Latest Results Indicate This Energy Major Is Among the Best Ways to Play Higher Oil

Description

Crude has rallied solidly since the start of 2018 to see the North American benchmark West Texas Intermediate (WTI) up by around 18% since the start of the year and Brent up by 16%. Higher oil is a boon for Canada's beaten-down energy patch, and one integrated oil major that is nicely positioned to benefit from firmer crude is **Husky Energy Inc.** (TSX:HSE). The driller reported some solid second-quarter 2018 results and remains focused on unlocking further value for investors.

Now what?

Husky owns and operates a diversified portfolio of upstream oil assets comprised of oil sands and offshore operations as well as a range of downstream assets, including refineries, a heavy oil upgrader, and pipelines. The integrated nature of Husky's business makes it resilient to weaker oil prices.

Key to Husky's success has been its ability to appropriately deploy capital so as to maximize the returns generated by those assets. It is also a relatively low-cost operator, having projected 2018 breakeven costs of US$42 per barrel; importantly, these costs are expected to fall to as low as US$37 a barrel by 2022. In an operating environment where WTI is trading at close to US$70 per barrel, this highlights the profitability of Husky's operations.

Despite Husky's second-quarter production falling by 7.5% year over year, it reported some solid financial results. Revenue popped by an impressive 37.5%, while funds from operations almost doubled to $1.2 billion. Husky reported net earnings for the quarter of $448 million compared to a $93 million loss for the equivalent quarter in 2017.

The strong growth in the company's financial performance can not only be attributed to higher oil, but also to its focus on reducing costs. For the second quarter, production, operating, and transportation expenses were a remarkable 10% lower year over year, while operating costs for its upstream operations fell by 3% per barrel produced. This trend should continue because Husky is focused on unlocking synergies at its facilities and reducing expenses further.

The moderate drop in oil production can be attributed to a scheduled three-week turnaround at the SeaRose floating, production, storage, and offloading vessel, the divestment of non-core assets in Western Canada, and Husky's ongoing structural transformation to focus on higher-margin production. These factors are particularly important to note, because lower oil output was not a result of operational failures or worse-than-expected decline rates at core oil-producing assets.

Despite the deterioration in oil output, Husky is on track to meet its 2018 guidance, where it expects oil production at the top end of its forecast to be marginally lower than 2017. The push towards greater profitability and higher oil prices will more than make up for the shortfall in revenue created by reduced production.

Firmer oil prices have also given earnings from Husky's Lloydminster Upgrader, which converts heavy crude into high-value synthetic light oil, a solid boost. Second-quarter net earnings at the facility were a remarkable 17 times higher than a year earlier. A similar outcome was also witnessed for Husky's refining operations, where net earnings were almost three times greater than what was reported for the same period in 2017.

Because of its strong second-quarter financial performance, Husky elected to reward loyal investors by hiking its quarterly dividend by an impressive 67% to $0.125 per share. This gives the company a tasty forward-looking yield of just over 2%.

So what?

Husky remains a top play on higher oil. Its quality assets and low breakeven costs mean that it is well positioned to unlock considerable value as prices climb higher. While patient investors wait for Husky's stock to appreciate, they will be rewarded by further dividend hikes as its earnings grow.

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Author
mattdsmith