How to Beat the Pipeline Crunch with Husky Energy Inc.

Description

One of the most impressive operators in Canada's energy patch is **Husky Energy Inc.** (TSX: HSE). It wasn't long ago when the company was maligned by investors as it struggled to find direction. However, with the successful implementation of its four pillars strategy, Husky is now firing on all cylinders and continues to offer considerable value for investors.

The most recently reported quarterly results bear testament to this and show a company well-positioned to unlock further value for investors, particularly when its sustainable and juicy dividend yield of 3.7% is taken into account.

Diversified asset base and integrated energy operations give it an edge

One of Husky's key strengths is its portfolio of geographically diversified assets coupled with an integrated operating model, which combines both downstream (oil exploration and production) and upstream (refining and marketing) businesses.

This essentially means that Husky is not dependent solely on Canada's already stretched pipeline infrastructure to access crucial U.S. Gulf coast refining markets. This also reduces its dependence on the U.S. as a key export market for crude, with U.S. demand for Canadian crude expected to taper as light sweet crude production from the U.S. shale oil boom continues growing at an exponential rate and flooding U.S. refineries with light crude.

Husky is already able to access key East Asian and European energy markets, and was the first player in the patch to export crude to India, which over the long term will emerge as crucial energy market. The importance of accessing East Asian energy markets such as China can't be overstated enough. China is now the world's largest net importer of crude, and demand for energy is expected to grow as its economy expands rapidly and transitions from being export-oriented to focusing on domestic consumption.

This range of diversified oil-producing assets also allows Husky to sell a portion of its crude production at premium Brent pricing. For some time now, Brent has been trading at a premium to WTI, which at this time is 7.5%. It is also expected that this premium will widen over the longer term as growing U.S.

light sweet crude production floods the U.S. refining market with WTI, leading to greater supply than demand.

Another distinct advantage Husky holds over its peers is that it has secured prices for the natural gas sold from its Liwan gas project to China that are at a significant premium to the spot price. This means Husky is not exposed to the risk of margins falling significantly from natural gas sales as the spot price softens over the next year.

Husky's integrated operational model also allows it to more easily manage the price differentials between various crude blends and benchmark WTI and Brent prices, as well as the margins it is able to generate.

Second quarter results: unexceptional, but solid

All of the above are key factors that saw it report some solid results for the second quarter of 2014.

Husky's oil and gas production has continued to grow over the last three consecutive quarters, having shot up 2.4% compared to the previous quarter and 7.7% compared to the second quarter of 2013. It now produces 333,600 barrels of crude daily.

This steady growth in crude production can be attributed to the Liwan gas project coming online at the end of the first quarter of 2014, along with strong production from Husky's heavy oil thermal projects and increased production from the Ansell liquids-rich natural gas play.

As a result, cash flow remained relatively flat quarter over quarter but jumped a healthy 4% year over year, while net earnings fell down 6% quarter over quarter but shot up 3% year over year to a healthy $0.63 per share.

This saw Husky hit the consensus earnings estimate among analysts for the second quarter of 2014. For all of these reasons, as well as because of stronger industry-wide fundamentals, I expect Husky to continue reporting solid results for the remainder of 2014.

Investors will also continue to be rewarded by Husky's tasty dividend yield. Currently at 3.7%, it is the highest among Canada's integrated energy majors. It's also sustainable with a payout ratio of 60%, coupled with steadily growing cash flow. All of this makes Husky an attractive long-term growth story for income-hungry investors.

CATEGORY

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Date
2025/10/02
Date Created
2014/08/07
Author
mattdsmith