Husky Energy Inc: Is a Big Dividend Coming?

Description

While **Husky Energy Inc.** (TSX:HSE) has upstream and downstream operations in both Canada and the U.S., it's experienced some issues surrounding its assets in offshore China and Indonesia that are nearing production.

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Given their low sustaining capital needs and minimal decline rates, these Asian assets are core to the company's attempt to maintain profitable with crude oil prices as low as US$40 a barrel. For the last year or so, Husky has been in a contract dispute with its project partner, **CNOOC Ltd.** (NYSE:CEO).

The original contract was "take and pay," an agreement where the buyer either takes the product from the supplier or pays the supplier a penalty. The agreed price range was US$11-13 at a specified volume. But in November CNOOC insisted on taking a lower share of output at a discounted price. Husky was obviously not pleased with this arrangement and threatened to sue. With its deep ties to the Chinese state, however, investors weren't entirely confident CNOOC would be forced to fold.

In August investors received some clarity on the issue. Husky agreed to reduce the price range a bit (US$9.54-11.45), while CNOOC agreed to continue accepting the full volume. The market finally got what it's lacked in recent months: pricing clarity.

What now?

With the contract dispute over, Husky shareholders should be bullish about the future.

First, the project will restart ample cash flows at Husky. At the new rates, the annual free cash flow from this project should be close to $250 million.

Second, expansion plans between CNOOC and Husky can now be prepared as regularly scheduled. One such addition, the Lihua 29-1 project, will bring online roughly 80 mmcf per day. With the dispute behind them, both companies anticipate finishing the addition by 2018. CNOOC and Husky were also partners in some offshore gas fields in Indonesia. With production aiming to start next year, investors can now count on even more future cash flow increases.

Finally, Husky may at last restore its dividend. Last year it suspended its quarterly cash dividend of $0.30 quarterly, replacing it with a “share dividend.” Because the issuance of shares dilutes the earnings base, the new dividend was essentially for show only. Rising oil prices and an end to its contract dispute should allow it to restart cash dividends.

At US$50 crude, management anticipates generating $800 million in annual free cash flow. With a market cap of just $15.5 billion, that would be a sizable amount. Because the company reviews its dividend policy on a quarterly basis, a reinstated payout could happen sooner than most think.

As long as oil remains around US$50 a barrel, count on Husky rewarding shareholders with another dividend announcement. Even at half of its former rate, shares would yield nearly 4%.

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