HUSKY ENERGY

SECOND QUARTER 2018 CONFERENCE CALL AND WEBCAST TRANSCRIPT

Date: **Thursday, July 26, 2018**

Time: **10:00 AM MT / 12:00 PM ET**

Speakers:

Robert Peabody
President and Chief Executive Officer

Jeff Hart
Acting Chief Financial Officer

Robert Symonds
Chief Operating Officer

Dan Cuthbertson
Director, External Communications and Investor Relations

OPERATOR:

Welcome to the Husky Energy Second Quarter 2018 Conference Call and Webcast. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star and zero.

I would now like to turn the conference over to Dan Cuthbertson, Director, External Communications and Investor Relations. Please go ahead, Mr. Cuthbertson.

DAN CUTHBERTSON:

Thanks, and good morning. With me today are CEO Rob Peabody, COO Rob Symonds, and Acting CFO Jeff Hart. We will go through our second quarter results and then open up the line for your questions.

The call today will include forward-looking information. The associated risk factors and assumptions can be found in the quarterly news release, on our website and in our annual filings on SEDAR and EDGAR.

Unless stated otherwise, all figures are in Canadian dollars and before royalties.

Specific modeling questions can be answered offline by our Investor Relations Team following the call.

Rob will now start us off.

ROBERT PEABODY:

Thanks, Dan, and good morning, everyone. I'll begin with our announcement this morning that our Board of Directors has approved a 67% increase in the quarterly cash dividend to $0.125 per common share. This dividend level is affordable and gives us a yield that is comparable with our peer set, and we can fund the dividend, our sustaining capital requirements and the growth capital program in accordance with our five-year plan.

The Board looked at a number of factors in this decision. These include our demonstrated ability to generate strong free cash flow, our low debt levels, a more constructive outlook for oil prices, and the progress we have been making in improving our portfolio. This is most recently reflected by the early start-up at Rush Lake 2, the ramp-ups now approaching completion at Tucker and Sunrise, the continued strong performance of Liwan, meeting our gas production target at the BD Project in the Madura Strait, and our new oil discoveries in Asia and the Atlantic. The dividend increase is a demonstration of our Board's confidence in our financial framework and ongoing reductions in our cost structure, as well as the execution of a strategy that continues to materially improve our value proposition. Ultimately, we are delivering on the business objectives in our five-year plan that we outlined at our recent Investor Day.

Underpinning this value proposition is a commitment to process and occupational safety, which has to be at the core of everything we do. As announced at our recent Investor Day, we are taking a number of actions to reinforce this commitment. First, we have aligned management compensation more closely with our safety performance; second, we are in the process of recruiting a senior executive in charge of safety, and this position will report directly to me; and third, we are undertaking a full assessment of our safety processes and culture with an external expert.

Turning now to the quarterly results, we continued to see changes in market dynamics during the second quarter. These included constructive, if volatile, commodity prices, continued location and quality price differentials for Canadian heavy oil as a result of limitations on existing pipeline capacity, and discounts on Midland barrels due to the lack of pipeline capacity coming out of the Permian. Our business is well positioned in this environment and is backstopped by several advantages. We have our strong balance sheet, the integrated nature of our business shields us from location and quality differentials in North America, our U.S. refining business is well positioned to benefit from discounted Midland barrels, and we are plugged into the fast-growing energy markets in Asia. Our two businesses, the Integrated Corridor and the Offshore, are positioned to increase the stability and predictability of our funds from operations and free cash flow. This means we can return additional cash to shareholders, as demonstrated by today's dividend announcement, while still growing our business in line with the targets we set out at Investor Day. This investment in our large and unique portfolio of higher margin projects will also further improve our cost structure.

While Jeff will provide more context around the numbers, I'll touch on a few financial highlights from the quarter.

Funds from operations were up 69% from last year to $1.2 billion, and are now more than $2 billion year to date. Adjusted net earnings were $474 million, compared to $10 million last year, and free cash flow was $500 million in the quarter, making it $718 million year to date, which is up 90% over the first half of 2017.

Overall, we've had a very active quarter on the operations front. Rush Lake 2 Project, the project was finished and we have now started steaming the reservoir, six months ahead of our original schedule. We completed successful turnarounds at the Lloydminster upgrader and on the SeaRose FPSO. We reached record daily production rates at both Tucker and Sunrise earlier in the second quarter. At Liwan, we hit the highest production rates yet, as we continued to see strong gas demand in China. As mentioned earlier, the BD Project in Indonesia is fully ramped up and we have now reached our target production. We made two new exploration discoveries in our Offshore business, one in the Asia-Pacific and one in the Atlantic.

Thanks, and now Jeff will review our Q2 financial results.

JEFF HART:

Thanks, Rob. Strong Downstream performance and increasing gas sales in Asia both contributed to solid financial performance in the quarter. As mentioned, funds from operations were $1.2 billion and adjusted net earnings were $474 million, with free cash flow of $500 million. Our capital spending of $708 million was primarily directed to advancing our Lloyd Thermal Program and construction of the West White Rose Project in the Atlantic region. We exited the quarter with a net debt position of $3 billion, including $2.6 billion in cash. Our net debt remains well below our target framework at 0.8 times Trailing Twelve Months funds from operations, giving us significant flexibility. In addition, we have $4.2 billion in undrawn credit facilities. I'll also note that we had a 4% increase in working capital this past quarter due to rising commodity prices.

We had another good quarter along our Integrated Corridor. Downstream EBITDA was $495 million, which was driven by strong crack spreads in PADD 2. We saw realized margins of US$16.66 per barrel from our U.S. refineries, which included a pre-tax FIFO gain of US$1.72

per barrel. Our physical integration, which includes our Canadian upgrading capability at Lloyd, our refining and storage capacity in the U.S., and our ability to transport crude to higher value markets, shielded us from location and quality differentials, and we took advantage of our optionality by sourcing about half of our Lima crude feedstock from Midland, which is currently trading at a large discount to WTI. Our Infrastructure and Marketing EBITDA was $212 million, which reflected additional margin capture from our long-term committed pipeline capacity, including Keystone. In the Upstream portion of the Corridor, we realized an operating netback of $21.71 per boe, including a netback of $30.58 from our thermal operations at Lloyd, Tucker and Sunrise. When combined with the margin capture from Downstream, we realized an overall value chain netback of about $49 per barrel for our heavy oil production, compared to $44 per barrel in Q1 of this year.

In the Offshore business, the Asia-Pacific and Atlantic regions contributed about 30% of our funds from operations for the quarter. Liwan sales gas prices averaged CAD$13.96 per mcf, with liquids pricing averaging $71.88 per barrel. Our overall Asia-Pacific netback was $68.44, and in the Atlantic, we realized a netback of $57.79 per barrel.

Total Upstream operating costs were $14.22 per boe in Q2, compared to $14.65 per boe a year ago and $13.33 per boe in Q1. The current quarter operating costs were impacted by the SeaRose turnaround and seasonal maintenance in heavy oil. Our overall thermal operating costs averaged $11.10 per barrel, compared to $12.94 per barrel in the second quarter of 2017.

Before we turn to our Q2 operational highlights, I'll build on Rob's remarks related to the dividend increase. In particular, it's important to note that this new baseline provides a foundation for further dividend growth, as our asset base continues to benefit from our ongoing investments. Increasing the base dividend is also consistent with our financial framework, and this financial framework will continue to triangulate the dividend, sustaining capital requirements and our leverage, and currently we have ample headroom on our balance sheet.

Thanks, and now I'll turn the call over to Rob Symonds.

ROB SYMONDS:

Thanks, Jeff, and good morning, everybody. I'll start with an update on our progress at the Superior Refinery. To reiterate what we said at Investor Day, the investigation is still ongoing.

We plan to use the insurance proceeds to rebuild the refinery, and while we've yet to establish a timeline for return to normal operations, today, we believe it will be at least 18 months. We will update you further when we have a firm plan. While the incident at Superior was a serious setback, the refinery remains a good fit with our overall strategy. We spent the last decade building a robust program for process and occupational safety at Husky. We have made good progress, and Rob has outlined the steps underway for further improvement.

Now, looking at our quarterly results, overall production was about 296,000 boes per day, and this takes into account seasonal maintenance and weather-related impacts, as well as the three-week planned turnaround on the SeaRose. We're currently forecasting a 2018 production exit rate of about 330,000 boes per day.

Along the Integrated Corridor, overall thermal production from our Lloyd Project, Tucker and Sunrise averaged about 123,000 barrels per day. This was flat quarter-over-quarter due to the seasonal scheduled activity at several Lloyd thermal projects and some maintenance activity at Sunrise.

Steaming is underway at Rush Lake 2, with first oil on tap for early Q4.

We've been making good progress advancing Dee Valley, Spruce Lake Central and Spruce Lake North. At Dee Valley, we're drilling two pads, and the construction of the central plant facility is moving along very well. In fact, when I was there earlier this month, it was apparent how similar it is to Rush Lake 2. Combined with the two 10,000 barrel a day thermal projects that we sanctioned last year, we're bringing on a total of 60,000 barrels a day of long-life thermal capacity between the end of this year and the end of 2021.

At Tucker, we began production from the remaining five wells on the new 15-well pad that we brought on in Q1. These contributed to a new daily high point of over 25,000 barrels a day this past quarter. Including the planned turnaround, we expect Tucker volumes will stay fairly flat over Q3, but we remain on pace to hit 30,000 barrels a day by the end of this year.

At Sunrise, our average well rates increased during the quarter, with total gross production averaging just shy of 50,000 barrels per day. A reminder that we have a 50% working interest in this project. We reached a record daily rate of over 54,000 barrels a day earlier in May, prior to starting a series of planned well workovers and steam generator modifications that have reduced production by about 10%. We expect this maintenance to be completed in September. Meanwhile, we brought two new infill wells online in Q2. All together, we've drilled a total of 12 infill wells, with the final 10 to be tied in later in the year. Sunrise remains on track to reach 60,000 barrels a day by the end of 2018.

Looking now to our Resource Play business, at Investor Day we announced a new gas plant is under construction to further increase our processing capacity at Ansell. The Corser plant is being built and fully funded through our Midstream Partnership. It's due to be brought online in the fourth quarter of 2019.

In the Wilrich formation, we are advancing an 18-well drilling program in the Ansell and Kakwa areas. To date, seven wells have been drilled and four completed this year. In the Wembley and Karr areas of the Montney formation, two wells have been drilled as part of the 2018 program of up to eight wells. Wembley provides a good opportunity in our ongoing pivot towards liquids production in the Montney, where we have been seeing some very good NGL yields.

In the Downstream, average throughput was 355,000 barrels a day. This included a planned five-week partial turnaround at the Lloyd upgrader, with shutdown at Superior and outages at both Toledo and Prince George. Throughput at the Lima and Toledo refineries averaged about 237,000 barrels per day. Gasoline, diesel and jet fuels in the U.S. were around 217,000 barrels per day.

Turning to the Offshore business, our active exploration program has resulted in new discoveries in both the Asia-Pacific and Atlantic regions over the last couple of months. Offshore China, we drilled a successful exploration well on Block 15/33 and are now planning for commercial development. In the coming weeks, we will be drilling two additional exploration wells at the nearby Block 16/25. In addition, we have signed production sharing contracts for two blocks in the Beibu Gulf in the South China Sea, and we're determining a timetable to commence exploration activities there.

In the Atlantic, construction is moving forward at West White Rose. We're about to start pouring the concrete base and expect to begin slip forming in late summer; meaning, the top of the concrete gravity structure will be visible from the grading dock before the end of this year.

Construction of the topsides component is underway at Ingleside, Texas, and at Marystown in Newfoundland, work is continuing on the living quarters. Our most recent Atlantic discovery, White Rose A-24, was made about 10 kilometres north of the SeaRose. An appraisal program is planned, to start as early as 2019, to evaluate the full extent of the discovery. Any development could tie back directly to the SeaRose or the West White Rose wellhead platform, use current infrastructure and be on-stream by 2022. South of the White Rose field, another exploration well is scheduled to be drilled later this year.

Looking at current Offshore production, starting with Asia, the Liwan field averaged about 368 million standard cubic feet per day, or 180 million per day net Husky working interest. Liquids production was approximately 15,700 barrels a day, or about 7,700 barrels a day Husky net. The 29-1 field, we have signed contracts for some long lead items, including subsea equipment, umbilicals and other kit. We plan to drill three wells at 29-1 in Q4, bringing the overall number in the field to seven. First gas is forecast around the end of 2020. Once online, production is expected to ramp up to 45 million standard cubic feet per day of gas and 1,800 barrels a day of liquids net to Husky. The field will share infrastructure with the first two Liwan fields, including access to the onshore gas plant and customer base.

In the Madura Strait, offshore Indonesia, production from the BD Project averaged 29 million standard cubic feet per day net to Husky in the quarter, up from 19 million in Q1 of this year. Net liquids were higher than anticipated at approximately 1,800 barrels per day, up from 1,000 barrels a day in Q1. Recently, we have reached our net daily sales target of 40 million standard cubic feet a day of gas and 2,400 barrels a day of liquids.

In the Atlantic, production in the quarter averaged 27,700 barrels per day, reflecting the completion of the three-week turnaround on the SeaRose in June. The vessel has ramped back up and our overall Atlantic production is currently about 26,000 barrels a day net to Husky.

Finally, as you may have heard earlier this morning, Husky and its partners have reached a framework agreement with the province in respect to Bay du Nord. While more needs to be done before a decision to proceed is made, this represents a major milestone towards opening a new chapter of development in the Atlantic region.

Thank you, and now we'll go back to the Operator, so that we can take your questions.

OPERATOR:

We will now begin the analyst question and answer session. Any analyst who wishes to ask a question may press star and one on their touchtone telephone. You will hear a tone to indicate you are in queue. For participants using a speakerphone, it may be necessary to pick up your handset before pressing any keys. If you wish to remove yourself from the question queue, you may press star and two. One moment, please, while we poll for questions.

Our first analyst question is from Greg Pardy with RBC Capital Markets.

GREG PARDY:

Thanks. Good morning. I'm just wondering if you could maybe just frame your oil discoveries in the South China Sea, maybe just in broad brush, in terms of timelines and production rates, that kind of thing. Is this a little bit like Wenchang? I just want to get an idea of that. Thanks very much.

ROBERT PEABODY:

Thanks, Greg, I appreciate the question. Of course, it's still early days and I think ultimate development of the scheme we come up with will depend a little bit on the two exploration wells we still have in front of us. What we do believe is the first discovery is commercial in its own right, and certainly, internally, we sometimes refer to this as the Wenchang replacement, so I think you're generally on the right track there. We are looking at relatively, what I would say, early production schemes, where we would target to get this on track in 2021 sort of time period. It depends a little bit. We would expect to take this through one of the existing FPSOs in the region. CNOOC has several very close which would be suitable for this, and, of course, ultimately, when this project moves forward, CNOOC will have a right to back into it for 51%, so it's very much in their interest to use those FPSOs for this development.

GREG PARDY:

Okay, great. Is it pretty shallow water?

ROBERT PEABODY:

Yes, it's very shallow water. I think it's 100 feet or so.

GREG PARDY:

Okay, great. Thank you.

OPERATOR:

Our next analyst question is from Neil Mehta with Goldman Sachs.

EMILY:

Hi, this is Emily on behalf of Neil.

ROBERT PEABODY:

Hi, Emily.

EMILY:

Hey. I just wanted to ask about how the Company sees itself positioned in a wide WTI/WCS environment, particularly as the Superior Refinery is expected to remain sort of offline for the next 18 to 24 months and you've got, roughly, 60,000 barrels per day of thermal production growing until 2020.

ROBERT PEABODY:

Yes, I'll turn that over to Jeff Rinker, who's here, who runs our Downstream.

JEFF RINKER:

Yes, this is Jeff. We still feel that even with the Superior Refinery shut down, we're in a quite good position to manage the wide WCS/WTI differentials. The Superior Refinery, when it was running in the first quarter, was running, on average, around 20,000 barrels a day of heavy crude. So, in terms of the overall balance that we have between heavy crude processing and heavy crude production, we're still relatively balanced.

ROBERT PEABODY:

I think I'd—the only thing I'd add to that is, you know, if you look at the differential between Canada and the United States, the big differential is a location differential, the secondary differential is the quality differential, and it's the location differential that we're seeing is very wide at the moment. In fact, the quality differential, once you get down to the Gulf Coast, is actually much tighter. So, in fact, the fact that we have the pipeline capacity, the kind of excess at the moment, but as we go, we'll be growing into our pipeline capacity over this period, but that is the major mitigate against the differentials.

Then, finally, on Superior, while Superior affects us physically, of course, we do have business interruption insurance, so we'll still get most of the benefits out of Superior from a profit standpoint, despite it being offline.

EMILY:

Mm-hmm, that makes sense. Does this accelerate sort of thinking on the asphalt plant that was originally delayed as a result of acquiring the Superior Refinery at all?

ROBERT PEABODY:

No, I think the timeline around that decision is still very much where it was. In fact, I would think that what ultimately sets that timeline is watching how additional pipeline export capacity develops from this basin. While I'm optimistic on that, we'll see how it all plays out over the next little while. Because, clearly, one of the things we've said before is that one thing to keep in mind always is that in the fullness of time, if Canada can get very well connected to the global market, there is actually lots of heavy processing capacity available to use in the global market, but the key is to connect with it. So, depending on how pipelines develop, that'll influence, to some degree, the ultimate view on that investment in an additional asphalt refinery.

EMILY:

Great. Thanks.

OPERATOR:

Our next analyst question is from Joe Gemino of Morningstar.

JOE GEMINO:

Thank you. I think you've touched on this a little bit, but can you talk about how you think about the pipeline expansion, and potentially rail, as you bring on the foreseen growth projects and potentially some growth projects even further down the line? Thank you.

ROBERT PEABODY:

Sure. In terms of kind of our—our current situation, of course, is we have adequate pipeline capacity, even a little bit of excess pipeline capacity, so we don't move anything on rail at the moment. We like that, because pipelines continue to be the best, most cost-effective and fundamentally safest way to move crude around, and as our production increases, we—our number one option—and as I said, I'm fairly optimistic about pipelines moving head. I mean, clearly, the Canadian government has made a very strong commitment to TMX. They bought it. I'm sure they want to see some sort of return on their investment in the fullness of time. I hope they do, I'm a taxpayer, too. So, I think that one's very strong. The Enbridge Line 3, I think has crossed most of its last significant legal hurdles and is moving ahead, I think, apace, and there's a lot of problems with developments going on with respect to XL, as well. So, I'm pretty optimistic about that, and we have additional capacity booked on those new lines to accommodate our increasing production, as long as those pipelines all do go ahead—I won't say on schedule, but if they go ahead close to their current schedules, I think we're in good shape.

JOE GEMINO:

Great. Now, in the circumstances that they didn't go through anywhere near schedule, or at all, would that change your outlook of your growth projects?

ROBERT PEABODY:

You know, we do run cases where we look at where you had to start moving onto rail for volumes, and if you did have to go that way, of course, in the fullness of time, you'd be looking at what I would call optimized rail travel, unit trains that are moving up and down, and you could optimize that for what we anticipate to be something around $18 a barrel transportation cost, if you're doing it on a long-term basis. That probably contrasts to a view with pipelines of something in the order of $15 or $12 a barrel, or $13 if you're very optimistic. So, it's an important factor, but it doesn't fundamentally undermine potential growth in the long term.

JOE GEMINO:

Great. Thank you.

OPERATOR:

This concludes the analyst Q&A portion of today's call. We will now take questions from members of the media. As a reminder, please press star and one on your touchtone phone to ask a question. If you wish to remove yourself from the question queue, press star and two.

Our first media question is from Ashok Dutta of Platts.

ASHOK DUTTA:

Hi, good morning, Rob. Two quick questions.

ROBERT PEABODY:

Hello, Ashok.

ASHOK DUTTA:

Hey, how are you guys?

ROBERT PEABODY:

Pretty good.

ASHOK DUTTA:

Thank you. Two quick questions, if I may. I'm just taking a chance here. You just spoke about the pipeline capacity. Could I ask you how much capacity do you have booked on the three lines?

ROBERT PEABODY:

I don't know if we've released that officially. We do have—I don't think it's particularly confidential. Jeff, do you want to—

JEFF RINKER:

Yes. So, we're committed to 19,000 barrels a day on the Trans Mountain expansion and 10,000 barrels a day on Keystone XL. Also, I think we're well positioned to be able to nominate for and get capacity on Line 3 expansion. That's not a dedicated capacity available there.

ASHOK DUTTA:

Okay, thank you, Jeff. Rob, my next question, what was signed this morning in St. John's, Newfoundland. So, the provincial government is going to take a 10% stake in the Bay du Nord. How does that change the equity structure within you and Equinor?

ROBERT PEABODY:

I'll turn that to Rob Symonds, he's very close to it.

ROB SYMONDS:

Yes. Actually, what happens is they buy 10% on a pro rata basis from us and Equinor, so we each go down proportionately.

ASHOK DUTTA:

Okay, all right. Thank you, that's all that I had.

ROBERT PEABODY:

Thanks, Ashok.

ASHOK DUTTA:

You're very welcome.

OPERATOR:

This concludes the question and answer session. I would like to turn the conference back over to Mr. Rob Peabody for any closing remarks.

ROBERT PEABODY:

Thanks, everyone. Thanks for joining us this morning. Just to wrap up, we are returning cash to shareholders through an affordable dividend that is more comparable with our peers and we continue to improve the free cash flow generating capacity of the business. As we execute our five-year plan, we are further improving our capability to generate funds from operations with a sustainably reduced cost structure. Our Integrated Corridor business and high netback offshore production are providing cash flow stability, which, along with our strong balance sheet, ensures we can successfully deliver on our long-term growth plans.

Thanks very much for your questions and for listening today.

OPERATOR:

This concludes today's conference call, you may disconnect your lines. Thank you for participating and have a pleasant day.