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Husky Energy Inc. Dropped 20% Last Week. Is it Time to Buy or Stay Away?

Description

On October 16 **Husky Energy Inc.** (TSX:HSE) had its credit outlook lowered by Standard & Poor's as slumping commodity prices put pressure on its business. The downgrade reflects "the changes to the company's business risk and financial risk profile caused by the persistent weakness of crude oil and natural gas prices, and the resulting downward revision of our hydrocarbon price assumptions," said Standard & Poor's.

In September the rating agency telegraphed its downgrade, saying that it was reviewing the credit ratings of all Canadian oil and gas explorers and producers as it revises its oil price estimates. Its 2015 crude price estimate is for an average $45 a barrel, with 2016 forecasted to have $50 oil and the 2017 average to be $60.

The downgrade was prescient, for on October 30 Husky shares were decimated after posting a $4.1 billion loss. It also announced the likelihood of western Canadian property sales and 1,400 in planned job cuts. Shares were down 13% last Friday, dipping nearly 20% on the week. Should you capitalize on the recent weakness, or is there more pain to come?

Most of the pain may be over

Husky's $4.1 billion quarterly loss included some major one-time items, including a $3.8 billion asset impairment and a write-down of $167 million legacy oil and natural gas assets. These are non-cash items and simply reflect the new operating environment.

In fact, most of the company's projects have already been financially planning for lower oil prices. Management noted that the business-planning assumption for the next two years is for crude prices of $40 a barrel and natural gas prices of $3 per thousand cubic feet.

These conservative assumptions combined with taking massive non-cash losses up front mean that Husky will most likely be able to avoid similar actions in the future. In fact, if commodity prices move to the upside, management's assumptions may be drastically undervaluing the company.

Underrated international-growth prospects

While most investors are focused on the company's Canadian oil sands properties, where it operates over 4,500 wells, there are some other projects that hold promise that many are ignoring.

"We are transitioning from a business with a large number of small plays into a business with a focus on fewer but more material plays," says CEO Rob Peabody. One of those "material plays" is the Liwan Gas Project, a deep-water development in the South China Sea that has been showing impressive results.

The project is a joint venture with **CNOOC Ltd.** involving a 261 kilometer undersea pipeline to the Chinese mainland. This $6.5 billion project includes the largest offshore platform in Asia, with the capacity to produce one billion cubic feet of natural gas per day. With the capital costs for the project largely covered, this is one example of an international project that could surprise the market.

Husky is a long-term play

If you're planning on investing in beaten-down shares in anticipation of a quick bounce, Husky shares may not be for you. The rationale for investing in the company is purely long term.

First, it has an increasing exposure to China, the world's second-largest energy consumer. While there are fears that China will be growing at a slower pace in the future, energy consumption is still on the rise. Husky's other assets are primarily oil sands projects. While oil sands have long-life reserves, profitability can be volatile given their high cost of production. For an investment in Husky Energy to pay off, you most likely need a time frame of three or more years.

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