



Did Husky Energy Inc. (TSX:HSE) Dodge a Bullet With MEG Energy Corp (TSX:MEG)?

Description

Husky Energy (TSX:HSE) has a horrible track record of success. Since the end of 1996, shareholders have accrued a depressing 0% return, including dividends. Over the past five years alone, shares have fallen by more than half.

This recent underperformance was made even more interesting by the company's hostile takeover bid of **MEG Energy** ([TSX:MEG](#)) last September. At the time, the deal was worth \$6.4 billion, with the cash component alone valued at \$11 per share.

MEG Energy eventually rejected the offer, and its shares have since sunk to just \$5.40 each. While Husky Energy's management team coveted MEG Energy's assets, it's possible that the failed bid was for the better.

Let's take a look at why Husky Energy is better off without MEG Energy.

These are terrible assets

On its website, MEG Energy sells itself as a "pure-play oil sands investment." That's not a good thing.

Oil sands projects are notoriously difficult. The infamous Syncrude oil sands project, for example, has seen years of delays, cost overruns, and unplanned outages. Plus oil sands production is lower quality, meaning it needs to be processed more than other types of oil. Extra processing means additional costs, forcing this output to trade at a discount.

Over the past decade, Western Canada Select — a pricing benchmark that includes many oil sands regions — has traded at an average \$17-per-barrel discount to WTI prices, a higher-quality benchmark mostly populated by U.S. regions. This discount can vary wildly, too. In late 2018, it [occasionally](#) widened to more than \$50 per barrel.

While MEG Energy's most recent investor presentation states the company is "increasingly insulated

from Canadian pricing,” lower-quality oil still drives its performance. For example, roughly one-third of its Edmonton production for 2019 is hedged at US\$43.80 per barrel, a steep discount from WTI’s current price of US\$60 per barrel.

MEG Energy wants investors to think its current pricing discount will be alleviated over time, but this could take years, if it happens at all. Through 2023, its management team anticipates 500,000 barrels per day of new rail capacity and more than one million barrels per day of pipeline infrastructure. This may come to pass, easing bottlenecks and narrowing the pricing discount, but they’re completely outside MEG Energy’s control.

For the foreseeable future, MEG Energy will be forced to sell its lower-quality output for discounted prices.

Sometimes failure is a good thing

Few other companies are likely to come to MEG Energy’s aid considering Husky Energy couldn’t force a deal at significantly higher prices. Analysts also don’t expect Husky Energy to go shopping again anytime soon, but the failed bid could be a signal that management is growing desperate for options.

“Accurate or not, the decision to pursue MEG does suggest some level of desire at the senior management and board level to alter the asset profile of the business,” said an analyst for **Raymond James Financial**. “And while we don’t expect Husky to immediately pursue alternative acquisition opportunities, the risk of that will likely weigh on the shares for a period of time.”

Hopefully, Husky Energy remains on the sidelines for a while longer. Currently, it has one of the best balance sheets in its peer group. This would have been imperiled if the MEG Energy bid was successful.

Additionally, the company has done a terrific job at lowering its all-in breakeven price. In 2018, it turned a profit at prices above US\$42 per barrel. By 2022, this breakeven level should fall to just US\$37 per barrel. Its integrated model with refinery capacity adds more stability to any pricing volatility.

In total, Husky Energy is well positioned for the future, even if it requires higher oil prices for shareholders to book big gains. Either way, investors should be happy the company avoided acquiring MEG Energy.

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