Why I’m Passing on This Integrated Canadian Energy Company

Description

The uncertainty in the Canadian oil sector the last few years has completely eroded investors’ confidence. Despite plenty of value opportunities all over the industry, the market is being cautious as investors have been burned far too many times in recent memory.

Despite the uncertainty, there is still value that exists, especially for long-term investors. Companies that are vertically integrated and can mitigate their exposure to commodity prices are some of the most attractive, especially in uncertain political environments.

One of the largest integrated Canadian oil and gas companies that has been weathering the storm well is **Husky Energy** (TSX:HSE). It has operations in western Canada, the United States, Asia Pacific, and Atlantic regions.

Since Husky is an integrated player, it has actually fared better in the current oil environment than some of the pure-play oil and gas producers. Last year, as oil differentials widened, the mid and downstream businesses captured most of the profits for Husky. This was contrasted in Q1 of 2019; better price differentials meant that the upstream business was able to generate most of the value.

The upstream segment has been suffering, as it was impacted by the mandatory curtailments in Alberta in 2018. Although Husky is diversified and has been growing its investments in its offshore production assets, the mandatory production cuts in Alberta have impacted the business enough to make total production decline year over year.

The Alberta oil sands projects have really been the laggard on the business. While the company is working to bring the costs down, they’re still currently too high. Management has also been investing in the higher-margin offshore projects for the future, which is a positive sign.

The investments and capital-spending projects are keeping Husky on track to deliver on its goal to grow the lower sustaining cost projects to more than half of total company production by the end of 2019.

In addition to the investments it’s making in its upstream assets, Husky has been investing in some of its downstream assets as well. The Lima refinery has been upgraded to operate more efficiently and is under further renovations to increase its heavy oil processing capabilities up to 40,000 barrels per day. Total throughput as of 2018 at Lima was 175,000 barrels per day.

Financially, the company looks well capitalized with debt to equity just 0.2. The company is not really trading at much of a bargain though, with price to free cash flow around 25 times. For long-term investors willing to wait, it offers a decent 4% dividend.

Another factor that could affect the stock performance in the short term is the sentiment from analysts. Most analysts favour Husky's integrated peers, which could be a short-term headwind for the stock.

Investing in integrated companies is definitely a better strategy than the pure-play producers given the environment the global energy industry is in. Although Husky is well run and has potential for future growth, I expect it to tread water in the near term. Other integrated companies look more attractive in current market conditions.

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