HUSKY ENERGY

SECOND QUARTER 2019 CONFERENCE CALL AND WEBCAST

CONFERENCE CALL TRANSCRIPT

Date: **Thursday, July 25, 2019**

Time: **9:00 AM MT / 11:00 AM ET**

Speakers:

Robert Peabody
President and Chief Executive Officer

Jeff Hart
Chief Financial Officer

Robert Symonds
Chief Operating Officer

Jeffrey Rinker
Senior Vice President, Downstream

Dan Cutherbertson
Director, Investor Relations

Operator:

Welcome to the Husky Energy Second Quarter 2019 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, one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star, zero.

I would now like turn the conference over to Dan Cutherbertson, Director Investor Relations. Please go ahead, Mr. Cutherbertson.

Dan Cutherbertson:

Good morning and thanks for joining us on the call this morning. CEO Rob Peabody, COO Rob Symonds, and CFO Jeff Hart are here to review our second quarter results and take your questions.

Today's call contains forward-looking information and non-GAAP measures. The risk factors and assumptions pertaining to the forward-looking information and additional information pertaining to the non-GAAP measures are contained in this morning's news release and in our annual filings on SEDAR and EDGAR. All numbers are in Canadian currency and before royalties unless stated otherwise.

Any specific modeling questions can be directed to our Investor Relations team after the call. Rob will now begin the call.

Robert Peabody:

Thanks, Dan, and good morning. We continued to execute against the plan we outlined at our recent Investor Day with an ongoing focus on capital discipline, consistent execution, and increased margins across our Integrated Corridor and Offshore businesses. The second quarter saw a large amount of planned and extended maintenance turnarounds in both the Upstream and the Downstream segments. Most of this work has now wrapped up, and we're looking forward to higher production in the second half of the year.

In addition to the turnarounds, our second quarter results were also negatively impacted by a number of non-routine adjustments. Jeff and Rob will give more details on these in their respective sections.

In the Integrated Corridor business, we're continuing to build low-cost thermal projects in Saskatchewan to provide feedstock for our Upgrader, asphalt refinery and U.S. refineries. The most recent Lloyd thermal project at Dee Valley is now steaming, with production starting later this quarter. We have four more of these Lloyd projects in development, with two more coming on next year.

At Sunrise and Tucker, we're focusing on using this period of Alberta production quotas to focus on increasing efficiency.

In the Downstream manufacturing business, you can see the positive impact of the work we completed at the Lima Refinery during the last turnaround. Throughput at Lima averaged almost 180,000 barrels per day in the second quarter. This is up about 15% from a few years ago and lets us spread the fixed cost at the refinery over more barrels.

In addition, following a planned shutdown for tie-ins in Q4, we'll finish the crude oil flexibility project. This will allow us to process up to 40,000 barrels per day of heavy crude at Lima by the end of this year. This project is now more than 85% complete.

At the Superior Refinery, our rebuild plan includes improvements designed to increase our average throughput while improving safety and efficiency. In the Offshore business, we continue to benefit from direct market access for our production. We see this in the realized price, which averaged over $82 per BOE in Q2.

In the Asia Pacific region, we finished drilling the final three of seven wells of the 29-1 field at Liwan. This project will add additional high netback production when it comes on-stream around the end of 2020.

In the Atlantic, West White Rose is now more than 40% complete and is expected to contribute more than $1 billion per year of cash flow during its peak years at our price planning assumption of US$64 flat Brent.

Altogether, while our results in Q2 were impacted by turnarounds and non-routine financial adjustments, we remain well-positioned for the remainder of this year.

With that, I'll hand the call over to Jeff for a more detailed view of our financial performance.

Jeff Hart:
Thanks, Rob. Funds from operations were $802 million compared to just over $1.2 billion in Q2 2018. This reflected a number of factors, including lower production due to Alberta quotas, a heavy turnaround schedule, and reduced volumes in the Atlantic and Asia Pacific regions. We were also impacted by lower year-over-year commodity prices, with Brent down about US$5.50 compared to the year-ago period. Heavy oil location differentials tightened by more than US$5 per barrel compared to Q2 2018. Typically, this would be captured by our Upstream heavy oil business, however, production in that segment was lower due to our busy maintenance schedule.

In addition, refinery throughputs were lower because of planned maintenance at Toledo and Prince George. Both of these turnarounds went on longer than originally planned. As Rob mentioned, our maintenance program is now largely complete, and our facilities are ramping back up. As such, we expect our overall annual production to remain within guidance.

Funds from operations were further impacted by non-routine negative adjustments totaling $106 million. This included just over $36 million for write-offs related to the Tiger's Eye exploration well in the Atlantic region. It also included a $59 million adjustment associated with the lump sum contract related to the Saskatchewan Gathering System expansion. Net earnings were $370 million, which included a positive $233 million provision for Alberta corporate tax reductions, partially offset by $77 million after-tax of non-routine negative items.

Overall, Upstream production averaged around 268,000 BOE per day. The average realized price was $53.35 per barrel, a 7% increase over Q2 2018. The Upstream operating netback was $33.61 per BOE. Per unit operating costs in the quarter were up 11% over the previous year to $15.83 per BOE, which was driven by turnaround activity coupled with lower production. The Infrastructure and Marketing segment recorded a loss of $38 million compared to a gain of $154 million in Q2 2018. This was due to the non-routine provision associated with the Saskatchewan Gathering System, as well as tighter heavy oil location differentials.

The Downstream operating margin was $286 million compared to $466 million at this time last year. This included a favourable FIFO pre-tax inventory valuation impact of US$0.60 per barrel. Downstream earnings also included $71 million in insurance proceeds related to the Superior Refinery, of which $54 million was related to business interruption. Capital spending was $858 million compared to $708 million in Q2 last year. This is in line with the budget, and we are on track with our annual guidance.

Net debt at the end of the quarter was $3.7 billion or one-times trailing 12 months funds from operations. Liquidity was $6.7 billion, including $2.5 billion in cash and $4.2 billion in unused credit facilities. Finally, our Board has approved a quarterly dividend of $0.125 per common share.

Thanks, and Rob Symonds will provide some additional operational details.

Robert Symonds:
Thanks, Jeff. As mentioned, Q2 was an active quarter for planned maintenance, including the consolidation of five Lloyd thermal turnarounds in June to provide for better efficiencies. The lower production also reflects our reduced Atlantic operations and the mandated quotas in Alberta, which are only marginally changed from what we faced last quarter. In fact, we were allowed to produce only 770 barrels a day more in Q2 than what was ordered in Q1, but July and August quotas are up by only another 1,000 barrels per day. As a result, Upstream production in Q2 was down 9% from a year ago.

Our Saskatchewan thermal program continues to progress, with Dee Valley coming on production later this quarter. Once it is fully ramped up, and we complete three additional planned turnarounds in Q3, we expect to exit this year at just over 90,000 barrels a day of Lloyd thermal production. I'll just add that this thermal growth, combined with the expected increase in offtake in Asia and the Atlantic coming fully back on-stream, will have us exiting the year at around 320,000 BOEs a day.

In the Downstream, overall throughput from the upgrader and refineries was about 340,000 barrels a day. At the Superior Refinery, demolition work is progressing to plan. We expect to start rebuilding this fall, pending the appropriate permits, with a target of resuming full operations in 2021. As Jeff noted, we had two major turnarounds in Q2, both of which went on longer than originally planned. All of our Downstream facilities, with the exception of Superior, are now back running at full rates.

Moving to the Offshore business and starting with Asia, in the second quarter our share of gas production from the Liwan Gas Project averaged 160 million standard cubic feet per day, and our share of Madura was 34 million standard cubic feet per day.

In the Atlantic, two infill wells were brought online in May. A new flowline connector was recently installed on the seabed, and the drill centres at North Amethyst and South White Rose extension are being readied for restart. The Southern drill centre was brought back online in early June. We've used the downtime on the SeaRose to tackle various maintenance and regulatory scopes, so we no longer require the turnaround originally planned for the vessel in August.

Finally, at the West White Rose project, construction is progressing at our three fabrication sites in Newfoundland and Texas. The tow-out and installation of the concrete gravity structure is scheduled for 2022 with first oil around the end of that year.

Thank you. Now I'll turn the call back to the Operator for questions.

Operator:
Thank you. We will now begin the analyst question-and-answer session. Any analyst who wishes to ask a question may press star, one their touchtone phone. 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, please press star, two. One moment please while we poll for questions.

Our first question comes from Neil Mehta with Goldman Sachs. Please go ahead.

Neil Mehta:
Hey, team. Thanks very much for taking my questions this morning. I guess the first one is a high-level question, Rob. It's just where we stand in terms of the operational performance

turnaround. I know that is your number one priority as leader of this organization, so just talk about where we are and how this quarter fits into that strategy.

Robert Peabody:
Yes. Thanks, Neil. I think overall, I guess the first thing I'd just say is I think the quarter overall was reasonably what I'd call steady for operational performance. We didn't have any sort of incidents, thank goodness, that really affected operations. I mean, most of the lower production you saw were combination of quotas and planned turnarounds in most cases, and, in particular, in the heavy oil segment where we decided to synchronize those turnarounds in order to do them as efficiently as possible in June. So, nothing untoward in the operation.

Of course, in general, on the whole journey of continuing to focus on a high reliability organization, I think we took a good amount of ground in the quarter with Peter Rosenthal really getting in the seat as the SVP in charge of that, reporting directly to me. We've reorganized a little bit so that all the safety people in the organization report back to Peter, and Peter has held engagement sessions with those people. He's been out into all the businesses. I think he was happy to see in general where we were – because this wasn't the start of a journey; we've been working with various people for the last year or so – and he's setting a very clear plan going forward.

I think we're getting a lot of traction, and it's gratifying to see quarter-over-quarter when we look at the metrics that we're looking at the lower-level incidents which we track in order to get a sense of if things are getting better or worse. We're seeing quarter-over-quarter improvements in all those metrics.

Neil Mehta:
Yes. That's helpful. I guess the other question I had was just the Infrastructure and Marketing segment. I think there was some non-routine provision here with your Saskatchewan Gathering System, along with… it looked like differentials might have caused this to really miss our expectations. But anything you can call out there, and how we should just think about the run rate for the segment?

Robert Peabody:

Yes. Sure. I'll let Jeff kind of start into that. We also have Jeff Rinker here, so if there's a little more detail, he might provide that as well.

Jeff Hart:

Yes. I'll talk, number one, to what we call kind of one-time or the unusual item. There's a couple of projects that we had that were set scope in the agreement and, ultimately, with expanded scope on this project, the cost is a little are higher. But I'd look at last year's. The first couple of projects basically had a positive impact last year in a similar magnitude. We're through the first projects on this, and net-net it's neutral over the last couple of years, but we did see it manifest itself this quarter, so I wouldn't model that going forward.

Then you're right; on the second part, on an ongoing basis, really, infrastructure marketing and our storage capacity as well as our export capacity out of Basin, and that was negatively impacted by the Alberta production quotas and the tighter location differentials. That's really where it manifest itself in the financials. As you look at last year, given the wider differentials, we were gaining in that segment versus the Upstream.

Robert Peabody:

Jeff, did you want to—Jeff Rinker, maybe just give a sense of if you look forward, what's kind of a more typical sort of earnings level, given that it's very hard to pick a typical earnings level in this area?

Jeffrey Rinker:

Yes. I think you just take out the things that are clearly one-off, right, so the Saskatchewan Gathering System item is not going to recur. I think also you have to think about when you compare the results of this quarter to the previous quarter, there is a certain timing element that figures into the I&M segment where typically we're buying crude in January to ship in February and receive in March of the long-haul pipelines. For example, in the first quarter we were still seeing some benefits in the very, very wide differentials that we saw in the fourth quarter that were coming through in the results in the first quarter; we didn't have that benefit in the second quarter this year when the differentials were quite tight and flat throughout the quarter.

Robert Peabody:

Good. Thanks.

Neil Mehta:

Thanks, guys.

Operator:

Once again, any analyst who wishes to ask a question, please press star, one at this time.

Our next question comes from Prashant Rao with Citigroup. Please go ahead, Sir.

Joe:

Good morning. This is Joe on for Prashant. Thank you for taking our questions.

Robert Peabody:

Thank you.

Joe:

Could you give us an update on the process of your potential sale on the Canadian Retail and Commercial fuel business and the Prince George Refinery? You indicated that you were seeing strong interest. Has the market changed during the last few months? Should we expect more details by year-end?

Robert Peabody:

The process continues, is what I can tell you, and we are still in negotiation with a number of parties and, hopefully, we'll have something to say on that before the year end.

Joe:

Okay. Got it. Then my second question is, for Asia Pacific, after completing and ramping up the Liunha 29-1 and the projects in Indonesia, what will be some of the future growth opportunities between 2021 and 2023?

Robert Peabody:

I think there's a number of options and possibilities. We're working in the region with various parties. Rob, did you want to add to that?

Robert Symonds:

Yes. This is Rob Symonds. In Indonesia, the existing developments that'll be coming on in '21, there are additional Madura fields that could be tied into that gathering system in the Indonesian space. We're also looking at other alternatives, but those are the firm ones. As you move to China, post 29-1, the deep water space is without specific additional things, but in the shallow water the discovery we made last year at 15/33 is something that we can bring on-stream, so that would be something else. We're also in the shallow water offshore China, where things can move quite quickly because of the existing infrastructure. We do have two additional blocks in the Beibu Gulf area that could also be brought on.

Joe:

Got it. Thank you.

Operator:

Our next question comes from Neil Mehta with Goldman Sachs. Please go ahead.

Neil Mehta:

Sorry, guys. Last time that I'll speak.

Robert Peabody:

It's been a while.

Neil Mehta:

Yes, it's been a while. Just one or two other ones. I guess it's been six or seven months now since the MEG deal didn't go through. Is there any more colour you can provide about why that didn't materialize? Then just your latest thoughts on the M&A environment and whether Husky's happy with the portfolio that it has, whether we should continue to think of the organization as a potential buyer of assets?

Robert Peabody:

Okay. In general, of course, I'm not going to talk on any specific M&A. I think we've been pretty thorough on our explanations around MEG. We thought it was a good idea strategically; they never really wanted to dance in this party, and as I've always said, it's hard to contemplate a combination if the other side is really not too interested in it. By the time we came to the end, we saw decreases in oil prices, in a very different environment.

We had a very clear off-ramp and, frankly, again, if you look at where the overall market is, I think if you look across the entire energy sector, let alone MEG, equity values are quite significantly down, and I think there was a bit of a sense that was coming at the time too, frankly. So, the idea at the time we would've been ended up paying substantially higher than the current market price of MEG, even if you add 30% to it.

I think all those factored into it. As we said at the time, we're still very happy, and as we outlined again at our Investor Day, we still have a very large portfolio of resource to develop, particularly—well, in both actually, the Offshore business, but particularly in the Integrated Corridor where we have a strong pipeline of heavy oil thermal projects. We still have a lot of opportunity to expand Sunrise over time, which we still think is a phenomenal resource; it's a very large resource, and as we expand it, it's become more and more efficient going forward as well.

Given that portfolio, there wasn't a compelling reason where we felt we had to go and do a transaction. That being said, we're going to continue to look at various things, but I think we've been also very clear about the criteria that they've got to be accretive. If we're going to do a transaction, we want it to be accretive to earnings, and we want it to be accretive to cash flow, and we actually want it to be accretive to free cash flow.

Those are sort of the criteria we're looking at. There may be some possibilities out there; we haven't seen them yet.

Neil Mehta:

Thanks, guys. Appreciate it.

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, one on your touchtone phone to ask a question. If you wish to remove yourself from the question queue, press star, two. We will pause for one more moment.

Our first question comes from Robert Tuttle with Bloomberg News. Please go ahead.

Robert Tuttle:

Yes. Hello. Can you hear me?

Robert Peabody:

Hello, Robert. Robert? Yes.

Robert Tuttle:

I was wondering your view on Alberta's plans to sell the rail program and if you guys are at all interested in that or no.

Robert Peabody:

Yes. I mean, I guess what I would say there is we're not a big fan of curtailment. I think we made that clear in the past, but I think what the Alberta Government is trying to do is a couple of things, which we would support, which is try to make some of their rail capacity available to companies. I think, hopefully, if we can get more crude moving on rail out of this basin, it just gives a lot more flexibility to handle the issues around curtailment and fundamentally get this market working again, working with kind of free market principles which we certainly would advocate.

I know they're talking about that. I know the industry has put some proposals to the Alberta Government around how we could maybe combine using more rail with easing curtailment quicker than might happen if we just have to rely on pipelines, and, again, we're very supportive of those sort of the initiatives.

Robert Tuttle:

Are you involved in the discussions about this proposal of loosening the limits but in exchange for more rail? Where does that stand, those talks?

Robert Peabody:

I've been involved in some of the work to put some proposals to the Government on that.

Robert Tuttle:

Okay. Thank you.

Robert Peabody:

Super. Thanks.

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:

Yes. Okay. Well, thanks very much. Thanks for your questions, and I'll just close by saying that 2Q was a heavy quarter for planned maintenance in both the Upstream and the Downstream. It was also disappointing that we didn't see much of an increase in the Alberta production quotas, and so we continue to work with them on that. However, we did make some good progress on the projects underpinning our drive to increase volumes, throughputs, and margins as we outlined in the Investor Day that we had a few months ago.

Thanks again for joining us today.

Operator:

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