualitative risk assessments compared to other stocks covered by Citi Investment Research.

**Volatile Commodity Prices** - EnCana is sensitive to changes in the price of natural gas. A portion of their exposure is hedged, however some of their expected natural gas production is unhedged and subject to market price volatility.

**Lack Of Diversification** - All of the EnCana assets are now related to natural gas production in North America, and so they lack commodity or geographic diversification and will be adversely affected if natural gas prices are low.

If the impact on the company from any of these factors proves to be less than we anticipate, the stock could materially outperform our target. Conversely, if the impact on the company from any of these factors proves to be greater than we anticipate, the stock could underperform our target price.

## Appendix A-1

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Analyst: Robert S Morris  
Covered since December 7 2009

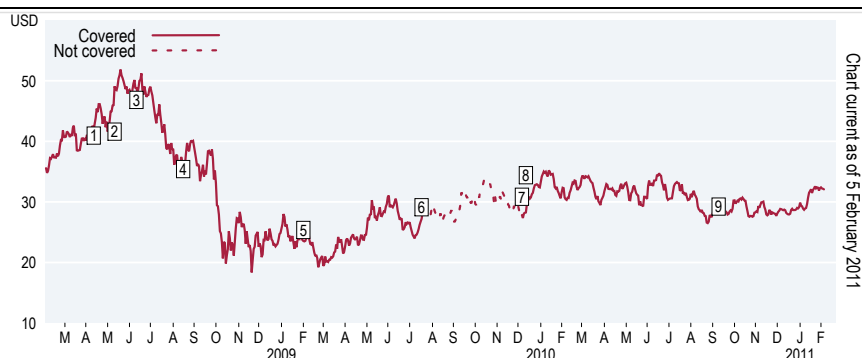


Chart current as of 5 February 2011

	Date	Rating	Target Price	Closing Price
1	11-Apr-08	2H	*44.95	41.88
2	12-May-08	2H	*50.84	49.09
3	11-Jun-08	2H	*51.91	48.88

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	15-Aug-08	2H	*40.14	35.45
5	2-Feb-09	2H	*25.15	23.55
6	17-Jul-09	Coverage terminated		

	Date	Rating	Target Price	Closing Price
7	7-Dec-09	*2M	*16.05	27.83
8	11-Dec-09	2M	*30.00	28.26
9	9-Sep-10	2M	*28.00	28.94

Rating/target price changes above reflect Eastern Standard Time

### EnCana Corp (ECA)

#### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Robert S Morris  
Covered since December 7 2009

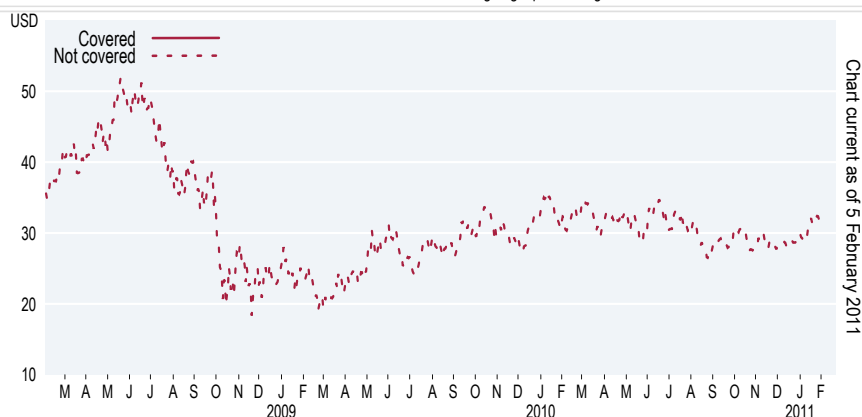


Chart current as of 5 February 2011

\* Indicates change

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
52%	37%	11%	0%	100%	0%
45%	44%	40%	0%	44%	0%

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