Is Husky Energy Inc.'s 5% Dividend the Next to Be Cut?

Description

Dividend investors got some bad news on Thursday, as **Cenovus Energy** announced it was slashing its dividend some 40% because the company's management just doesn't see this energy bear market going away soon. It also announced it was cutting 300 more jobs and also making more cuts in its capital spending program.

Cenovus is just the latest major energy producer to reduce its payout. Over the past six to nine months, many of Canada's other oil giants have cut their dividend, especially the ones with a high payout. The notable exception has been **Crescent Point Energy**, but many investors speculate that it's only a matter of time until that producer cuts as well.

Because of all these cuts, many income investors have made the choice to avoid the whole energy sector altogether, content to sit on the sidelines until the price of oil is higher. But others are flooding into the space, convinced this decline in crude is only temporary, and that the stable producers can survive the storm.

But surviving and being able to pay the dividend are two very different things. When there's pressure on the balance sheet, cutting the dividend is a prudent move by management. That's exactly the issue surrounding **Husky Energy Inc.** (TSX:HSE) right now. Will the company continue paying its generous 5% dividend, or is it next to be axed? Let's take a closer look.

Right now, it's not pretty

As I type this, the future of Husky's dividend definitely doesn't look good, especially as crude lingers below $50 per barrel.

The company has made some prudent moves over the last few months, including issuing new debt and preferred shares to fund new projects in the oil sands. While this has helped shore up the balance sheet, there still isn't a whole lot of excess cash left.

As of June 30th the company had just $177 million worth of cash on the balance sheet compared to debt of more than $6 billion. Additionally, each quarter sees $300 million in dividends heading out, which isn’t good.

But looking a little deeper, it’s not quite so bad. Through the first two quarters of 2015 Husky generated $1.76 billion in cash from operations, while spending $1.55 billion in capital expenditures. The company plans to spend about $3 billion in 2015 on capital expenditures, which means it’s on pace to generate about $400 million in free cash flow this year.

That’s not exactly ideal, since it has committed to paying investors $1.2 billion in dividends. But there are a couple of things that indicate a dividend cut isn’t imminent.

Firstly, the company has more than $3 billion in available liquidity from two different credit lines. And since its debt-to-equity ratio is comfortably below 20%, it definitely has the balance sheet flexibility needed to draw that credit. In other words, it won’t be the end of the world if Husky borrows to pay the dividend for just a little while.

Husky also has new production coming online later this year, and has been aggressive in cutting costs. Both of these factors should slightly improve cash flow over the last two quarters of the year.

And besides, there’s always the possibility that crude improves. If the price improves to where it was just a month or so ago, Husky’s dividend will be in much better shape.

Ultimately, that’s what it comes down to. Yes, Husky could borrow to pay the dividend for a few quarters. But in a world where low oil prices are beginning to look like more like the norm, I’m not sure the company would be smart to do so. Keeping the balance sheet strong might be a bigger motivator than paying investors. Thus, income investors have to be careful with Husky. It’s a great operator and there’s certainly a case to be made for owning it at these levels. It’s just not a safe income stock with crude below $50 per barrel.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

POST TAG

1. Editor's Choice

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Tags

1. Editor's Choice

Date
2025/07/08
Date Created

2015/07/31
Author
nelsonpsmith